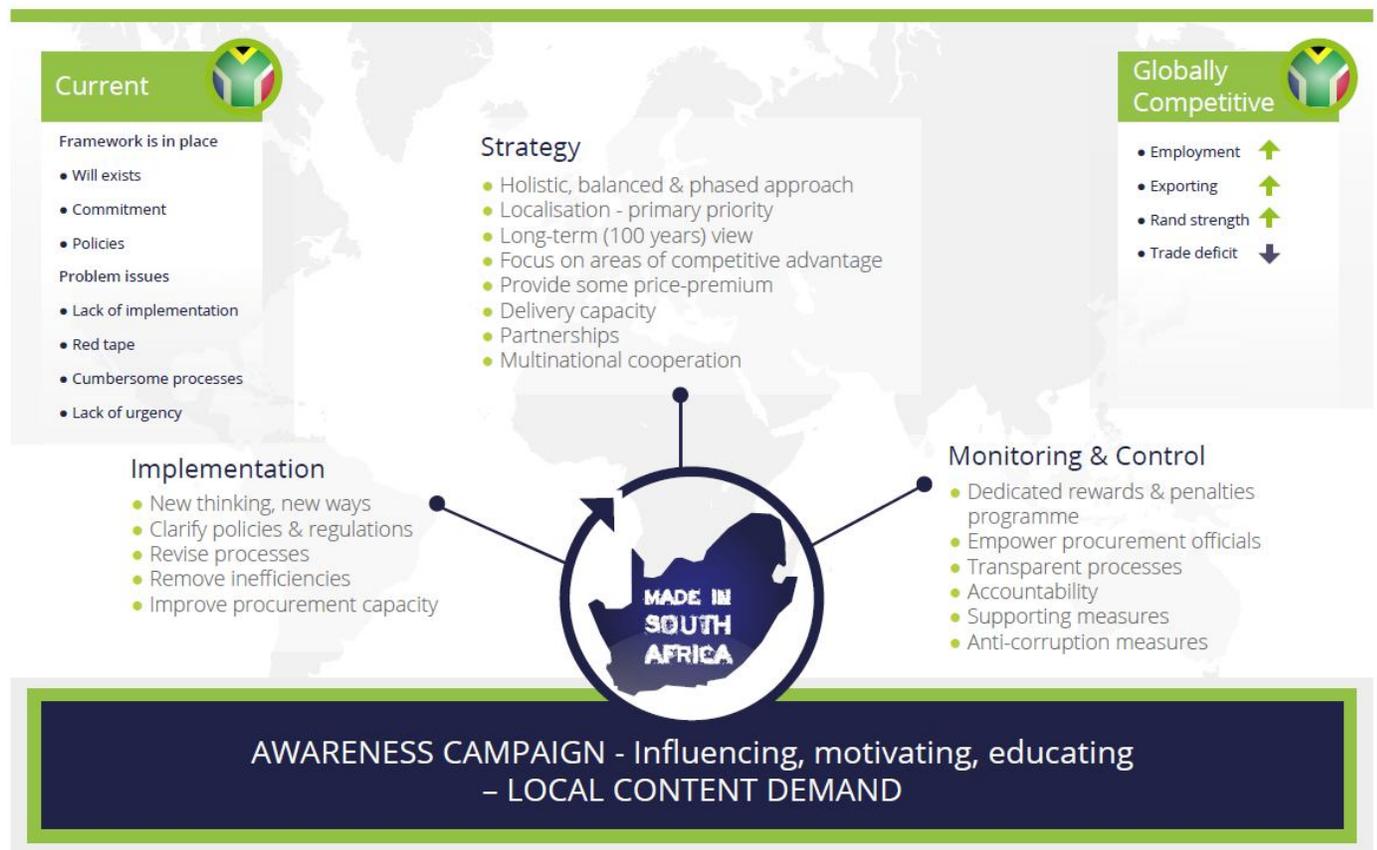


Localisation: Driving Industrialisation through the National Infrastructure Plan

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ENHANCING GLOBAL COMPETITIVENESS



1. Overview

Localisation, the topic of the 30th Infrastructure Dialogue, is a topical focal point of various high-level discussions on infrastructure development in South Africa. The subject is currently debated by the Department of Trade and Industry (dti), with this engagement involving all government departments responsible for infrastructure in the country. The dti too submitted a proposal to fast-track local procurement while National Treasury recently hosted a workshop on the topic.

