Rooting SA: Strengthening the local automotive industry

Value Beyond Compliance series

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“We want the industry to be globally competitive, but competitiveness is not just a function of what happens on the factory floor.”

– Trade and Industry Minister Ebrahim Patel
Manufacturing is often seen as a gateway to inclusive growth. It has the potential to create jobs, deepen and broaden local value chains, advance technology and cultivate local skills. As such, numerous countries, like South Africa, have solidified manufacturing as the cornerstone of their industrial policies.

The automotive industry is part of the manufacturing basket, and so many developing economy governments have incentivised domestic automotive manufacturing. For some countries, such as Thailand, this investment has also contributed to deep socio-economic gains. However, other countries have not realised their full potential. In addition, the global automotive industry is now experiencing slowing demand and manufacturing volumes as a result, making government incentives increasingly important to retain global automotive manufacturers.

The South African automotive industry employed around 110 000 people directly and contributed 6.8% (4.3% manufacturing and 2.5% retail) to gross domestic product (GDP) in 2018. The government has recognised the importance of well-designed automotive incentives, supporting the industry through consecutive industry incentive programmes. Yet, when compared to other emerging countries with local automotive manufacturing, localisation remains relatively weak.

South Africa’s latest automotive policy, the South African Automotive Masterplan (SAAM), aims to rectify this by broadening and deepening local value chains and embedding industry into the domestic economy. Meaningful localisation, at its core, forms part of value beyond compliance. It supports innovation and productivity, and aligns economic performance with social progress, thus driving inclusive growth.

This report investigates enabling localisation factors as compiled from industry interviews, while unpacking the South African automotive context and supplementing it with corresponding international best practice, and Deloitte Africa’s own experience in meaningful localisation and value beyond compliance practices.
Global automotive industry overview

Globally, there is a symbiotic relationship between the automotive industry and governments: the automotive industry depends on government incentives to improve viability, while governments support automotive industries to spur economic development.

The automotive industry often relies on this support, with net profit margins relatively low – mostly single digits. The dependence was recently highlighted when Ford, Holden and Toyota’s manufacturing plants in Australia closed due to a lack of government support, with many local suppliers (and jobs) following suit.

The automotive industry – defined in this report as the automotive manufacturing sector – usually consists of three categories, all of which can create employment opportunities in the producing country:

- **Original Equipment Manufacturers (OEMs)**
  Design, assemble and market the final automotive product, and, on occasion, manufacture equipment for it. Components are typically procured from suppliers according to the OEM’s specific criteria.
  
  *Examples: BMW, Ford, Mercedes Benz, Nissan, Toyota and Volkswagen*

- **Tier 1 suppliers**
  Manufacture components and/or systems according to specified criteria. These firms supply OEMs directly. Inputs into these parts and systems are typically procured from the tier 2/remaining tier suppliers.
  
  *Examples: Bosch and Continental*

- **Tier 2/remaining tier suppliers**
  The tier 2/remaining tier suppliers produce parts and/or raw materials throughout the automotive industry value chain. Importantly, these suppliers usually serve multiple industries and not exclusively the automotive industry.

  *Examples: Aluminium, plastic and steel industries*

Globally, tier 2/remaining tier suppliers dominate the automotive supply chain and are responsible for 50% of value addition (Figure 2). These suppliers often drive localisation and are important to deepen skills, employment and value chains in the host country.

![Figure 2. Global value addition composition (% of total value addition)](image)

This typical global composition, however, requires conducive domestic business, economic and policy environments to support local suppliers.
Rooting SA: Strengthening the local automotive industry

Case study: Thailand – the Detroit of Asia
Thailand has made great strides in realising its automotive aspirations. Over a 60-year period, the country has transitioned from an assembler to a top automotive manufacturing and export hub. Its success has attracted leading global automakers, assemblers and component manufacturers.

This progress is evident in the numbers. Thailand’s automotive production increased by 383% from 2000 to 2017. There are 31 assemblers and over 2,000 suppliers located in Thailand, which produced around 2.2 million vehicles in 2018. This local production caters for most of the local demand, meeting over 95% thereof. In addition, local production amounted to US$30bn in foreign revenue with around 55% of cars and 60% of commercial vehicles exported. It is thus no surprise that the automotive sector constitutes approximately 12% of GDP. This all translates into employment: the automotive sector employs around 850,000 people. This has also led to various training initiatives, upskilling people in lifelong and, often, industry-transferrable skills.

