

WHAT IS THE FUTURE OF MANUFACTURING IN SOUTH AFRICA?

A summary by Bekithemba Ngulube, August 2014



KEYNOTE ADDRESS

WHAT IS THE FUTURE OF MANUFACTURING IN SOUTH AFRICA?

SPEAKER

Nimrod Zalk, Industrial Development Policy and Strategy Advisor, Department of Trade and Industry

Focus of presentation:

- *Manufacturing allows for an increased share of non-agricultural employment growth in the country*
- *There is a strong correlation between growth in infrastructure investments and manufacturing output growth*
- *South Africa has been de-industrialising since the apartheid era, as a result, re-industrialisation is proving difficult especially post-financial crisis*
- *Diversification in the manufacturing sector is key to future growth prospects*

Manufacturing is of particular importance to any economy that seeks to grow. Nimrod Zalk notes that there are few industrialised countries that have been able to achieve growth status without going through the industrialisation process. Advancement in technology does allow countries to leapfrog certain stages of the development phases, but an economy still needs to develop the capabilities to maintain an adequate employment base. In light of this, manufacturing therefore allows for an increased share of non-agricultural employment growth.



Amidst the multitude of divergent views on the manufacturing sector in South Africa, an empirical context is needed to balance the views on the sector. Broadly, strong empirical evidence suggests that manufacturing remains important if developing countries such as South Africa reach convergence with developed countries.

South Africa is unique in that its economy has a clear and evident structural break, identifiable by the break from apartheid to democracy in 1994. Apartheid era manufacturing was largely capital and energy intensive dominated by 6 large conglomerates and State Owned Enterprises (SOEs). This, coupled with a largely unplanned and incoherent tariff policy meant that the economy boomed on the back of its manufacturing base. A large factor in the decline of the manufacturing sector was the Apartheid government's inability to diversify the manufacturing sector.

The manufacturing sector in South Africa was previously

rooted in infrastructure and mining mega projects which also boosted the fortunes of the engineering and related sectors. The peak of the manufacturing sector is directly aligned to the peak in investment in infrastructure and mining mega projects. This offers a clear reminder to current policy makers to leverage periods of high growth in investment demand.

South Africa, like many developing countries, has had premature deindustrialisation and efforts to re-industrialise may be difficult given the unique pressures that come with being a developing country.

Post 1994, there has sadly been a continuation of the Apartheid-era industrial path. The focus has remained on commodity manufacturing and those sectors that form intermediate manufacturing inputs. The few non-commodity manufacturing successes include the automotive sector as well as the machinery and equipment sector. There is a need to re-focus mining and minerals as downstream inputs into the manufacturing sector, suggested Nimrod Zalk. With regards to beneficiation, a logical and coherent approach that will move away from the current status quo is needed, where the benefits are captured in the immediate phase creating immense cost pressures on the manufacturing sector.

The first formal government intervention came with the Industrial Policy Action Plan (IPAP) in 2007. Using a wide range of instruments, government focused on stimulating a number of key sectors through economy-wide policy interventions. The timing of the intervention could not have been better, as alluded to by Nimrod Zalk, as it meant the sector was largely shielded from the fall out of the 2008 global financial crisis. Some of the constraining factors highlighted by Nimrod Zalk are labour markets, the broad business environment, monopolistic pricing, demand and skills shortages as well as relative prices and profitability. There is no uniquely identifiable area that is a problem, but addressing each of these and moving towards a diversified manufacturing sector will ensure the sector can continue to grow in the future.

Strategies towards developing a diversified manufacturing sector include localisation, diversified exports, strategic trade policy, tackling import fronting, developing a competitive and stable currency, an aggressive export-driven manufacturing outlook and a stronger push by the government towards greater regional economic integration.

Government needs to implement policies that limit the cost-price squeeze on manufacturers specifically targeting monopolistic input prices, rising electricity prices and the wage bargaining framework. Financing diversified manufacturing will depend on developing a tax framework that encourages investment within the sector, actively promoting the role of development finance institutions and fiscal responsibility on the part of government.

South Africa's proximity to the rest of Africa is a potential major boon for the sector. The continent is the fastest

growing region in the World. South Africa must grasp the opportunity to supply the continent. Albeit from a low base, South Africa's diversified export growth to Africa has far outstripped growth of exports to the European Union. The low base means that this can be sustained over extended periods of time. The opportunities for South Africa are linked to the mining and infrastructure sectors and the rise of the African consumer.

