South African Automotive Benchmarking Club Newsletter
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Contents

The focus article of the September-October newsletter will briefly outline the Automotive Production Development Programme (APDP) in relation to the Motor Industry Development Programme (MIDP). The APDP is the industry programme that will be in place in 2013 when the MIDP, the current programme that has been in existent since 1995, comes to an end.

Given the important role that the MIDP has played since it was introduced in 1995 in the development and growth of the local auto industry, an outline of the APDP, as contained in this newsletter, must therefore be viewed as being of crucial strategic importance to all SAABC member firms. The analysis of the APDP versus the MIDP will be undertaken in relation to four key automotive policy areas. These are the tariff regime, the local OEM vehicle allowance – Local Assembly Allowance ((LAA) versus the Duty Free Allowance (DFA), industry incentives – Production Incentive (PI) versus Import-Export Complementation (IEC) as well as the capital investment assistance that will be available – Automotive Investment Allowance (AIA) versus Productive Assistance Allowance (PAA).

Finally, "News from the regions" unpacks the SAABC activities over the previous months.

If there are any comments regarding any of the issues highlighted during the newsletter, please email the SAABC Project Co-ordinator, Cleopatra Ndlovu, on saabc@bmanalysts.com.

Focus article…

How does the APDP stack up against the MIDP?

By Sean Ellis

Introduction

The newsletter for September-October will briefly discuss a very pertinent issue to all Benchmarking Club members – the dynamics of the Automotive Production Development Programme (APDP) relative to the existing architecture of the Motor Industry Development Programme (MIDP). The focus article is based on engagements with industry stakeholders, as well as discussions with Dr. Justin Barnes, one of the architects of the APDP.

It is now common knowledge that the MIDP will be replaced by a new automotive industry programme. This new programme will be the APDP and is anticipated to be implemented in January 2013 at the latest – when the MIDP concludes. While this is over four years away, it is nevertheless crucial that all South African based automotive firms begin to build into their firm-level strategies the implications of the APDP for their business. This is why the topic of this focus article is deemed so critical to Club members.

Importantly, there are several notable differences between the two programmes. It is the intention of this newsletter to attempt to briefly outline these differences so that there is an increased understanding of the programme amongst SAABC member firms. Specifically, these differences relate to:

- Tariffs
- Local OEM vehicle allowance
- Industry incentives
- Capital investment assistance

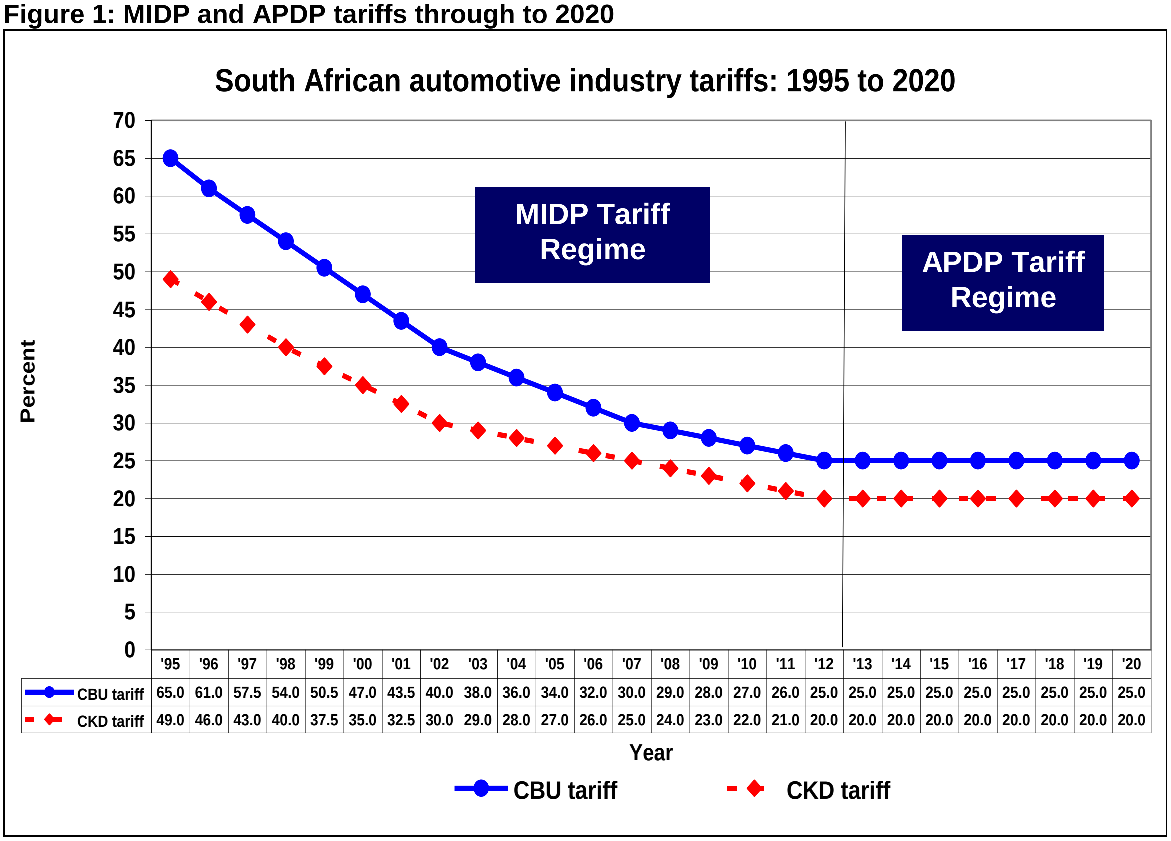
A short discussion of each of these areas will be provided with the article then ending with a brief summary and conclusion of the APDP.