The success described above required long-term strategic and concerted efforts. Pragmatic, coherent and dynamic government policies were, and remain, integral to the success of the industry.

Figure 3. Thailand’s automotive structure

Figure 4. Thai automotive policy development
The Thai government used a phased approach to attract OEMs and benefit from the automotive industry. After focussing on protectionist measures, the Thai government shifted its attention to attracting multinational automotive manufacturers, promoting exports and building local capacity for greater export production. Importantly, the objectives were generally clear, with incentives, investment and growth aligned to support the objectives. For example, Thailand’s automotive industry focussed on producing select vehicles (appropriately called the product champion) and components locally. This strategy narrowed the scope of local vehicle manufacturing and thus components, increasing volumes and improving economies of scale. Policy was developed to support specific investment as well as local demand for these vehicles. By focussing incentives and support on targeted areas, Thailand was able to deepen the relevant supply chains. Notably, Thailand also concentrated on developing local skills, including for lower tier suppliers, often by entering into strategic partnerships and sharing the responsibility of transferring the needed skills to domestic suppliers and employees.

The government also introduced industrial policy which linked to the abovementioned objectives. These policies translated into practical benefits for multinationals; including exemptions on corporate income tax and import duties on machinery and raw materials, immigration permits for experts, land ownership options and supercluster automotive zone benefits. This was not the only policy that contributed to automotive development. The government also created strategic trade agreements with key countries such as Australia, China and India, yet another benefit to automotive exporters. These agreements assisted OEMs to tap into the growing regional middle class, and to source raw materials. However, Thailand’s policy is also dynamic and adjusts to the changing internal and external environment. Given the global trend of moving towards digital and green automotive solutions, Thailand’s current policy iteration focusses on promoting green vehicles. Subsequent incentive schemes have been established to support its 2027 Vision of becoming the Global Green Automotive R&D base. For example, Thailand has already attracted electric vehicle (EV) investment from Nissan, Toyota and Honda by introducing applicable tax breaks. These comprehensive and targeted policy reforms, alongside economic stability, well-developed infrastructure and upskilling the local labour force, have proven strong drivers for the Thai automotive industry.
Local automotive industry overview

For decades, the automotive industry has been fundamental to South Africa’s economy. It contributed 6.8% (4.3% manufacturing and 2.5% retail) to GDP in 2018. In addition, automotive exports are valued at nearly R180bn, and comprised 14.3% of South African exports. Moreover, in 2018 the industry employed around 110 000 people (across vehicle and component manufacturing), producing over half a million vehicles. This makes South Africa the largest automotive producer in Africa (54.3%) with many of the major OEMs operating in South Africa. However, Morocco – the second largest African producer – has increased production significantly, and produces more passenger cars than South Africa.

While the sector is important to the South African economy, the low and decreasing level of local content (see Figure 1) remains distressing. In 2015, local content was recorded at 38.7% – below some of our automotive peers and the current SAAM target of 60%. This is challenging for the domestic economy – localisation drives employment and skills development – and for the automotive industry in particular. By importing goods, the automotive industry is exposed to exchange rate volatility, something the rand is renowned for as one of the most traded emerging market currencies.

As shown in Figure 6, the structure of South Africa’s automotive industry is dominated by OEMs and tier 1 suppliers, with few tier 2/remaining tier suppliers. In comparison (Figure 2), the tier 2/remaining tier suppliers typically contribute 50% value addition to the automotive industry globally relative to South Africa’s 20%.

This is exacerbated by the lack of volumes and inadequate local production capabilities. Volumes are important in utilising economies of scale: significant volumes decrease input costs, making production economical. Local lower tier suppliers thus often struggle to deploy economies of scale, skills and advanced technologies.

There are more challenges, all of which affect small suppliers more than their downstream counterparts. Inconsistent electricity supply, fragmented transport infrastructure and low business confidence plague the South African economy. Rectifying these inefficiencies and supporting small local suppliers, in this environment, are crucial for their survival.
Case study: The South African policy landscape

The Thai case study above highlighted some key areas for developing an automotive production hub. Government policies are pivotal, and should be practical, simple, targeted and aligned.

