

The job champion companies tend to fall into two categories with respect to turnover:

- 47% had annual turnover's of less than R10 million; and
- 25% fell into the mid-sized category of between R20 million and R100 million.

In many instances companies noted that the employment decrease over the last ten years had been driven by efforts to increase competitiveness, through cost cutting and capital intensive upgrades.

Figure 93: Job champions and losers by profitability

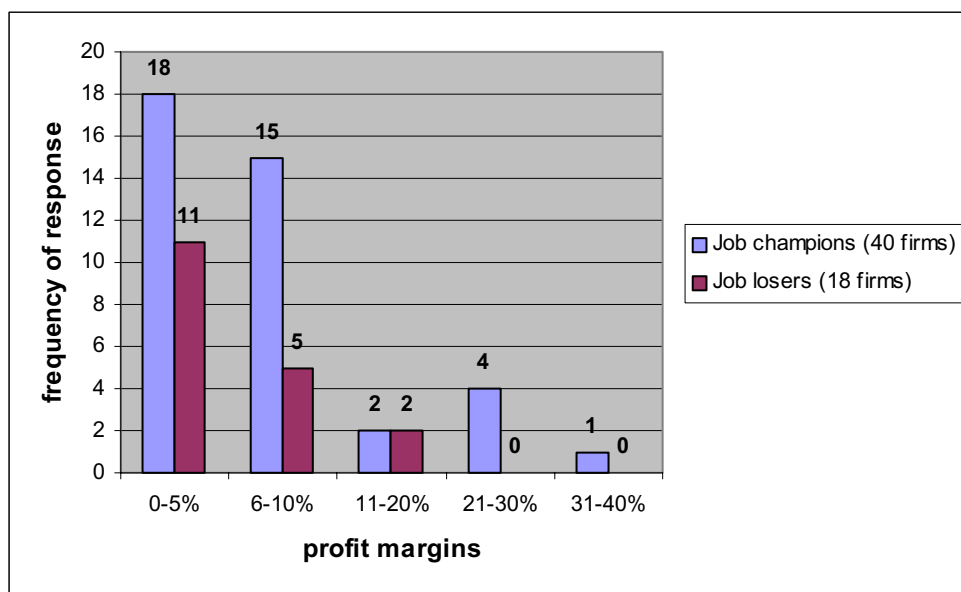


Figure 93 reflects that although the majority of job champions were characterised by profit margins of between 0-10%; there were job champions that reported profit margins of up to 40%, whereas all job losers reported profit margins of below 20%. This discrepancy in profit margins could be the result of job champions differentiating their products and targeting niche markets, enabling premium prices to be charged, which in turn translate into higher profit margins.

4.3 Employment drivers

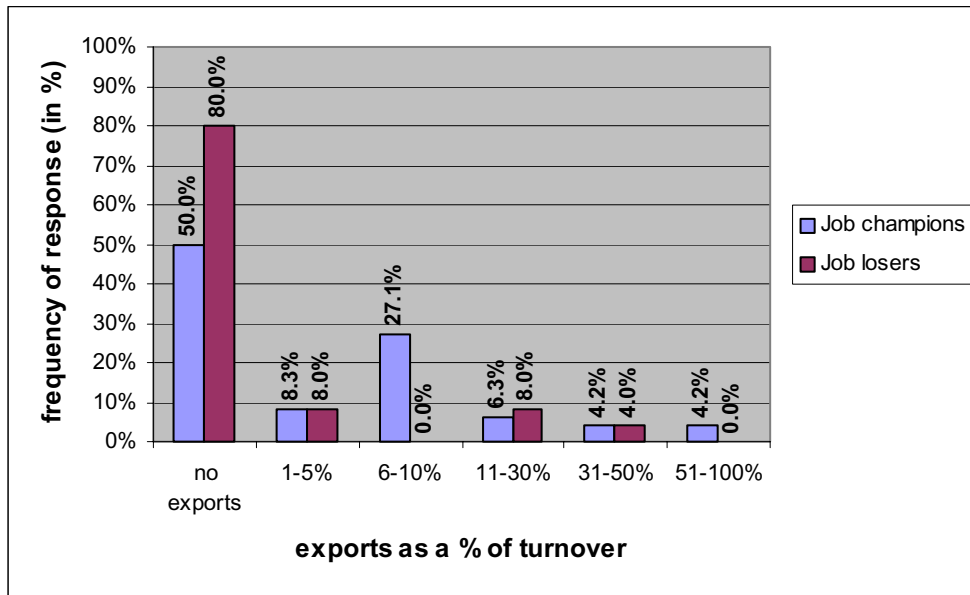
4.3.1 Industrial strategy

Tariff liberalisation

While tariff liberalisation resulted in a considerable increase in imports within the automotive sector, this has been largely offset by MIDP driven exports. Undoubtedly the restructuring of the sector in the early 1990s was in part driven by the need to adapt to increased competition in the sector. Globalisation of ownership has most negatively affected South African workers and job creation where local companies have prepared themselves for sale (Phillips, 2002). During the mid-to-late-1990s, most companies but especially component manufacturers, experienced downsizing and job-destroying productivity improvement programmes. These efforts were in preparation for sale of ownership to foreign companies. In some cases, the downsizing efforts continued after the sale, this time prompted by internal group benchmarking exercises.

