

The South African Automotive Supplier Benchmark Report 2019

Executive Summary



Produced for NAACAM by B&M Analysts

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Foreword

The South Africa Automotive Supplier Performance Report 2019 is 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.

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

The automotive supplier benchmarking data analysed in this report is gathered through the benchmarking undertaking contained within the programmes facilitated by 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 - www.benchmarking.co.za), the Durban Automotive Cluster (DAC - www.dbnautocluster.org.za) and the Automotive Supply Chain Competitiveness Initiative (ASCCI - www.ascci.co.za).

The benchmarking database comprises automotive component suppliers located in Canada, China, Hungary, India, Mexico and the United States as well as South Africa. For the purpose of the benchmark analysis compiled for NAACAM, the firms are grouped accordingly to the following categories:

- South Africa (SA, n=92)
- Developed country¹ (DC, n=64)
- Less development country² (LDC, n=97)

The benchmark analysis also includes the Average (Avg), Upper Quartile (UQ), Median (Med) and Lower Quartile (LQ) performance levels of the SA-based firms, providing an overview of the spread of performance levels amongst local firms.

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

¹ Canada, United States and Hungary

² China, India and Mexico

Automotive manufacturing trends

Industry performance data for 2018 highlights that the global automotive industry's growth stalled in 2018. Organisation Internationale des Constructeurs d'Automobiles (OICA) reported that, after a record total of 92.9 million passenger and light commercial vehicles were produced in 2017, the 2018 level dropped by 1.4% to 91.5 million. This decline of 1.3 million units is the first decline in global light vehicle production since 2009.

The global automotive industry's performance is underpinned by highly variable regional performance. A further analysis of the OICA 2018 data highlights that production continues to be dominated by Asia-Oceania (49.5 million units), followed by Europe (21.0 million) and then North America (16.9 million). South America and Africa account for less than 5 million vehicles, with their 2018 totals sitting at 3.2 and 1.1 million units respectively.

Over the last 5-years, production volumes for Asia-Oceania, Europe and North America, the major regions, are up by 3.1% (6.9 million units), 1.5% (1.5 million) and 1.0% (800 thousand) respectively. The volumes for South America are down by 5.0% (1.2 million units), with Africa volumes having grown by 12.2%, with this representing 460 thousand units.

The decline in global volumes in 2018 is reflected in volumes declining for the three major regions. Asia-Oceania volumes are down by 1.2 million units, with Europe and North America volumes down by 270 and 120 thousand respectively. Volumes for the two smaller regions both increased over the last year, with volumes in South America 100 thousand higher, and Africa's 90 thousand higher.

The production growth evident in Africa over the last five years is mainly linked to Morocco, where volumes increased from 167 thousand in 2013 to 400 thousand in 2018. Volumes in Algeria have increased from zero in 2013 to almost 71 thousand, with South Africa growing from 514 to 582 thousand.

Focusing on South Africa, light vehicle production volume, as reported by the National Association of Automobile Manufacturers of South Africa (NAAMSA), increased in 2018 to 582 thousand; up 1.4% on the previous year. This overall performance does mask a disparity in the performance of vehicle types: LCV volumes increased by 7.8%, while passenger vehicle production fell by 3.2%. Total light vehicle production growth of 6.5% is projected in 2019 to 620 thousand, and then by 3.4% in 2020 to 642 thousand units. While LCVs are expected to continue to grow in 2019, the growth is projected to be only 1.5%, and then 2.6% in 2020. Far more healthy growth is projected for passenger vehicles of 10.6% and 4.2% in 2019 and 2020 respectively. As highlighted by NAAMSA, 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 2019 and 2020.

When considering production by the seven major local OEMs (Source: NAAMSA), there remains highly varied production output volumes. The four largest local producers are Toyota, Volkswagen, Ford and Mercedes-Benz, all of which produced volumes of over 100,000 units in 2018, and while BMW's volumes were far lower, it is reported to have a production capacity of close to 80 thousand units. South Africa's most important platforms by volume are currently the Mercedes-Benz C-Class, the Ford Ranger/Everest, the Toyota Hilux/Fortuner, the Volkswagen Polo and the BMW X3.

Lastly, automotive manufacturing is expected to be heavily influenced by a set of value chain disrupters in the next five years – both those disrupters specific to the automotive industry as well as those relevant to manufacturing more broadly.

Domestic supplier performance

Growth

South African suppliers increased their average Rand sales by 10.7% in real terms from 2016 to 2018, with a similar growth rate evident in 2017 and 2018 of 5.1% and 5.4% respectively. The local suppliers' growth is far stronger than the comparative production volume growth for the SA OEMs. Encouragingly, the SA supplier upper quartile sales growth figure (the point that separates the top 25% of suppliers from the bottom 75%) in 2018 is 16.5%. This highlights that the top 25% performing local suppliers achieved sales growth of 16.5% or better in the last year. The latest average sales growth level for the SA suppliers, as well as the upper quartile figure, suggests that local firms are securing increased local business opportunities at a Tier 1 and Tier 2 level that are not simply linked to OEM volume growth, which appears to be the case for the local lower quartile supplier.