South African automotive policy, much like Thailand’s, began with an inward focus. At the start of the 1960s, policy prioritised local content for local consumption. This started to change in the late 1980s with later phases of the local content programme. Post-democracy saw liberalisation increase further with the Motor Industry Development Programme (MIDP), which reduced tariffs at an even faster rate.38

In 2013, the MIDP was replaced by the Automotive Production and Development Programme (APDP). Although both these programmes aimed to increase production volumes, the MIDP focussed on exports, while the APDP shifted focus to increasing production in general. Both these policies, however, were accompanied by stable, if not declining, levels of localisation.39

Source: Black, et al., 2018;40 and Davies, 201841

Figure 7. South African automotive policy landscape – focus on localisation

- Localisation was used to protect foreign exchange
- Further phases were introduced, with phase 6 introduced in 1989
- Prioritise liberalisation to increase volume
- No local content requirement
- Focus on exports
- Shift away from solely exports, towards supporting production in general (irrespective of market)
- Promote higher degree of localisation (target set at 60%)
- Support local value addition – shift from Vehicle Assembly Allowance (VAA) to Volume Assembly Localisation Allowance (VALA)

Government policies are pivotal, and should be practical, simple, targeted and aligned.
In 2018, the South African Cabinet approved the extension of the APDP to 2035 with amendments which align with the new automotive policy document, the SAAM 2035. Importantly, the SAAM gives a clear vision and sets objectives for the industry – a crucial element of policy certainty for the automotive industry.42

The SAAM’s vision:
“A globally competitive and transformed industry that actively contributes to the sustainable development of South Africa’s productive economy, creating prosperity for industry stakeholders and broader society.”

Key summary of SAAM:
- **Achieve 1% of global vehicle production by 2035 (increase from current 600 000 units to almost 1.4 million units a year)**
- Increase local content from current **39% to 60%**
- **Double employment** in the value chain from current levels to about 240 000
- Achieve at least **level 4 BEE status** from 2021
- Support to be based on **value addition** rather than production sales value.”

Source: Davies, 201843

The SAAM and APDP policies are widely regarded as supportive and well-developed, with the changes focussed on creating greater opportunities for local suppliers. The SAAM targets 60% local content with the extended APDP moving away from VAA towards VALA.44 The latter excludes imported content and is expected to drive greater localisation, compelling OEMs and tier 1 suppliers to source locally.45

Yet, the SAAM and APDP do not function in isolation. There are multiple government departments which influence the automotive industry through different policies, e.g. the promotion of EVs. The APDP, the Green Transport Strategy and the EV Roadmap all aim to support EV production. However, government and the industry have yet to finalise a comprehensive and aligned plan.46 South Africa would benefit from better alignment across policies, not only in the EV space, to support the industry’s vision.47

Misalignment frequently also extends across industries. Alignment is especially important for tier 2/remaining tier suppliers, who globally tend to supply multiple industries rather than solely the automotive industry.
Enabling localisation

The latest policy changes have heightened the emphasis on localisation, intentionally shifting focus from imported to local content. Nevertheless, the desired level and quality of localisation require determination. Local suppliers need to be grown and/or created; if done properly, this will benefit all stakeholders in the long run.

Below are insights on developing meaningful localisation drawn from interviews conducted with various automotive stakeholders. Three key themes emerged:

**Figure 8. Key localisation enablers**

- **The will**
  - Drive efficiency gains in the:
    - public sector such as structural reforms, alignment of efforts, special economic zones and administrative efficiencies
    - private sector such as OEM collaboration and transparency

- **Volumes**
  - Increase volumes by promoting:
    - regional integration
    - incentives for locally produced vehicles
    - cross-industry value chains

- **Upskilling**
  - Cultivate the local skills base by focusing on:
    - individual business needs
    - continuous business development

Source: Deloitte Africa interviews and research

The best automotive vision means little without the will to follow through. This requires proper regulation, implementation and, importantly, the will to change inefficient structures and systems in both the public and private sectors.