The South African government is committed to moving localisation forward. The multi-trillion Rand national infrastructure plan under the direction of the Presidential Infrastructure Coordinating Commission (PICC) seeks to address and reverse the de-industrialisation trend of the past two decades. The multi-sectoral scope of the national infrastructure plan allows for the identification of opportunities to establish new supplier industries and to rejuvenate existing industries.

Based on the Infrastructure Development Act 23 of 2014 the government has a responsibility to ensure that its infrastructure spent over the coming years contributes to national development goals such as industrial localisation, transformation, employment and skills development. Developing the industrial economy will provide employment opportunities and increase the country's export basket, while reducing import dependency. Localisation through industrialisation will help to stabilise the Rand and improve the global competitiveness of South Africa.

In practical terms, localisation implies local procurement by government and the private sector alike. Local procurement in turn should benefit the development of Black entrepreneurs, particularly women and youth-owned enterprises. Government has set a target of developing 100 Black industrialists over the next three years, a goal which is only achievable through localisation, which is driven by industrialisation.

This Infrastructure Dialogue brought together a panel of speakers from government, the Industrial Development Corporation and the Black Business Council. These experts provided critical insight into, and unpacked the challenges and opportunities associated with driving industrialisation and localisation through infrastructure development.

The dialogue took the format of a plenary discussion with three panel members. A brief introduction and word of welcome was given by **Rudi Dicks** of the Department of Planning, Monitoring and Evaluation. **Richard Goode** of the Development Bank of Southern Africa (DBSA) introduced the panel members and acted as facilitator. The panel members comprised:

Mr Kugan Thaver	Head: Strategic High Impact Projects SIP 5 & 8 and the PICC (Presidential Infrastructure Coordinating Commission) Localisation Unit, Industrial Development Corporation (IDC)
Mr David Jarvis	Head of Corporate Strategy and Portfolio Management, Industrial Development Corporation (IDC)
Mr Gregory Mofokeng	Secretary General of the Black Business Council in the Built Environment (BBCBE)

2. Current Situation

The Localisation Unit of the PICC was established two year ago, with the mandate to focus on 18 Strategic Infrastructure Projects (SIPs). Applying its understanding of the state procurement process and inputs necessary to foster infrastructure development, the PICC looks for the best ways of utilising state investment in the development of infrastructure and industrialisation.

The overarching vision is not to localise everything but to localise where possible, and to ensure effective implementation at all governmental levels from national and provincial to municipal spheres. While the dti provides the policy framework, the PICC focuses on implementation and how to best leverage state spent within the SIPs.

Housed within the IDC, the PICC Localisation Unit has access to resources, industry knowledge and funds. The PICC interacts with State-owned Corporations (SOCs), focusing strongly on the viability of each business case for localisation including technical and management capacity. Where the business case is evident there is less emphasis on security required for funding. Where SOCs might not have the budget, the PICC offers assistance in fast-tracking feasibility studies. However this takes time and does not produce results overnight.

The PICC's major objective is job creation. The Localisation Unit assists entrepreneurs to set up factories that will ensure employment, skills development and capacity building. The IDC has various schemes and support programmes for the development of entrepreneurs. Importantly however, economic viability is key. Over and above SOC investment programmes, there are other role players and government levers behind localisation. These include the National Infrastructure Plan, the triple Procurement Preference Policy Framework Act (PFA) as amended to give preference to localisation, Industrial Policy Action Plan (IPAP) and the National Industrial Participation (NIP).

Overall the will and required framework to ensure localisation is in place, yet government and SOCs still lacks implementation capacity. Just one example of this lies in the limited capacity of procurement officers to select local suppliers, which is critical to ensure effective implementation. Critically, it must be borne in mind that this debate is not purely about localisation of all inputs as the end goal, rather it is a strategic choice of what to localise. It is

Localisation Defined

There is a lack of understanding surrounding the meaning of localisation, which in itself allows for different interpretations of policy regulations. The PICC localisation unit works with the following straight forward definition: manufacturing in South Africa of goods and components and/or the assembly thereof.

