

# The South African Automotive Supplier Industry Benchmark Report 2018

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## Executive Summary



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## Foreword

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The South Africa Automotive Supplier Performance Report 2018 is the second one produced for the National Association of Automotive Component and Allied Manufacturers (NAACAM) by B&M Analysts SA (Pty) Ltd. This publication is an executive summary of the findings.

NAACAM is the leading voice of automotive component manufacturers in SA, and both represents as well as provides a range of value added offerings to approximately 165 manufacturing and service suppliers in the sector.

The report is part of NAACAM's effort to keep its membership apprised of industry trends and empirically assessed performance information. We believe this is key to unlocking any blind-spots within the supplier community itself, whilst also giving industry stakeholders valuable insight into influencing factors within the sector, often from a shop-floor lens. The words of leading Indian cricketer Sachin Tendulkar are instructive in this context: "Control the Controllable!"

We trust you find the information contained herein valuable and hopefully it assists in your strategic decision making.

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## Notes

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Automotive supplier benchmarking data analysed in this report is gathered through the benchmarking programmes of B&M Analysts and its affiliates. Data on suppliers in South Africa is gathered largely via benchmarking activities undertaken on behalf of the South African Automotive Benchmarking Club (SAABC), the Durban Automotive Cluster (DAC) and the Automotive Supply Chain Competitiveness Initiative (ASCCI).

The benchmarking database primarily comprises comparators from Hungary, India, Mexico and South Africa (SA). For the purpose of the benchmark analysis, comparators are grouped accordingly to the following categories:

- South Africa (SA, n=86)
- Developed Country (DC, n=56)
- Less Developed Country (LDC, n=124)

Automotive suppliers based in South Africa are encouraged to participate in the benchmarking activities via one of these structures as a part of the ongoing benchmarking activities undertaken by B&M Analysts and supported by NAACAM.

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## 1 Global and domestic industry performance

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Industry performance data for 2017 highlights that, from a global perspective, the automotive industry continues to display healthy growth. A record total of 93 million passenger and light commercial vehicles were produced in 2017, with the 10-year compound annual growth rate 3.3%.

While healthy global growth is apparent, this is underpinned by highly variable regional performance. An analysis of Organisation Internationale des Constructeurs d'Automobiles (OICA) production output data by region for 2017 highlights that production is substantially dominated by Asia (50 million units), followed by Europe (22 million) and then North America (17 million). South America and Africa account for only 3.3% (3 million) and 1.0% (900 thousand) respectively of total global production.

From a growth perspective, production volumes for Asia, Europe and North America, the three major production regions, have grown by 23%, 12% and 10% respectively over the last five years. More recently over the last year, while Asia and Europe report continued growth (of 2.4% and 3.0% respectively), volumes in North America declined 4.1%. At the opposite end of the spectrum, volumes in South America have decreased by 24% since 2012, although a recent recovery is evident. Production volumes in Africa have increased by a significant 62% from 2012, although this is off a very low base (2012 volumes were only 590 thousand). Some of Africa's growth is linked to South Africa (53 thousand units), however the primary driver has been North Africa. Algeria grew production from a zero base to 60 thousand units, while volumes in Morocco have increased by 233 thousand units over the past five years.

Focusing on South Africa, local OEM production volumes declined for the second consecutive year in 2017; with levels down by 1.2% on the previous year. This performance masks a disparity in the performance of vehicle types: LCV volumes increased by 3.0% over the last year, while passenger vehicle production fell by 4.2%. Total light vehicle production growth of 7.5% is projected in South Africa in 2018. LCVs are expected to continue to lead local production growth at 8.0% as compared to 7.1% for passenger vehicles.

The local industry's production volumes continue to be supported by exports, which have been around 60% in recent years, and are expected to remain at this level in 2018. Passenger vehicle exports are particularly high at around 70% of production, while LCV exports are much lower at around 44% in 2017. Despite the higher volume of passenger vehicles produced locally, more locally produced LCVs are sold in South Africa than locally produced passenger vehicles (136 thousand versus 100 thousand in 2017).