This starts with the South African business environment. Structural reforms are vital for broader economic efficiency gains. Although reforms do not specifically target the automotive industry, the impact on it could be two-fold: stimulating local business for the automotive industry to procure from, and supporting economic growth, thus increasing automotive demand. In addition, this could assist in addressing low-hanging fruit, such as scrap metal localisation, and rail and port efficiency.

The issue of will also relates to Special Economic Zones (SEZs), which could often be used more efficiently. Many small suppliers do not have access to these advantageous zones, leading to higher production costs and limited exposure to technical expertise. For example, preferential electricity pricing and consistent power supply are typical benefits of SEZs.

Government processes, furthermore, often lead to unintended administrative burdens. This is especially damaging for smaller businesses with limited administrative capacity. For example, VAT administration can be cumbersome, resulting in wasted resources, and refunds are often slow, resulting in cash flow difficulties. This also applies to incentive schemes, with some small businesses finding incentive programmes difficult to access, and finding the process slow.
Overall, strategy and policy efforts should be aligned and more holistic to pursue strategic interest areas. This includes targeted trade strategies to decrease tariffs and unlock volume, as well as prioritising specific value chains for local development. Progress needs to be monitored and evaluated to keep parties accountable.

Efficiency gains are also required from the private sector. Collaboration between OEMs is central: clustering incentives and opportunities will give greater support to small business. This could also assist OEMs and tier 1 suppliers in finding a supplier base. A unified approach to information sharing and utilising small local suppliers can thus assist everyone in the sector.

Moreover, small local suppliers need transparency and adeptness from OEMs for business planning and forecasting. Current and potential small suppliers often do not understand the opportunities available in the industry, exacerbating difficulties in identifying opportunities and planning. This also relates to current processes, where some payment terms are lengthy, creating cash flow challenges for small businesses. This is worsened by the naturally low profit margins of the automotive industry.

Economies of scale are essential for an industry with low profit margins. Scale is one of the greatest challenges facing the South African automotive industry, with current production volumes around 600,000 vehicles. With the domestic economy weak, and unlikely to yield significantly more demand in the short term, it is crucial for the industry to find alternative methods to stimulate demand.

One such way is through regional integration. The middle class in Sub-Saharan Africa (SSA) is expected to increase substantially: by 2035, around 50 million adults are expected to earn more than US$10,000 annually. If binding structural constraints are resolved, the SSA Automotive Pact Task Team estimates that SSA production could increase to around 2.05 million units. As Deloitte Africa has stated previously, it is not unfathomable to see this market as the “final frontier for the global automotive industry”. South Africa is well positioned as the anchor economy, which is an opportunity the country cannot afford to waste. However, markets in SSA are fraught with challenges: these include inadequate logistics, overlapping trade agreements, insufficient financing options, and misalignment across policies. In addition, these markets tend to be dominated by second-hand vehicles.

Moreover, African markets are vastly different, and it requires time and effort to understand local conditions. It is important to develop targeted product strategies per country (or even per city), and establish local and international partnerships to overcome current barriers. Nonetheless, there are opportunities. Progress has been made with some African countries revising or developing automotive policies (including legislation to curb second-hand vehicle importation) and the SSA Automotive Pact Task Team investigating regional integration.

South Africa also has opportunities for economies of scale. Volumes can be stimulated by incentivising South African consumers to buy locally produced vehicles. This can come in various forms: Thailand uses import duties, India offers upfront subsidies with EV purchases, Kenya plans to limit second-hand car imports, and China incentivises the acceleration of auto replacement. As a World Trade Organisation (WTO) member, South Africa would need to investigate these different options, ensuring the country complies with international trade regulation.

Furthermore, volumes for tier 2/remaining tier suppliers can be increased by deepening the cross-industry value chains (and not solely focussing on the automotive industry). This is done globally, with lower tier suppliers supplying multiple industries. A targeted approach may prove beneficial and would entail understanding South Africa’s import base and products used across industries. One possibility, for example, is plastics. Plastics are used in multiple industries, including the automotive industry (e.g. plastic injection), and are currently being produced as a by-product in South Africa.

Business excellence is no easy feat. With the focus on local manufacturers, some of whom may not yet exist, the industry needs to understand what type of upskilling small suppliers require. This likely entails a wide range of development, from technical training in R&D centres, to basic financial and management training on business readiness.