Average SA supplier employment levels, which include both permanent and contract employees, increased by 3.5% over the corresponding two-year period, with the increase in 2018 being 2.8%, similar to the local OEM growth of 2.5%. The upper quartile employment growth level for 2018 is 6.4%.

A review of operating profitability levels for local suppliers highlights that, after improving to 6.2% in 2017, the 2018 average declined to 4.3%. The SA suppliers' levels remain well behind the comparative DC and LDC averages, with the upper quartile level of 12.0% only ahead of the LDC average, but behind the latest DC level.

The analysis of cost management for the SA suppliers from 2016 to 2018 reveals that variable costs, at 80% of sales, is the highest of all the comparators. Costs associated with direct labour and fixed costs increased in 2018, with this placing pressure on margins.

Positively, the customer ratings for the seven local OEMs (of Tier 1 firms) highlight that satisfaction levels of suppliers have improved in recent years. This is evident in the SA OEM customer satisfaction levels (based on the Customer Benchmark Index score) improving in 2018 to 88.8% from 87.34% in 2017 and 86.15% in 2016. Price does, however, remain the largest area of underperformance.

In support of the improved aggregated customer satisfaction levels, the number of respondents that indicated that supplier performance improved has increased from 29.7% in 2016 to 37.8% in 2018.

From a growth perspective, the number of customer respondents that believe there are opportunities to increase their current buy with SA Tier 1 firms has declined from 76.7% in 2016 and 77.2% in 2017, to only 60.0% in 2018. Despite this, growth opportunities do still exist with local OEMs in the areas of supplying more of current products, supplying additional products in the existing range, and supplying new developed products. The average level of 'certainty of long-term supply' for 2018 is 91.1%. This is down on the 2017 and 2016 levels of 94.6% and 96.9% respectively. Thus, while growth opportunities, as noted, do remain, these do not appear to be guaranteed for all current local suppliers.

Competitiveness

The cost competitiveness assessment considers the contribution of employment, utilities (comprising electricity and water), and operational waste costs (the costs associated with inventory, quality, reliability, flexibility and human resources). The cost competitiveness analysis methodology 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 overall cost competitiveness profile of the SA suppliers for 2018 reveals that they are positioned just ahead of the DC and LDC counterparts. However, the analysis highlights that limited cost competitiveness progress has been made in recent years by the SA suppliers at an aggregated level, with levels worsening in 2018. The SA upper quartile level, the proxy for the leading local suppliers, highlights that strong performance is present, although the lower quartile level, the proxy for the weaker local supplier, also confirms that challenges are also evident for many domestic suppliers.

The waste cost analysis considers contributors to overall cost competitiveness that are largely within the control of the suppliers. An analysis of these contributors yielded the following insights:

- Supplier incurs operational costs equivalent to around 9.3% of sales, with costs having deteriorated by 0.7% 2018, after improving by 5.8% in 2017.
- The slip in waste costs in 2018 is due to weakening quality, reliability, flexibility and human resources associated costs. Waste costs linked to inventory improved in 2018, after weakening in 2017.
- The analysis of stock highlights raw materials as the biggest factor, representing 19.6% of the waste cost total and 64.5% of the stock total.
- Customer quality and internal scrap rates are the major quality cost elements, with quality linked costs having increased in 2018, reflected in weakening customer returns as well as internal reject and rework/repair rates
- The total costs linked to unplanned (e.g. breakdowns) and planned (e.g. changeovers) downtime is a major collective issue, representing 29.1% of the waste cost total. In addition, the associated total costs linked to reliability and flexibility have deteriorated over the last year

The competitiveness analysis does also highlight a large differential between the top performers (upper quartile) and the weaker performer (lower quality) in several key competitiveness areas.

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 will support growth. The benchmarking data analysis provides the following insights into the issue of relative organisational productivity and the progress thereon:

- While productivity can be assessed in several ways, the primary metric used in this analysis is local value addition (VA) as a function of both employment costs and capital expenditure (CAPEX). When utilising this metric, productivity for the average SA supplier improved in 2018 after having weakened in 2017. The latest SA productivity average is positioned ahead of the LDC level, but behind the DC average.