There remains highly varied production output volumes and growth amongst the SA-based OEMs. The four largest local producers are Toyota, Mercedes-Benz, Volkswagen and Ford, all of which have production capabilities of over 100,000 units per annum. BMW is reported to have a production capacity of 76 thousand units. The Isuzu acquisition of the local General Motors operation is viewed as a positive in the long term for local production, although no production and/or export volumes have been confirmed.

South Africa's most important platforms by volume in 2017 are the Mercedes-Benz C-Class, Ford Ranger/Everest, Toyota Hilux/Fortuner and Volkswagen Polo. A further level of analysis of the OEM platform production data suggests that South African suppliers will face increased competition for local content in the medium term from competing countries such as Thailand, Spain, Germany and increasingly, China.

## 2 Domestic supplier performance

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### 2.1 Growth

South African suppliers increased their average Rand sales by 13% in real terms over the 2015-17 period, with this mainly linked to an 8% growth rate in 2017. The local supplier's growth is just behind the corresponding growth amongst the Less Developed Country (LDC) suppliers, although far stronger than the production volume growth of the SA OEMs which declined in 2016 and 2017. Positively, the SA supplier upper quartile (the point that separates the top 25% of suppliers from the bottom 75%) real sales growth figure is 15.8% in 2017. This highlights that the top 25% performing local suppliers, in terms of sales, achieved average growth of 15.8% or better in 2017. The recent average sales growth level for the SA suppliers, as well as the upper quartile figures, suggests that local firms are securing increased local business opportunities at a Tier 1 and Tier 2 level.

Average SA supplier employment levels (including both permanent and contract employees) increased by 8.7% over the corresponding two-year period, with the increase in 2017 being 2.5%. The upper quartile employment growth level for 2017 is 6.3%.

Encouragingly, an analysis of cost management of SA suppliers from 2015 to 2017 reveals some definite progress. Variable costs, as a percentage of sales, which comprise materials, direct labour and manufacturing overheads, have come down. This improvement, in conjunction with fixed costs being maintained, is reflected in an improved breakeven point, and has resulted in the average operating profit levels being achieved by SA suppliers in 2017 improving notably. SA supplier operating profit however remains substantially lower than the LDC level.

Also, positively, SA OEM customer satisfaction levels (based on the Customer Benchmark Index score) improved again in 2017 to 87.3% from 86.2% in 2016. This is linked to improved ratings in the areas of cost, which refers to product pricing, and product development, as well as quality and flexibility to a lesser extent. Albeit minor, the overall SA OEM rating for reliability did decline in 2017.

Another relevant finding from the SA OEM customer survey in 2017 is that the average level of 'certainty of long term supply' sits at 94.6%, which is on par with the rating for 2016 of 96.9%. In addition, over three-quarters (77.2%) of all SA OEM respondents do believe that there are opportunities to increase their buy allocation from local suppliers. This is linked not only to increasing their current volumes (80.3% of customer that confirmed that opportunities existed indicated that they believed this was possible), but also increasing the range of products that they buy from local suppliers (84.3% indicated this was possible) and especially by working with suppliers to develop new products to purchase (89.0% indicated that this was possible). Thus, from a localisation perspective, the customer survey findings highlight that they (the SA OEMs) would like to allocate increased business to local suppliers.

### 2.2 Competitiveness

When considering the competitiveness of SA suppliers, their overall cost competitiveness relative to a LDC and Developed Country (DC) proxy, namely, India and Hungary respectively, is undertaken. This cost competitiveness assessment considers the contribution of employment, utilities (comprising electricity and water), rental, and operational waste costs (the costs associated with inventory, quality, reliability, flexibility and human resources). The cost competitiveness analysis seeks to quantify the source of local value adding competitive advantage (and therefore also needs to be considered within the context of additional factors such as location of target market, level of local value addition and material costs).