As is often the case in South Africa, the skills spread is wide. This often leads to blanket-approach incubation programmes being less effective. Skills training should cater for the individual business needs (see section titled Deloitte Africa: Lessons from the trenches). For example, some suppliers need to acquire better technology – giving small local suppliers the opportunity to leapfrog to the next level of productivity. For others, they may need to acquire negotiation and forecasting skills training. Depending on the need, it could be beneficial to partner with global experts to increase local competency. Once again, this requires a targeted approach.

Additionally, continuous business development is crucial for long-term success (and the lack thereof is partly noted for the failure of past incubation programmes). Long-term coaching, especially throughout the business life cycle, assists in dealing with new-found challenges. This requires regular check-ins, and embedded incubation practices, processes and systems. Another consideration is having incubation programmes in industrial parks or SEZs. This would give small businesses access to preferential agreements of SEZs and the necessary exposure to OEMs and tier 1 suppliers.
Meaningful localisation, which both deepens and broadens local value chains, is crucial in aligning economic and social progress. This requires a shift away from a compliance-driven approach, towards value beyond compliance thinking, which fosters innovation and productivity. For localisation, this involves developing successful strategies to develop and/or create sustainable local suppliers, based on their individual needs and aspirations.

The focus area for Enterprise and Supplier Development (ESD) is specifically small, medium and micro-sized enterprises (SMMEs). SMMEs have the greatest need for developmental support, and require different ESD support at different phases of their growth journey (Figure 9). Their needs, and the challenges they face, are well researched and documented, not only in South Africa, but globally.

Based on Deloitte Africa’s experience, some of the important considerations when supporting SMMEs are:

- Entrepreneurial competence is correlated with the business’s survival and success
- Education and training are also correlated with successful SMMEs (as evidence in South Africa has indicated)
- Support should be differentiated by sector, size, skills and other factors
- Different stages of business growth should be taken into consideration
- The low survival rate for start-ups in South Africa (most fail within the first three years) is correlated with inadequate managerial skills
- Accessing and retaining skills within SMMEs is a key competitive advantage.

Figure 9. SMME support phases - Emerging Micro Enterprises (EMEs), Qualifying Small Enterprises (QSEs) and Generics

<table>
<thead>
<tr>
<th>Types of ESD support</th>
<th>EMEs</th>
<th>QSEs</th>
<th>Generics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Incubation programmes</td>
<td>&lt;1 year or 1–3 years</td>
<td>1–3 years and up to 5 years</td>
<td>3–5 years and &gt;5 years</td>
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<tr>
<td>Training</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Equipment and materials</td>
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<tr>
<td>Financial assistance (i.e. loans)</td>
<td></td>
<td></td>
<td>Favourable funding (e.g. loans) for expansion, transformation, and productivity improvements</td>
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<tr>
<td>Managerial development</td>
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<tr>
<td>Acceleration programmes</td>
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Source: Deloitte Africa, 2019b,c
Deloitte Africa’s ESD framework
Traditionally, ESD programmes have focussed on organisational programmes, which often disregard the specific needs of SMMEs and their operating environment. Deloitte Africa has taken a different approach.

Our ESD framework is underpinned by an industry approach (e.g. tier 1 suppliers collaborating to develop their tier 2 suppliers), with elements of cross-industry deliberation. Hence, the framework considers direct and side value chains to identify volume and opportunities for small suppliers. It therefore supports small suppliers in achieving a sustainable growth path.

Figure 10. Deloitte Africa’s ESD framework

Data-driven opportunity identification
We identify opportunities for enterprise and/or supplier development by analysing data at organisation, sector and cross-sector levels. This includes understanding relevant value chains, and undertaking proper market sensing, while considering the potential capabilities of suppliers. This process helps to identify opportunities that are likely to succeed.

Individual approach
After identifying and prioritising opportunities, it is important to create a personalised programme. We work with entrepreneurs to match their capabilities to the selected opportunity. This means creating individual development plans – including elements such as types of funding, skills development or mentorship – and implementing these effectively.