For the past two decades South Africa experienced a decline in manufacturing. In certain key industries there are only a handful of manufacturers that utilise local materials, while in other industries there are no manufacturers left. The majority of South African suppliers are importers with a percentage of local assembly taking place.

With the objective of industrialisation and the goal of realising the multiplier effect, resulting in job creation and skills development, revival of manufacturing remains pertinent on South Africa's agenda. Specifically because as an enabler of sustainable job creation and skills development, manufacturing unlocks downstream value and as such, needs to be key in the infrastructure programme.

about industrialisation and building a robust and competitive economy; one which can survive amidst global economic volatility. It is also about increasing employment opportunities and productivity.

3. Localisation Opportunities

Within the local context there are numerous opportunities to revive fading industries and develop new industries. Based on local resources and the nature of the South African economy, engineering capacity that has been lost should be rebuilt on the back of infrastructure development. Opportunities for new industry development too lie in areas such as renewable energies. Such market opportunities should be expanded to local manufacturing and linked to infrastructure development.

Other opportunities exist in goods and services rendered for rebuilding, refurbishing, upgrading and maintenance. As part of the National Development Plan, government has allocated R9.6 billion for the development and rehabilitation of roads. This includes thousands of kilometres of resealing and re-graveling together with the patching of approximately 810 000 m² of potholes. Government is committed to procurement of 75% goods and services from local suppliers, offering vast opportunities for the private sector and the development of entrepreneurs and Black industrialists.

It was cautioned in the dialogue that it is not practical and in some cases, not profitable to localise all industries. Operating with the global economy, involvement of multinational manufacturers is a necessity. However, it is pertinent to identify sectors where South Africa has local content opportunities, and to leverage these in cooperation with multinationals. As such, we will not only localise but simultaneously create export opportunities into Africa, for example, in the clothing industry.

There are also numerous opportunities for localisation in semi-urban and rural areas. It has become too easy to order components or products from the metros instead of setting up local

Designation Defined

There are a number of goods and products designated by the state as having to be sourced locally. The list of products is available from the dti, which is the custodian for designation. The definition around designation was felt to be currently inadequate.

If a product is designated it should be sourced locally. However there is no regulation covering raw materials and the manufacturing of designated products. Avoidance of leakage and ensuring that state spent goes back into the South African economy is not guaranteed through the current definition, which should also cover locally sourced raw materials as well as local manufacturing.

The process of designation too needs to be reviewed, as it is cumbersome and takes too long. Commitment and decisive action is required to implement procedures that will speed up the process and result in designation.

In addressing these challenges, it was suggested by panelists that a predictable products pipeline be developed, with current and potentially designated products listed on a dedicated website. Having information about designation in the pipeline will assist SOCs and businesses in strategy planning. Furthermore, some procurement officials are unaware of products that are designated. Education for industries and businesses in this regard is vital.

manufacturing facilities. In some cases raw materials are available in local areas, yet the necessary funding and time required to develop manufacturing facilities are not. In such cases it is important to evaluate the long-term benefits versus short-term gains. Setting up factories in relevant rural areas will revive local economies and avoid mass migration to cities.

The majority of scalable opportunities for localisation come from the Government's Infrastructure Development Plan, and resourcing should be in compliance with policy regulation. However the private sector presents distinct opportunities, which should be investigated and pooled into the localisation drive.

BELL EQUIPMENT CASE STUDY

Bell Equipment is a South African company active in the yellow metal sector. This sector has a current value of approximately R14 billion per annum with an annual growth rate of 8%, which is forecasted to remain at this level.

In global terms Bell Equipment is small, but locally the company is a significant player.

One of its products, the articulated dump truck is manufactured in Richards Bay and locally it enjoys 45% in market share. However the company operates at a capacity of less than 50%. Other products include tractors and graders yet market shares for those products are lower. The company has been surviving due to its pricing strategy amidst a very competitive market.