However, while there has been a slightly worsening balance of trade in the automotive sub-sector, liberalisation appears to have had little impact on the metal products sub-sector, although liberalisation had clear implications for job loss, as the majority of job losers are domestically focused. This is a likely indication of the fact that these companies were unable to adapt to the opportunities presented by an opening economy. However, exporters have also shed jobs in order to increase export competitiveness. Figure 94 shows that job champions had a higher propensity for export than job losers. However, the fact that 50% of job champions did not export, means that exporting is not a precondition for employment growth.

Figure 94: Job champions and losers by export propensity



Unlike the other Metal and Engineering sectors, the automotive industry has been strongly influenced by government supply-side measures.

The sub-sectors that are fairly low-technology and compete on the basis of labour and input costs more than value-added have seen increasing imports from China and India as tariffs have dropped.

Supply-side measures in general

The following table shows a picture consistent to that of the Metals and Engineering sector as a whole; namely extremely low levels of awareness of Government’s supply side incentives, and even lower levels of uptake. The one notable exception is the SMEDP, which as achieved some success. It is especially the schemes aimed at promoting innovation (SPII, Innovation Fund and THRIPP), which seem have had no impact in this sector. This is disturbing, given that these measures are often of material benefit to recipients. The positive side is that this means a potential clutch of growth and employment drivers have not been explored.

Table 26. Level of awareness, use of, growth and employment results of the various government support schemes (in %)

Support Measure	Awareness	Made use of	Resulted in growth	Resulted in employment creation
Competitiveness fund	7.2%	1.0%	1.0%	0.0%
Sector partnership fund	9.6%	1.0%	1.0%	1.0%
Small, Medium Enterprise Development programme (SMEDP)	40.4%	7.2%	5.8%	5.8%
Venture capital scheme	7.2%	0.5%	0.5%	0.5%
Technology and Human Resources for Industry Programme (THRIPP)	3.8%	0.5%	0.5%	0.5%
Innovation fund	7.2%	0.0%	0.0%	0.0%
Support Programme for Industrial Innovation (SPII)	9.6%	0.0%	0.0%	0.0%
Standard leased factor building schemes	5.3%	0.0%	0.0%	0.0%
Export finance guarantee scheme	12.5%	3.4%	2.4%	2.4%
Export marketing and investment scheme	10.1%	1.9%	1.0%	1.0%

Supply side measures – the MIDP

Perhaps the most well-known demand side driver in the light and heavy engineering industry is the Motor Industry Development Programme or MIDP. The MIDP is designed to encourage local component and automobile manufacturers to embrace trade liberalisation and at the same time remain growth oriented. The programme has been very successful, as the export figure of R19-billion of automotive components from South African last year has shown. The MIDP is therefore a positive trend driver. However, because of the premise of the MIDP, every export Rand can be matched 100% by an import Rand. If not controlled, this can prove to be an impediment to the optimisation of employment growth, because of increasing imports.

Because R19-billion worth of automotive products have been exported, the export credits generated can be used to import components and vehicles duty-free and these incoming imports reduce opportunities for local vehicle-component manufacturers (Creamer, 2003).

The result is lower local content in vehicles manufactured and increased imports of built-up vehicles. One third of passenger vehicles are now imported.

Even the export sales are not neutral in composition in that the main components exported are catalytic converters (R9 billion). However these converters are not fitted to South African vehicles in large numbers, so they do not benefit the component manufacturers greatly. The export Rands earned by these exports then allow for more competitive imports.

Another R2 billion of the R19 billion is made up by the export of leather seats, which also do not contribute to significant mainstream economies of scale. Steel alloy wheels comprise a large majority of exports. The main problem is that these exports do not lower unit costs for mainstream local automotive component manufacturers. This may be an impediment to the optimisation of the positive export trend.

Although exports generate useful foreign exchange and duty savings for vehicle companies, they do not facilitate economies of scale that flow through to the manufacturing process in the local assembly of vehicles. The net effect of all this is to increase importation of vehicles, which is not a sustainable long-term strategy. Catalytic converters and seats are also vulnerable to substitution as they are manufactured items and import substitution in these product categories would severely affect the export trend. Recent input constraints have however started to force exporters to diversify their exports. Leather seat manufacturers are suffering from a lack of hides, catalytic converters are experiencing price hikes in raw material costs and steel alloy wheel production facilities are running at full production.