Robust post-investment monitoring
In an ever-changing environment, efficient monitoring and effective adjustments are crucial for SMMEs’ long-term sustainability. ESD programmes therefore need to be agile. In this phase, we monitor and evaluate SMMEs’ progress, and adjust the programme to support their long-term sustainability. The data collected feeds back into the first step, i.e. data-driven opportunity identification, to ensure we have the best information to make the best decisions.

Moreover, the framework is dynamic and iterative – collecting data throughout the process, and adapting to shifting needs. Deloitte Africa’s ESD framework consists of three basic steps:

- We identify opportunities for enterprise and/or supplier development by analysing data at organisation, sector and cross-sector levels.
- After identifying and prioritising opportunities, it is important to create a personalised programme. We work with entrepreneurs to match their capabilities to the selected opportunity. This means creating individual development plans – including elements such as types of funding, skills development or mentorship – and implementing these effectively.
- In an ever-changing environment, efficient monitoring and effective adjustments are crucial for SMMEs’ long-term sustainability. ESD programmes therefore need to be agile. In this phase, we monitor and evaluate SMMEs’ progress, and adjust the programme to support their long-term sustainability. The data collected feeds back into the first step, i.e. data-driven opportunity identification, to ensure we have the best information to make the best decisions.

Having the right processes, people and procedures in place to ensure successful localisation is key in driving value beyond compliance. This helps our clients to obtain value for their money and exertions, and drives social progress by developing sustainable businesses.
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The road ahead

The SAAM has recognised the need for and urgency to drive meaningful localisation. The reasons are clear. Developing the local automotive industry and subsequently tier 2/remaining tier suppliers has the potential to generate high-value economic activities, improve living standards, and create higher-paying jobs, while developing upstream (e.g. plastics) and even services-based downstream (e.g. maintenance services) industries.

Nevertheless, legislation alone is not enough and key areas – including the will, volume and upskilling – need to be addressed to unlock the full potential of the local automotive industry.
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Endnotes

3 The Department of Trade and Industry, 2018. Geared for Growth: South Africa’s automotive industry masterplan to 2035, s.l.: The Department of Trade and Industry.
4 For example, Brazil, China, India, Indonesia, Mexico, Thailand and Turkey all have developed their automotive manufacturing sector.
6 Such as the Motor Industry Development Programme (MIDP), Automotive Production and Development Programme (APDP), and South African Automotive Masterplan (SAAM).

Value beyond compliance is about the fundamental synergy between business performance and social progress in creating shared value. See Deloitte, 2019a. Value Beyond Compliance: A new paradigm to create shared value for mines, communities and government, s.l.: Deloitte.
8 For example, the global auto and truck net profit margin is 5.14%, auto parts is 4.34%, while automotive retail is 3.12%. See Damodaran, A., 2019. Data. [Online] Available at: http://people.stern.nyu.edu/adamodar/New_Home_Page/data.html [Accessed 20 April 2019].
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35 Ibid.
36 Ibid.
39 Ibid.
40 Ibid.
42 Ibid.
43 Ibid.
44 Ibid.
47 Automotive Supply Chain Competitiveness Initiative, 2015. Lessons for South Africa from the Thai automotive industry’s success, s.l.: ASCCI Quarterly.
48 Interviews were conducted with 20 industry stakeholders across six organisations (such as OEMs, industry bodies, and tier 1 suppliers).
54 For example, Kenya plans to lower the restricted age of imported second-hand cars. See Miriri, D., 2019. Kenya to restrict second-hand imports to boost domestic car sector, s.l.: Reuters.
56 Automotive Supply Chain Competitiveness Initiative, 2015. Lessons for South Africa from the Thai automotive industry’s success, s.l.: ASCCI Quarterly.
60 Many corporates already upskill people to break down the skills divide. For example, Bosch established a training centre where learners on multiple Bosch programmes have the opportunity to undergo vocational training. See Bosch, 2019. Quality Bosch Parts Made in South Africa. [Online] Available at: https://www.bosch.africa/news-and-stories/bosch-brits-plant/ [Accessed 26 August 2019].
61 Basic business skills often let companies down: bottom lines are insufficient, worsened by the lack of negotiation and forecasting skills. This is often exacerbated by the lack of transparency from OEMs and tier 1 suppliers.