Bell Equipment is an example of a local company with manufacturing capacity that is not fully utilised. This begs the question: How do we protect this company and others like it from competitive importers that add no additional value to goods provided without shutting out the healthy effects of competition?

An application for designation has been made at the dti, but the applications remain in the process without response, amplifying the red tape challenges facing such manufacturers. The critical question here is: How can we speed up the process of designation to ensure that such opportunities are not lost?

4. Challenges & Requirements

With opportunities come challenges. In order to realise localisation through industrialisation, South Africa needs to mitigate the following challenges.

4.1 The Price-Premium Issue

A pertinent question which has come to the fore in the latest discussion around localisation centres on price-premium. This is currently seen as the major stumbling block for realisation of localisation.

Many of the domestic industries cannot compete with international suppliers due to a variety of factors such as raw material pricing, labour cost and economies of scale. In particular, for the development of Black industrialists profitability is essential and for the manufacturing industry to continue to exist, and to expand the price-premium is a given in the short-term.

“One of the questions at the forefront in the South African context is: Why do local companies and local suppliers price themselves out of the market when bidding to providing goods and services for the infrastructure programme? On average the price-premium is as high as 30% and it must be asked whether this is a cost issue or a benefit.”

Rudi Dicks, Department of Planning, Monitoring and Evaluation

In order to reverse de-industrialisation the approach towards the price-premium issue should be holistic. The price-premium associated with local procurement has a multiplier effect that creates value through economic contribution and employment. The benefits of localisation should therefore be clearly defined and should become the objective for allowing the price premium.

The question then is who will carry the cost?

In the short-term suppliers should be assisted by government to enter the market, to become productive and profitable. Suppliers should ensure that they become competitive over time and independent in the long-term.

Upcoming Black industrialists should also understand that building an industry takes time, with manufacturing for example typically taking 20 years to realise a return of up to 20%. Black entrepreneurs' focus should therefore be on the long-term benefits, which often contradicts rapid and substantial returns.

Buying imported goods due to price can also be expensive in the long-term. Procurers should have access to information in order to understand the long-term impact and be able to calculate real cost over time.

It was noted that the priority focus should not be on the price-premium, but rather on establishing cost-effectiveness in the value chain. In getting industries up and running, the price-premium is a given, particularly in the short-term. To maintain cost-effectiveness as a priority, an exit strategy that includes a premium price decline over time must be in place.

The benefits in terms of a growing an industrialised economy as a whole should warrant the cost of the price-premium. This however raises further questions. What is the price of industrialisation? What should the percentage of the premium be in various cases? How should this be managed? How should this be monitored?

4.2 Delivery

The question of delivery is inherently linked to the issue of price. For example, in the case of water pumps, does it have to be installed now or can it wait for a factory to be established, which may take a year. How do we mitigate these issues? For industrialisation to take place, sacrifices will have to be made. In certain cases, it becomes necessary to delay in order for the country to be enabled to become economically competitive in the future. Yet in this regard, there is currently no formal strategy planning in place in South Africa. Issues of price and delivery need to be addressed in a broader, long-term industrialisation strategy.

4.3 Strategy Planning

Localisation through industrialisation should be strategised and planned involving all role players.

At a strategic level, South Africa needs to look at sectors that have disappeared over the past two decades. Having said “in the global competitive world in which we operate, it is impractical to localise everything”, the country needs to look at areas in which it excels and in which its competitive advantage lies.

“Following a holistic approach based on comprehensive research, which can enable evidence based long-term strategy formulation, should lead the localisation process. The critical point here is that localisation cannot be an after-thought. In other words, from the onset it should be a primary objective of infrastructure development.” **David Jarvis**, Head of Corporate Strategy and Portfolio Management IDC

New finance measures, with a focus on OPEX (Operating Expenditure) as opposed to CAPEX (Capital Expenditure) are required. Strategically the country needs to take a long-term view over and above focusing on what will work for the next five to 10 years. The question at hand is: What will be good for the next 100 years and how can South Africa serve in the needs of Africa?