1. Tariffs

Pre-MIDP the nominal protection rates for CBUs and CKD components were 115% and around 80%. Under the MIDP these tariffs reduced significantly in 1995 to 65% and 49% respectively. These protection levels have continued to decline at a steady rate with the current 2008 CBU and CKD tariffs sitting at 29% and 24%, reducing year-on-year to 25% for CBUs and 20% for CKDs in 2012.

There has been debate for several years, both within and outside the industry, regarding the final protection level required by the industry. Some analysts have argued that current rates are already too low, while others have debated whether the industry in fact needs the levels of protection it presently receives. Under the APDP automotive tariffs, and thus the level of protection offered to industry, will remain at 25% and 20% for CBUs and CKDs respectively. The tariffs will thus remain unchanged from 2012 MIDP levels. The automotive tariff regime in South Africa from 1995 through to 2020 for the MIDP and APDP is graphically outlined in Figure 1 below.

Figure 1: MIDP and APDP tariffs through to 2020



	'95	'96	'97	'98	'99	'00	'01	'02	'03	'04	'05	'06	'07	'08	'09	'10	'11	'12	'13	'14	'15	'16	'17	'18	'19	'20
CBU tariff	65.0	61.0	57.5	54.0	50.5	47.0	43.5	40.0	38.0	36.0	34.0	32.0	30.0	29.0	28.0	27.0	26.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0
CKD tariff	49.0	46.0	43.0	40.0	37.5	35.0	32.5	30.0	29.0	28.0	27.0	26.0	25.0	24.0	23.0	22.0	21.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0

Thus, the first fundamental difference between the two programmes is the while tariffs reduced consistently under the MIDP, the APDP will allow for no further tariff reductions.

2. Local OEM Vehicle Allowance

The MIDP allowed local OEMs manufacturing for the local market a DFA (Duty Free Allowance) of 27%. The DFA was implemented in 1995 and will remain in place until 2012. This basically means that 27% of a local assembled vehicle's wholesale price can be rebated against the duty payable on imported components that are used in the production of vehicles for the local market. Local OEMs thus receive a discount of 27% on duties that they incur when importing. Under the APDP the DFA will be replaced by the LAA (Local Assembly Allowance). The LAA percentage will be lower than the DFA, at 20% in 2013, reducing to 19% in 2014 and 18% in 2015. The LAA will then remain fixed at 18% until 2020. A fundamental difference, however, is that the LAA will cover all vehicles assembled in South Africa irrespective of their market focus. Local assemblers will also only be able to access the LAA if their total annual plant production volume exceeds 50,000 units. The APDP permits this to be across one or several models and platforms. The prerequisite is that 50,000 vehicles must be assembled within the plant.

3. Industry Incentives

One of the biggest changes to the local automotive policy relates to the incentive component. The APDP's PI (Production Incentive) will replace the IEC (Import-export complementation) aspect of the MIDP. This is also the one aspect of the APDP where there appears to be a lot of debate and dialogue, both positive and negative, as well as some confusion.

Under the MIDP firms accrue benefits that are linked to exporting. These benefits are based of the qualifying local material utilised in the product as well as the value of export performance. The value of export performance is the same for both CBUs and components and, from 94% in 2003, has come down year on year by 4% with the 2009 level of 70% to be maintained through until 2012.