PANEL DISCUSSION

WHAT POLICY INTERVENTIONS DOES SOUTH AFRICA NEED TO DRIVE THE GROWTH OF MANUFACTURING?

PANELLISTS AND CHAIR

Nizam Kalla, Managing Director, Amka Products

Jeff Nemeth, President and Chief Executive Officer, Ford Motor Company of South Africa

Coenraad Bezuidenhout, Executive Director, Manufacturing Circle

Jonas Mosia, Coordinator for Industrial Policy, COSATU

Raymond Padayachee, Head: Industry and Manufacturing Sector for SA and Africa, Siemens

Dr Martyn Davies, Chief Executive Officer, Frontier Advisory

Focus of discussion

- *Continuous engagement of key stakeholders in the sector (labour, unions, government and private sector) is a means to create favourable investment climate necessary for manufacturing growth*
- *Skills development programmes benchmarked to international standards and moving unskilled labour up the value-chain key to capacity enhancement*
- *Competitive manufacturing through a diversified export-driven manufacturing sector*
- *Forward-looking thinking by government and targeted planning and implementation vital in policy considerations*

The South African manufacturing sector definitely has a lot of potential. The key to this will be attracting new investment into the sector particularly from external investors. The sector faces a number of key challenges. Coenraad Bezuidenhout highlighted the fact that South Africa has severe institutional impediments that could potentially prevent the sector from growing. These constraints have seen the manufacturing sector decline quite significantly since 1994.



The recent platinum group minerals (PGM) strike showcased the volatilities the sector is exposed to. The strike resulted in R67 million worth of purchases lost every day. Although a large share of economic indicators are down, declines in the economy have shown up particularly

in the manufacturing sector.

All stakeholders need to keep engaging through the institutions that are in place. As Jonas Mosia indicated, these institutions may not be perfect, but pointing fingers and blaming organised labour will not help. The unions do not condone acts of vandalism which has become an increasing element of strikes. The high unemployment rate in South Africa is a source of great frustration for many but unions, through education and developing an informed member base, could resolve some of these issues in the short-term. The impact on the livelihoods of employers and employees could be catastrophic if the status quo is allowed to fester.

Developing skills for the manufacturing sector will be critical towards attracting investment into the sector. The trade unions will play an increasingly important role in directing policy towards skills development. Although trade unions including COSATU are primarily involved in wage bargaining, they have a vested interest in ensuring that policy is directed towards skills development, according to Mosia. Policy must ensure that manufacturing today and that of the future has the capacity to sustain large-scale industries as envisaged by the Industrial Policy Action Plan (IPAP). Creating effective demand in the economy will be an important element for this.



Furthermore, Raymond Padayachee reinforced the notion of creating effective demand by stating that both government and business are missing the point in South Africa. There is often a short-term view taken with regards to skills development in the country. The sector cannot continue on a path that creates jobs for unskilled labour. The country needs to move unskilled labour up the value-chain, allowing it to leverage potential productivity gains and in turn placing the sector in a position to be able to compete globally with China and become Africa's industrial powerhouse (akin to Germany in Europe).

The future of manufacturing will be to compete on a global scale whilst leveraging regional opportunities. Automation will be essential for creating capacity for competitiveness. In manufacturing, economies of scale matter. South Africa does not have the market size in order to sustain large-scale manufacturing activity. Its proximity to the rest of Africa provides it with an incredible opportunity to export with sufficient economies of scale.

According to Jeff Nemeth, Africa is the next economic frontier and pan-African infrastructure projects - particularly those relating to transport - will be pivotal for the manufacturing sector. Government however needs to

engage with and understand where they can partner with industry in order to improve the business operating environment in South Africa. Some of the key issues that will need to be addressed are cost pressures relating to labour, electricity and ports.

The Industrial Policy Action Plan (IPAP) is a good step towards transforming South Africa's manufacturing sector. IPAP has evolved into something better than its original form and is a great example of effective coordination according to Bezuidenhout. IPAP is a diverse programme of actions which makes trade and other tools subservient to industrial policy.

Nemeth stressed that South Africa should not miss out on the opportunity to reindustrialise. He highlighted that the American economy has reindustrialised over the last five years, in large part due to the shale gas revolution.