The assessment of suppliers for 2017 reveals that South African suppliers are positioned ahead of Hungarian counterparts, and just behind suppliers in India. The analysis further highlights that, while minimal, definite cost competitiveness progress has been in recent years by the SA suppliers at an aggregated level, with the SA upper quartile level (a proxy for the leading local firms) emphasising that leading performance is present in South Africa.

Relative employment costs (in terms of total payroll costs for suppliers) show that this focus area remains a significant contributor to the cost competitiveness of local firms. Total utility and rental cost data reveals that the average SA supplier can be considered to have an advantage in this area. Waste costs remain a notable portion of the total, with the average sitting at 25% of the total in 2017.

An in-depth analysis of the waste costs of local suppliers provides insights into how they are adapting their operations in the face of stiff global competition:

- An assessment of the overall waste costs performance for 2017 in the areas of inventory, quality, reliability, flexibility and human resource highlights that the average SA supplier incurs operational costs equivalent to 7.8% of sales and performs better than their India and Hungary-based counterparts (9.1% and 10.1% of sales respectively).
- SA supplier waste costs improved by 4.9% and 7.9% in 2016 and 2017 respectively, representing an overall improvement of 12.5% over the two-year period. This was due to consistent improvements in quality, reliability, flexibility and human resources.
- Strong progress in several operational areas is apparent over the last two areas. These relate to customer quality performance which improved by 64.6% from 2015 to 2017, supplier quality which improved by 61.8%, customer delivery performance which improved by 7.5%, internal material unavailability downtime which improved by 42.7%, tooling breakdown downtime which improved by 21.3%, supplier delivery performance which improved by 17.1% and changeover downtime which improved by 24.7%.
- While scope for additional and continued improvements clearly exists for SA suppliers, especially when reviewing the performance levels of lower quartile figures, the upper quartile levels do highlight that strong performance is evident within the local supplier industry (with this also substantiated by the SA OEM supplier upper quartile ratings as well as during the process benchmark exercises).
- Looking forward, some of the biggest opportunities for further reducing waste costs, and thus improving cost competitiveness amongst SA suppliers, lie in the areas of inventory, especially raw materials, which makes up most stock, as well as work in progress, where levels have deteriorated by 13.5% since 2015. Additional operational areas requiring ongoing and sustained focus include internal rework, machine breakdowns and changeovers.

### 2.3 Productivity

People and associated relative employment costs are a critical enabler of organisational performance and therefore a contributor to organisational cost competitiveness, which in turn supports growth. The analysis of the benchmarking data provides the following insights into the issue of relative organisational productivity and the progress thereon:

- Productivity of the average South African supplier (calculated in terms of local value addition as a function of employment costs and capital depreciation) has improved by 9.8% over the past two years

to a ratio of 2.7. Regardless, this remains far lower than the equivalent ratio for the average LDC supplier of 4.3, suggesting a need for local suppliers to substantially bolster their productivity.

- Capital investment levels, an important enabler of productivity improvement and driver of sustainable competitiveness, remained low at 3.6% of sales in 2017. In contrast, LDC suppliers invested an average of 6.7% of sales, while DC suppliers averaged 6.6%.
- Investment in people, a second key enabler of productivity improvement, reflects training expenditure as a percentage of remuneration of 1.5% amongst local suppliers. This is an improvement on the 2015 and 2016 levels of 1.2% and 1.4% respectively, with the local firms also positioned ahead of the latest LDC level of 1.4%.
- Commitment of employees is an additional key enabler of productivity and productivity improvement. It is positive to note that absenteeism levels amongst South African suppliers continues to improve and are well below those reported for LDC and DC suppliers. Over the past two years, absenteeism improved by 14.2% to just 3.0%, while the upper quartile level for SA firms at just 1.7%. The lower quartile level of 4.1% is also ahead of the latest LDC and DC figures.