When the APDP is introduced the export incentive will be replaced with a production incentive that calculates benefits on the basis of actual local production value and not material costs. The production value will be the sales value of the product, excluding all material inputs (i.e. Production Value = Profit + Overhead + Labour). The PI percentage will start at 55% in 2013 and reduce by 1% annually until it reaches 50% in 2018. It will then remain at this level in 2019 and 2020. A CBU adjustment of 80% will also be in place for the entire period of the APDP. This is to ensure that the level incentive is made equal when being used to import CBUs and CKDs. Its value of benefit will therefore be 11% of actual production value at SAABC members. The basic equation for SAABC members will thus be:

(Sales – Materials Costs) x 55% x 20% CKD duty = 11% benefit

There are a also number of outstanding PI issues that still need to be mentioned which are adding to the level of confusion that exists. These include who will actually earn the PI-linked duty certificate? How will material be defined? Will 2^{nd} and 3^{rd} tier component manufacturers qualify? There also exists a possibility that an additional 5% PI will be offered to sectors negatively impacted upon by the shift from the MIDP to the APDP. Ultimately, then, this aspect of the new programme should benefit those SAABC members where a high level of value addition takes place or is planned going forward. Conversely, those export oriented SAABC members who add little value in their operations are going to be severely compromised. Quite clearly, all Club members therefore need to start considering this aspect of the new programme in terms of their long-term strategies and planning.

4. Capital Investment Assistance

The MIDP's current Productive Assistance Allowance (PAA) allows firms to claim 20% of an investment back over a five year period (i.e. 4% per year for five years). However, the PAA has been difficult to access because of restrictive qualifying criteria, and as such has been of minimal value to most SAABC members. Only vehicle assemblers have effectively qualified, along with a few 1st tier suppliers whose investment has been underwritten and directly linked to a local OEM. The PAA will be replaced by the APDP's AIA (Automotive Investment Allowance). The level of support offered to industry under the AIA will remain at 20%, the same level as for the current programme. However, the AIA will have three major differences compared to the PAA:

- Firstly, it will be accessible to vehicle assembles and automotive component manufacturers. Importantly, supplier investments **will not need to be focused on or underwritten by an OEM** (i.e. the AIA is far less restrictive than the PAA). The only prerequisite is that the investment must be automotive.
- Secondly, the AIA will be payable over **three years** and not five as is the case with the PAA. This will mean that the annual benefit that firms receive will be 6.67% over three years as opposed to the current 4% over five years
- Thirdly, an **additional 10%** may be made available to firms **for high technology investments, and investment linked training**. This is related to the high additional costs that are incurred through implementing advanced capital and technologies.

Importantly, while the tariff change, LAA and AIA aspects of the APDP will be implemented in January 2013, the dti has proposed that the AIA be implemented in 2009, most likely in the middle of the year.

Thus, while the capital investment incentive will remain at 20%, the AIA will be far less restrictive than the PAA with the 'payback' also over a shorter period – 3 versus 5 years. Also, firms may be able to secure an additional 10% of their investment to cover additional technology and skills costs. The expectation is that the AIA will result in investment levels increasing substantially in the future.

5. Summary

In terms of the four areas discussed – tariffs, local OEM vehicle allowance, industry incentives and capital investment assistance – it is clear that there will be notable changes between the current MIDP (1995 – 2012) and the future APDP (2013 – 2020). These are briefly outlined in Table 1.

Table 1: Summary outline of MIDP versus APDP

	MIDP (1995 – 2012)	APDP (2013 – 2020)
Tariffs	The level of protection offered by tariffs reduced consistently from 65% and 49% for CBUs and CKDs respectively in 1995, to 25% and 20% in 2012	The level of protection offered by tariffs will remain constant at 25% and 20% for CBUs and CKDs respectively from 2013 to 2020
Local OEMs Vehicle Allowance	DFA – 27% of the local assembled vehicle's wholesale price is rebated against the duty payable on imported components that are used in the production of vehicles for the domestic market	LAA – 20-18% of local assembled vehicle's wholesale price is rebated against the duty payable on imported components that are used in the production of vehicles, irrespective of where the production is sold, as long as annual units per plant exceed 50,000
Industry incentives	Export linked duty credits earned – benefits calculated on local material used	Market neutral Production Incentive in place – benefits calculated on local production value
Investment assistance	PAA: • Only benefits OEM and 1st tier suppliers whose investment is linked to a local OEM • 20% benefit, payable over 5 years (4% per year)	AIA: • Benefits OEM and auto component suppliers as long as investment is auto focused • 20% benefit, payable over 3 years (6.67% per year)