Will policy-makers in South Africa be bold enough to take the decision to start fracking in the Karoo? Padayachee responded to this point by stating that South Africa cannot continue to 'kick the can down the road' and policy makers need to do what needs to be done in order to secure the country's future. Real transformation will come to the sector when its stakeholders begin to understand that we need to create an environment that will foster entrepreneurs that will create the next million jobs in the economy, says Nizam Kalla. In addition, government needs to develop a clear vision of what is needed and harness the clear opportunities that are available in Africa without politicising discussions around the manufacturing sector.

Government needs to take a long-term view, particularly with its goals and objectives with respect to the manufacturing sector. Competitiveness is ultimately what will drive growth of the sector in the future. Directing objectives towards a more innovation driven sector will be crucial. A much more focused and coherent focus is needed to tackle these issues and a dynamic understanding of the sector is required in order to allow for more coordinated interventions.

DELOITTE PRESENTATION & DISCUSSION

THE EXCITING FUTURE OF MANUFACTURING

SPEAKERS

Karthi Pillay, Africa Manufacturing Industry Leader, Deloitte South Africa

Bronwyn Kilpatrick, Automotive Leader, Deloitte South Africa

Jason McPherson, Advanced Materials Systems Specialist, Deloitte South Africa

Roy Campbell, Forestry, Pulp, Paper and Packaging Leader, Deloitte South Africa

Focus of discussion

- *3D and 4D printing shaping manufacturing in the near future*
- *Advanced Materials Systems (AMS) – A structured approach to innovation*
- *The future of forestry, pulp, paper and packaging is currently underpinned by an evolving industry leveraging new areas of growth*

The manufacturing sector is a very appealing sector and holds lots of promise for the future; as new technologies continue to permeate systems, processes and products. The big question is, are South African manufacturers thinking enough about where the sector is going or will we be sitting here in fifteen years wondering why enough was not done?

All too often, too much emphasis is placed on the present. The key is to be a future-oriented manufacturing sector. Evidence of the changing dynamic of the manufacturing sector can be seen through technology companies that are becoming manufacturers, like Google and its driverless cars and the introduction of disruptive technologies, like ride share apps, Uber and Lyft.

Some key global megatrends to be aware of that will shape the manufacturing sector of the future are 3D and 4D printing, Crowd-sourcing and gamification, analytics and big data; and the quest by manufacturers to get closer to the consumers who want smart tailored content. Karthi Pillay suggested that the products of the future will need to embed interactive capabilities into their products.

Advanced material systems (AMS) are about maximising growth on materials-enabled solutions and creating a

pathway for reigniting growth. Outputs of AMS are functional solutions. AMS is about understanding the market opportunity in order to understand what systems, processes and components will be needed to meet demand. Success requires that target markets define system performance and cost - not the material, said Jason McPherson. Furthermore, recognising the ecosystem complexity and how value is created is crucial in approaching the opportunity.



Bronwyn Kilpatrick stressed the point that the current generation will reconfigure where the industry is going in future. People will increasingly be paying for mobility and an autonomous vehicle is definitely on the horizon. An understanding of how this will impact fleet services and other ancillary services will be required. The industry will move towards computerised testing and design resulting in fewer defects, longer life spans and reduced maintenance. Changes in the automotive industry are increasingly being driven by the notion that people will no longer need vehicles to connect to the World.

Is there any future in the Forestry, Pulp, Paper and Packaging industry? Indeed there is, stated Roy Campbell. Wood products are increasingly being used for unusual applications including food and clothing. Paper will not disappear from offices overnight and Africa for example has a large potential market of people who do not as yet use tissue paper. The sector in South Africa is safe in that the country provides one of the best ecosystems for growing hardwood. Niche products will prove to be influential for the industry. The very products that seem to be killing the paper industry can actually help save the industry. Campbell alluded to the fact that cell phones have cellulose which is a by-product of trees. In future, manufacturers within the sector need to look at what problems they are trying to solve rather than what products they are trying to make. To remain competitive, manufacturers need to understand the future and what role South Africa will play in the future of manufacturing. The impact on the value chain will be felt across all sectors. The impact will be more drastic and immediate, particularly for manufacturers operating in emerging markets. South Africa has fared well in global manufacturing competitiveness with respect to Africa, but has slipped somewhat in recent times in the global ranks. Manufacturers need to harness the drivers of manufacturing competitiveness in order to increase competitiveness and ensure that South Africa does not fall into the trap of manufacturing for manufacturing's sake, said Campbell.



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