Comprehensive research focused on competitive advantage, local capacity within industries, capacity to grow, constraints, challenges and potential opportunities needs to be conducted.

Localisation is not a quick process. It needs to be implemented in a phased approach with continued research identifying opportunities and new suppliers, allowing time for entrepreneurial development and growth.

A key focus of any localisation strategy is partnership and cooperation between role players. The

”In maintaining a balance between localisation and globalisation, it will be critical to partner with multinationals in the development of long-term infrastructure development strategies. South Africa should be positioned as an investment destination for factories and manufacturing for delivering goods and services into the rest of Africa.” **Kugan Thaver**, PICC Localisation Unit

debate between government and business should continue fostering partnership and shared objectives. Government departments presently work in silos. Overcoming this, it is important to break down existing barriers, enhance cooperation and prioritise opportunities for localisation. Further, in order to optimise government infrastructure funds, spending should be consolidated.

The IDC is looking at opportunities to link larger contracting companies to smaller contractors through dedicated initiatives. One concern with regard to partnerships is that smaller role players could be exploited. It is critically important that role players are aligned in working towards mutually beneficial outcomes, while building economies of scale.

4.4 Implementation

The framework for localisation is in place and there is significant debate on the subject but when it comes to implementation there is a lack of capacity, commitment and new thinking. Getting localisation right requires urgency and new ways of doing things.

”The latest catch phrase, “Radical Economic Transformation” implies serious and urgent change. We need to think differently, develop new processes and new ways to speed up the process.” **Gregory Mofokeng, BBCBE**

Demonstrating a case in point, a recent Transnet tender offered opportunities for local suppliers to provide parts. When a prospective local supplier approached Transnet to participate, the application was rejected owing to the fact that the

supplier did not yet have a factory. On application for funds, the IDC requested a letter of appointment. Transnet only provided a letter of intent, which carried no weight in the tender process. As a result the prospective supplier was denied any opportunity to participate.

There are also inefficiencies in the process which cause leakage. Localisation may not be an easy programme to adopt, however existing inefficiencies should be highlighted. It is pertinent to review policies and processes and do things differently in order to ensure effective outcomes and adequate support. A successful intervention in the past five years is that of the Competition Act. Similar regulations are required in order to enable entrepreneurs to enter the economy and become part of the industrialisation development.

Funding is an important factor in the realisation of localisation. An acceptable business case must be viable despite there always being a degree of risk involved. Government should manage these risks and be willing to take a loss. Furthermore, tenders need to cover all requirements, not only supply and localisation objectives should be captured in all state and SOC tenders. Tender conditions must incorporate development, factories, Black entrepreneurship and skills development.

4.5 Monitoring & Control

There are numerous opportunities for localisation however the capacity to track and monitor initiatives and report on progress is limited. There is currently also a lack of capacity to facilitate outcomes and enforce policy regulations. Procurement officials are uncertain with regard to their role in the legal framework. The tracking and monitoring of interventions, as well as effective control, should form part of localisation strategies.

Measures should be put in place at a procurement level to ensure that officials understand their role, not only in terms of procurement but also relating to the monitoring and control thereof. For example, in solar heating panels there are two components that are designated, the glass panel and the steel tank. How are these components tracked and monitored for localisation? In larger infrastructure development contracts there are numerous sub-contractors, which make the tracking of specific components complex.

”It is important to build in localisation support measures for participants to understand how they could be supported and benefit from regulatory compliance.” **David Jarvis**, IDC

Measures and processes at procurement level should also be reviewed and simplified. In addition, existing regulations are ambiguous, resulting in misaligned interpretations.

To address this, disagreements between role players should be identified through dialogue. Where necessary policies should be revised and clearly stipulated.

Procurement officials and decision-makers too are often not familiar with regulations. Where there are uncertainties, the capacity should be created to provide information and clarity. It is pertinent that procurers are aware of the rules of the game.

Compliance requirements should be clearly defined. Due to insufficient control, suppliers are often not required to adhere to regulations. Although tenders stipulate certain percentages of localisation, adherence is not monitored and controlled. Where regulations and tenders are violated, harsh measures and penalties should be in place and applied. Supplier contracts should also be water-tight. Where contracts are violated, contractors should be punished.