So what does this ultimately mean for auto firms – Will the APDP offer more, fewer or similar benefits to the local auto industry when compared with the MIDP? The answer to this question is that some firms will benefit more, some will benefit far less and others should continue to receive similar benefits. Overall, three particular aspects of the programme are encouraging in terms of developing and supporting the entire industry:

- The new programme will benefit industry in general and not certain sectors to the detriment of others (i.e. it is a market neutral programme)
- The APDP is structured around encouraging increased local value addition. This should lead to a growth of the local auto industry, not only at a 1st tier level but also at the 2nd and 3rd tier level
- The APDP offers the local auto industry certainty through to 2020 which should assist with long-term strategic planning
- The programme encourages local OEMs to produce at least 50,000 units per year, thus potentially giving SAABC members the opportunity to produce at reasonable economies of scale

While certain issues still need to be clarified, it would appear fair to argue that the APDP does appear to be a policy that will significantly benefit SAABC members as a whole and assist it to achieve the government's objective of 1.2 million vehicles produced locally by 2020. It will also encourage increased value addition, with this crucial in terms of increasing investment levels in the industry, as well as employment.

In closing, it must be emphasized that the APDP is the policy framework that provides the guidelines within which the industry operates (i.e. it outlines the '*rules of the game*'). There are however several additional factors that remain crucial in ensuring that the industry prospers going forward. These include:

- Investment in people (i.e. training and skills development)
- Investment in processes (i.e. adoption of WCM throughout individual organizations)
- Investment in capital
- Proactively dealing with (local) sub-supplier performance levels

Lastly, considering the focus of this newsletter as well as the relevance of the APDP, an executive strategic day-long session on the programme will be held for all five Chapters of the SAABC at the start of 2009. The sessions will be facilitated by Dr. Justin Barnes and will include an outline of the new programme as well as its implications for firms. All member firms will receive an invite once the sessions are finalized.

News from the regions…

By Sean Ellis, Chief Facilitator: SAABC

The Past

- A total of twelve **process benchmarks** were undertaken during September and October, with twelve **benchmark reports** also compiled for member firms. Seven benchmark **presentations/feedback sessions** also took place.
- In addition to the firm-level activities, four **World Class Manufacturing** sessions were held during September and October. All four focused on **Continuous Improvement (CI)** and were hosted by **Dorbyl Automotive Systems** in Port Elizabeth, **Ramsay Engineering** in KwaZulu-Natal, **Shatterprufe GaRankuwa** in the Gauteng as well as **Mercedes-Benz SA** in East London. The final CI session for the Western Cape Chapter was held at the beginning of November at **International Trimmings & Labels**, a non-auto firm that kindly agreed to host the session
- As with all the previous session, a special **'Thank You'** is extended to all the host firms who greatly assisted in making the various sessions a success.
- Therefore, all 15 WCM sessions have now taken place (see Table 2 below). The ratings for the JIT, TQM and CI sessions, held for each Chapter, will be presented in detail in the last newsletter of 2008.

Table 2: SAABC WCM Best Practice Workshop Programme – 2008

Chapter	JIT	TQM	CI
KwaZulu-Natal	Feltex Automotive Trim (22nd April)	Pi Shurlok (16th July)	Ramsay Engineering (17th September)
Port Elizabeth	Faurecia Interior (17th June)	Bel-Essex Engineering (8th July)	Dorbyl Auto System (29th October)
Gauteng	Inergy Automotive (6th May 2008)	ZF Lemforder (21st May)	Shatter. GaRankuwa (4th September)
East London	Faurecia Interior (12th May)	Feltex Automotive Trim (26th August)	Mercedes-Benz SA (10th September)
Western Cape	EMCON Technologies (26th February)	Senior Automotive (30th July 2008)	ITL (4th November)

The Present & the Future:

- The SAABC is now in the final stretch of 2008. There thus remains an increased focus on scheduling and undertaking all outstanding firm-level activities. The necessary member firms are being contacted regarding their 2008 services.
- Douglas Comrie and Sean Ellis will be travelling overseas at the end of November. Douglas will be going to the UK and US, with Sean to visit Thailand. They are planning to visit with several automotive suppliers as well as associations and organisations. A special word of appreciation is extended to all those SAABC member firms that have assisted in scheduling visits to their sister plants in the UK, US and Thailand.

- For more information on any of the SAABC activities outlined in "**News from the regions…**", please contact the Project Co-ordinator, Cleopatra Ndlovu, telephonically (+27 31 765 3870) or via email (saabc@bmanalysts.com)