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- Capex is a crucial enabler of productivity improvement and a driver of sustainable competitiveness. The average level for local suppliers is comparatively low at 3.8% of sales in 2018, down from 5.0% in 2017. In contrast, the DC and LDC suppliers invested an average of 9.0% and 7.2% respectively, with these levels ahead of the SA upper quartile figure of 4.9%. The SA supplier median level of 2.0% further highlights that very low levels of investment are taking place amongst a majority of local suppliers.
- Investment in people, a second key enabler of productivity improvements, reflects training expenditure as a percentage of remuneration of 1.4% for local suppliers. This is weaker than the levels for 2016 of 1.5%, with local firms also positioned behind the latest LDC average of 1.5%. The SA supplier median figure of 1.0% further highlights that 50% of local suppliers spend 1.0% or less of their remuneration bill on training and development of people.
- Commitment of employees is an additional key enabler of productivity and productivity improvement. It is positive to note that absenteeism levels amongst SA suppliers are ahead of the DC and LDC averages. However, after improving from 3.4% in 2016 to 3.1% in 2017, levels have remained unchanged. The SA supplier upper quartile level is 1.8%, with the lower quartile level of 4.0% also ahead of the latest LDC and DC figures.

Points for consideration

Investment in capital, technology and people

- Capex amongst SA firms remains a major concern. After increasing in 2017 to almost 5%, levels dropped in 2018 to under 4%. The is behind the comparative averages for the DC and LDC firms of 8.9% and 7.2% respectively and implies the emergence of a capital and technology 'gap' at some points. Also, the data highlights that 50% of local firms spent less than 2% on capex in 2018, with 25% spending less than 0.6%. This confirms that a significant portions of SA suppliers are allocating insufficient funds to upgrading their capabilities and technology.
- Supplier investment in skills development reflects a slight decline in the past year to just 1.4% of remuneration. Further to this 50% of local suppliers spend 1.0% or less of their remuneration bill on training and development of people, confirming that a significant portion of suppliers are spending insufficient funds to improve productivity and therefore competitiveness.
- A significant focus on capital upgrading, as well as the introduction of the associated technology and investment in skills, is required by the local supplier industry if productivity is to be bolstered, competitiveness enhanced, and growth opportunities realized. A failure to focus on investment in operations in line with industry requirements will place significant pressure on local suppliers going forward.

TQM adoption and supporting practices

- The customer assessment highlights improved quality and flexibility local Tier 1 suppliers, although limited progress is evident for reliability. The benchmark findings do note that performance, and the associated costs, linked to these areas has weakened.
- An increased focus on the adoption of Total Quality Management (TQM) as an operational philosophy is required. Crucially, this needs to be supported by the associated best practices linked to reliability

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and flexibility, incorporating Total Productive Maintenance (TPM) and Single Minute Exchange of Dies (SMED). This is to ensure that capital is available as planned, and that there is a 'fast changeover' approach and mindset in place. While the firm-level assessments do find that some progress has been made, the holistic adoption of this philosophy, and the linked practices, is still lacking at the majority of local suppliers

- This implementation of this recommendation is vital to ensuring that the unnecessary costs associated with quality, reliability and flexibility are reduced, supporting the enhanced costs competitiveness of suppliers to achieve all key customer demands, including price

SCM enhancement and localisation focus

- While some progress has been made in relation to improved raw materials stock holding, it is evident that far more focus is required on the reduction of this high cost item for SA suppliers, with it remaining the largest waste cost factor.
- The enhanced adoption and implementation of Supply Chain Management (SCM) best practices at SA suppliers is required to further reduce raw material stock levels.
- Crucially, the focus on reducing raw materials needs to be supported by an increased and proactive drive to localise so as to reduce the levels of imports which sit at almost 30%. This drive on localisation must be at two levels – identification of value-added opportunities that can be undertaken by firms themselves, as well as those that can be undertaken by local suppliers. This is crucial in support of the achieving the local content objectives of 42% and 60% for the SA-based OEMs by 2023 and 2035 respectively.

Supplier upgrading and development focus

- A major observation to emerge from the latest benchmarking findings, especially when considering the spread of performance, is the differential between the top 25% performers (the upper quartile) and the rest of the SA suppliers (the lower quartile)
- While strong performance is clear for all measures for the top performers, the performance of the bottom 25% and, in several instances the bottom 50%, is highly concerning. This concern is also supported by the benchmark site visits
- This highlights that up to half of local suppliers require increased focus and support in bolstering their performance in key operational related areas, including quality, reliability and flexibility as well as HR
- The upgrading and development of underperforming suppliers, especially those that are negatively skewing the industry's overall performance, is a prerequisite to support the upgrading of the entire industry to World Class levels

Summary

The benchmark analysis confirms that there are certain areas of weakness amongst local suppliers, with a focus on the identified recommendations required to overcome these. However, the findings also verify that local suppliers are in many cases well positioned to grow through increased localisation and/or exports. Realising these opportunities while simultaneously strengthening the competitiveness position of the weaker suppliers are therefore two important development opportunities for the automotive supplier industry.

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