Financial Mail

27 July 2007

CASE STUDY 1: AUTOMOTIVE INDUSTRY

Paradise lost

By Claire Bisseker and David Furlonger

DTI gets moving on MIDP after auto industry's confidence slips

The motor industry development programme (MIDP) has often been cited as a government success story. Set up by the department of trade & industry (DTI) 12 years ago, it has helped create a major vehicle manufacturing industry in SA. But now the DTI risks losing it all thanks to a series of bungles and delays.

The MIDP has been under review since 2005. The department is already months late in announcing its intentions. Changes - including a likely radical overhaul of the core incentive and duty-rebate system - will affect the way the industry does business. But the delays mean several companies have to postpone, or even cancel, investment and export plans. Industry executives say the delay has already cost more than R1bn in new investments and that up to R6bn more could be in jeopardy.

WHAT IT MEANS

Companies operating in a policy vacuum
MIDP delay has cost cancelled investments

Top industry representatives gathered in Pretoria on July 12, expecting to be given at least a glimpse of what the revised industrial incentive programme will look like post-2012, when the current programme expires. Instead they were told that the review was nowhere near finality. University of Cape Town economics professor Anthony Black, who turned down the job of reviewing the MIDP in 2005 partly because he felt the DTI's nine-month timeframe for the project was too tight, has been asked to come back and help it finish the work.

"We've been left high and dry on a programme that should have been finished a year ago," says the representative of a large motor manufacturing company, who spoke on condition of anonymity. "It's a farce, it's pathetic. It's laughable that government cannot serve an industry of this size. Billions of dollars are at stake." Trade & industry minister Mandisi Mpahlwa, who attended the July 12 meeting, was told bluntly by one CEO: "We leave this meeting with a great sense of disappointment."

But as of this Tuesday, the DTI was making all the right noises. Aware of the *FM*'s investigations into the department and of industry disquiet, DTI director-general Tshediso Matona took the unusual step of revealing to the *FM* what the DTI will place before the cabinet *lekgotla* this week.

Assuming the cabinet approves the plan, the minister will make this announcement to the industry by the end of July:

- At a minimum, the industry can expect the current levels of MIDP support to continue until 2012.
- From 2009, incentives will shift towards broad-based investment support for all players in the industry as opposed to the current assistance for exporters only.
- The date for finalising the post-2012 MIDP review is June 2008, but Matona hopes the work will be completed by March 2008. At a push it could be done by December 2007.

Matona adds that in the post-2012 MIDP structure he's "hoping to be able to respond to the industry's requests for enhanced levels of support, though they're not going to get everything they've asked for. One of the options is to locate support more at the local components end of the value chain."

Meanwhile, the delay is costing the industry. The local manufacturing plants of companies like Ford and BMW cannot bid against Ford or BMW plants in other countries to manufacture new models locally until they know SA's incentive and duty structure post-2012. Next year, BMW is due to make a binding decision on where to manufacture the new 3-Series, which will be launched in 2012. Other BMW plants have already submitted detailed bids to BMW head office. SA is being left behind.

"The delay is unbelievable," BMW SA MD Bodo Donauer recently complained to the *FM*. "The lack of clarity is becoming a critical issue. I can't understand why it takes so long."

Similarly, Ford Southern Africa CEO Hal Feder says he's battling not only for every investment against Ford plants elsewhere in the world but also to keep Ford's two SA plants off the international list of Ford plants to be shut down. Since 2000, Ford has invested R1,6bn in its Silverton, Pretoria, operation alone. It also has an engine plant in Port Elizabeth.

"There's no sentimentality towards SA anymore," says Feder. "Global business is moving fast. There are places - like China, India, Thailand and Eastern Europe - that are coming on strongly with industrial policy incentives and these are all factors Ford will evaluate."

Nissan SA is also nervous of delays. Its Japanese parent, and international partner Renault, are about to decide where Renault's new entry-level car, the Logan, will be built. Nissan SA is in the running but MD Julio Panama says the company needs to know the MIDP investment climate "no later than the beginning of September". If not, it can probably kiss its export business goodbye.

Components manufacturers are also feeling the effects. Roger Pitot, director of the National Association of Automotive Component & Allied Manufacturers (Naacam), says some potential SA suppliers to the locally built new Mercedes-Benz C-Class and Toyota Corolla were unable to bid. "Without knowing the investment and allowance climate in which they would be operating for the duration of the contracts, they pulled out," says Pitot.

"The DTI just doesn't seem able to latch on to how its shenanigans play out in the boardrooms of Stuttgart, Detroit or Tokyo," says the representative of a multinational car firm. "The international executives look at this and ask how the SA government can constantly say they want us to be committed to their country when their department is totally dysfunctional. It causes us damage abroad and has negative long-term consequences for the economy and job creation."

Part of the problem, says an executive, is that some people within the DTI do not understand the long lead times involved in vehicle production. Most modern vehicles have six-year life cycles and planning processes follow the same pattern. Investment destinations are decided four or five years ahead of launch.

In any case, looking ahead to 2012 as the key date is misleading. Though the MIDP as a whole is due to continue until then, some elements expire in 2009. Then there is the productive asset allowance, which allows vehicle manufacturers (and, in limited cases, components companies) to claim back 20% of new model-related investments over five years. Sources say this is due to expire on January 1 2008, after which the DTI undertook to increase the allowance to 35% and also to include the components sector as a whole. Business decisions were taken on this assumption. Instead, executives were told on July 12 that it would be business as before and that nothing would change.

"We told the DTI we did not accept this and want the 35% as and when we were promised," says a source.

Dave Coffey, a former Naacam president and MD of components company Bel-Essex Engineering, says: "In this period of indecision, people will not invest or make decisions on new-model programmes. "

Said one well-placed analyst after the July 12 meeting: "Industry leaders are frustrated that government just doesn't seem to grasp the urgency of the situation but they're afraid of responding too aggressively. Then you risk having a complete overreaction like the [imposition of the] Chinese clothing import quotas - and how effective is that?"

Officially, the industry is putting a brave face on the debacle.

"It's a midterm review, it's work in progress," chides Naamsa director Nico Vermeulen. He appears to take comfort in the fact that the DTI agreed at the meeting to the creation of a joint industry/government/specialist task team to allow for "more intensive consultation".

However, DTI spokesman Vukani Mde says: "I don't recall us promising them intensive consultation. As far as I know, we are quite capable of finalising the work without the help of a task team."

So what went wrong with the review?

A team made up of Black, independent consultant Justin Barnes and former DTI economist Dave Kaplan was engaged in October 2006 to critique the review. They are unwilling to discuss their findings but a source close to the process says: "A considerable amount of good work was done by the review consultants, but at least six months of serious technical work and number-crunching has to be undertaken to make the financial aspects work."

But Black's evaluation team finished their critique a full nine months ago. What has the DTI been doing since then? Matona says national treasury was concerned about the fiscal implications and insisted on additional modelling. "There's a possibility that we could raise the levels of support but... treasury is worried about significant increases in the current levels of support."

Black feels two things are required to get the process back on track. First is recognition that the industry needs a proper programme, "and I do think the industrial support should gradually decline". Second, "we need a confidence-building exercise to reassure the industry that government will not make dramatic policy U-turns and will offer long-term certainty."

The proposed announcement outlined above, earmarked for the end of July, is intended to be just such a confidence-building measure. It may be enough to reassure some rattled motor industry executives. But it will be cold comfort for those who need the hard numbers right now.

Please press your 'back' button to return to the previous page.