In this regard, control is currently in the hands of SOCs but is not strictly implemented. The question was raised whether government or any other role player should create capacity to control implementation and ensure compliance. For example, in the human settlements sub-sector, contractors who are not performing are listed by the NHBRC (National Home Builders Registration Council), an entity that conducts a certain amount of quality control.

4.5.1 Accountability

Accountability goes hand in hand with compliance and control. Feedback loops on localisation activities, successes and failures are required. Successes should be celebrated and role players and participants should be held accountable in cases of a lack of compliance. For this purpose it is necessary to develop an incentive and rewards programme which includes penalties for failure to comply. Accountability can also be extended to consumers in the form of buying local content, which could be rewarded through innovative incentive schemes.

4.5.2 Corruption

When talking about localisation, the problem of corrupt officials whose behaviour undermines a level playing field cannot be overlooked. The legal framework should cover clear definitions of corrupt behaviours and activities, and should clearly outline the consequences for such actions. Intolerance of such actions should become a regulating priority in the South African justice system.

4.5.3 B-BBEE versus Localisation

Confusion often exists between procurement benefits under Broad-based Black Economic Empowerment (B-BBEE) and localisation. B-BBEE is specific and rewards procurement from Black companies, irrespective of local content. However when a company does not comply with the required B-BBEE status of Black ownership but complies under localisation, it needs to be rewarded for doing so.

”Localisation cannot be rewarded under B-BBEE. There is a need for a dedicated reward programme and policy for localisation. One that operates independently from B-BBEE.” **Gregory Mofokeng**, BBCBE

4.6 Education

When it comes to localisation through industrialisation there is a high level of uncertainty at various levels. Specifically in relation to the concept itself and what it entails, as well as policies and policy implementation. Information and practical guidelines need to be made available through easy internet access. Further debate and discussion on different elements affecting localisation implementation is also required to ensure knowledge sharing and understanding. Pertinent topics for further localisation dialogue should be identified and could cover matters such as Supply Development and Monitoring Mechanisms.

It is undoubtedly necessary to improve procurement officials’ capacity to ensure effective implementation. Procurers need to understand their role and exhibit adequate knowledge of policies and regulations. The impact of this will be correct policy implementation and decisiveness, which will greatly advance localisation.

South African retailers and consumers need to become part of the process through exhibiting positive buying behaviour. The “Proudly South Africa” concept needs to be applied and given momentum with a focus on local content purchase, with the specific aim to build and revive South African industries.

”It is important for business, retailers and consumers alike to understand the necessity for and the benefits and impact of localisation.” **Kugan Thaver**, PICC Localisation Unit

Through advertising it has become trendy to supply and purchase imported, well-known brand name products, often at a premium price. This is having a detrimental impact on locally manufactured goods, which in many cases offer the same quality.

Influencing and motivating retailers and consumers to choose and demand local content would require a dedicated awareness and communication campaign. In turn, this demand will generate healthy competition, which will enhance local quality and delivery.

5. Conclusion

Localisation is by far not an easy process to embrace, and changing direction can be cumbersome. Yet having said that, South Africa must reverse its de-industrialisation trend. In order to do this, the country requires advocacy for and implementation of localisation.

This needs to be adopted in a way in which the country's "globalisation" continues to be harnessed for competitiveness, while local content and related skills development through industrialisation are driven and adequately supported to grow. To get this right, South Africans will require belief in the essential demand, will and commitment, understanding of the long-term benefits, a critical mindset and the capacity to delivery.

A degree of realism is also required to ensure that such programmes are pitched accurately. Localisation is a slow process and is highly dependent on continued dialogue, communication, influence, motivation and education. It requires continued research, highlighting what works and what not, identifying new ways and new opportunities, ensuring continued designation of local content.

Critically, effective tracking, monitoring and control are imperative to ensure effective localisation through industrialisation and continued progress. South Africa is at a vulnerable juncture in its balancing act in growing the strength its local content. The economy is at a critical point in its economic outlook, which calls for urgency in order to realise a meaningful difference in shaping a sustainable socio-economic future.