### 3 Recommendations

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#### 3.1 Support future growth performance

The customer benchmark findings of the South African OEMs confirmed, in support of the industry's localisation drive, that there exist definite growth opportunities for local firms. These are identified as being linked to growing current volumes, expanding the current range, as well as around purchasing new developed products, from local suppliers. The assessment did however identify challenges regarding local suppliers securing additional business. The SA OEM customers identified new product development as an area to improve amongst suppliers, with the necessary capital expenditure to support localisation growth also needing to be increased. While complex and challenging, especially considering the structure of R&D networks, suppliers need to ensure an understanding of customer development needs and the resources needed (i.e. what are the necessary skills and supporting capital required to realise potential growth opportunities) to support these demands. Suppliers also need to look at influencing and situating these development needs within their R&D networks, but also recognising the supporting role of OEMs for this.

#### 3.2 Improved upstream stock management

The benchmark findings confirm that raw materials account for 60% of total stock held by SA firms, with limited progress made in this area in recent years. There is therefore a need for an increased focus on the effective management of upstream stock at SA firms. The increased adoption of Supply Chain Management (SCM) best practices will assist in bolstering and developing the relationship with suppliers, ultimately resulting in improved raw material stock holding. And while the high levels of imported raw materials represents a challenge, all improvement opportunities to reduce incoming stock levels must be pursued. This includes investigating localisation opportunities on a continued basis.

#### 3.3 Enhanced operational performance monitoring

While work in progress levels represent only 13% of total inventory, levels have deteriorated by almost 14% from 2015 to 2017. This highlights that suppliers are increasing internal stock levels (and thus costs) to enable them to meet increasingly onerous customer reliability, flexibility and quality demands. Supported by the benchmark data and in particular by the process benchmark visits, there is an increased need for SA firms to bolster performance monitoring of operations, especially internally. This enables

firms to accurately focus the necessary attention on continuously driving operational reliability, flexibility and quality improvements, which will ultimately result in reduced internal stock figures. In support of driving improved operational monitoring and ultimately performance, a supporting Continuous Improvement culture is required. The customer concerns regarding process innovation at suppliers further substantiate this recommendation.

### 3.4 Progressing productivity through deeper localisation

An increased focus on maximising value addition, including through improved material management and especially localization (in support of the previous recommendations) should be a major focus at SA suppliers. In addition, ensuring the necessary supporting productivity factors are in place is crucial. These include (a) investing in and having the necessary capital in place, (b) investing in people (training and development), (c) having committed people and (d) ensuring that the manufacturing environment is safe for all workers. A focus on all these areas will support enhanced productivity at local firms.

## 4 Summary

The benchmark analysis confirms that there are certain areas of weakness for SA suppliers, with a focus on the identified recommendations to support addressing and overcoming these. However, the findings also verify that the local supplier industry is making real progress. This is highlighted and confirmed at an aggregated level in the growth, competitiveness and productivity sections, with the key improvement areas outlined in the following table.

Focus area	Major SA supplier average areas of progress
<b>Growth</b>	<ul style="list-style-type: none"> <li>• Sales and employment</li> <li>• Cost management resulting in healthier operating profitability levels</li> <li>• SA OEM customer performance assessment of SA suppliers</li> <li>• Localisation opportunities identified by SA OEMs</li> </ul>
<b>Competitiveness</b>	<ul style="list-style-type: none"> <li>• Overall cost competitiveness profile</li> <li>• Total waste cost performance, with this linked to improved quality, reliability, flexibility and human resource driver performance because of operational progress</li> </ul>
<b>Productivity</b>	<ul style="list-style-type: none"> <li>• Value Added per unit of total employee costs</li> <li>• Value Added per employee</li> <li>• Commitment profile, linked to positive absenteeism, overtime and employee turnover performance</li> <li>• Commitment to training focus</li> </ul>

The benchmark analysis further confirms that leading performance is evident in South Africa. This is illustrated by the upper quartile performance levels and verified by the process benchmark firm-level engagements undertaken in support of the benchmarking process.

It is therefore clear that the SA suppliers are making real progress, and that leading performance is attainable and possible within the local environment.

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