Within the current MIDP framework, the only way vehicle manufacturers can use an export credit is to import and this has resulted in a substantial increase in the importation of vehicles, to the disadvantage of local automotive-component manufacturers. A further concern is the jobless aspect of the R19-billion export growth. Most of this growth has been achieved with static employment due to the highly automated nature of modern component production. Sales of local vehicles have also remained flat, while imports have risen. As the export programme continues to expand, so does the level of import credits earned and thus imported vehicles and built up kit levels look set to rise further. Possible relief comes in the wake of the recent announcement that the new phase of the MIDP will phase down the export credits from 100% to 70% by 2007. This should weaken the link between exporting and importing, forcing the OEM's to export 30% more to earn the same number of credits. The rising trend of local imports can be seen to be a negative trend driver both in terms of employment and sales for local component manufacturers.

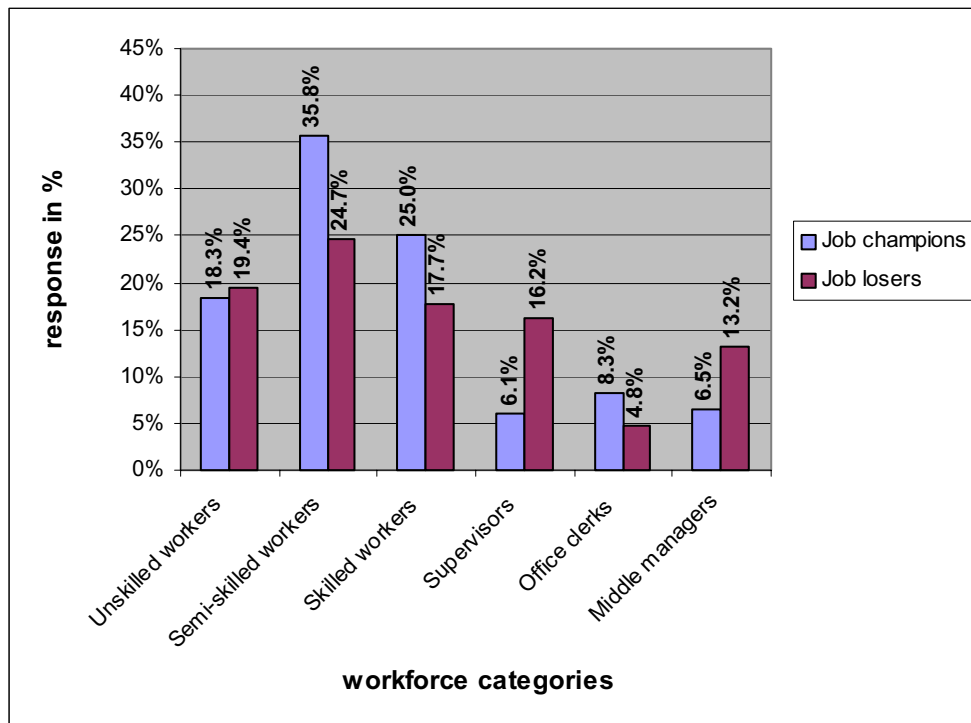
Another concern expressed by analysts is that export pricing is probably set at optimal value, in order to earn the maximum credits, thus leading to maximum imports. However, where volumes are lower, the entire industry is negatively affected.

The macro data generated (Barnes, 2002: 64) reveals that the growth of the industry is largely being driven by exports. However, whilst exports are a positive trend driver as noted earlier, the present import/export balance may prove to be an impediment to the optimisation of local employment. The prime objective of the export complementation scheme is to assist component suppliers to generate high volumes, making them more efficient and enabling them to compete in the domestic market against imports and to expand exports. While this objective has to some extent been achieved, the bulk of export expansion has not been by ‘traditional’ component suppliers but a rapidly emerging new group of mainly foreign-owned companies, frequently with links to vehicle manufacturers³⁰.

Labour market conditions

Job champions have a profile that has emphasised skilled workers in the workplace profile. This is consistent with a manufacturing sector that is increasing its output and sales. Figure 95 shows that while job champions tended to have a higher level of semi-skilled and skilled workers, job losers tended to have a higher level of supervisors and middle managers, and a lower level of unskilled and semi-skilled. It is not certain whether this suggests that top-heavy organisational structures in job losers may also be a contributing factor to their inability to grow jobs.

Figure 95: Job champions and losers by skill level



³⁰ Similar trends have been observed in other countries experiencing rapid international integration and export

Labour costs remain lower than European Union labour costs, which have served to underpin the employment stabilisation in the domestic sector. In all automotive companies surveyed, labour costs were highlighted as a competitive advantage, although this is because most competing production centres are located in countries with a higher wage base. In the metal products sub-sector, labour costs are higher than those of most of Indian and Chinese competitors.

Import parity pricing

Of current concern to manufacturers in the sector are high raw-material prices in general and the concept of import parity pricing by South African steel and aluminium producers in particular.

In the sourcing of raw materials such as steel, aluminium, leather and plastics, South African automotive component manufacturers experience a disadvantage in that they have to buy at international market prices. South African component manufacturers thus experience a serious disadvantage rather than the supposed benefits to be derived from the fact that South Africa is the source of the bulk of the value in the case of each of these raw materials. Unless resolved, this will remain a negative trend driver, as no competitive advantage is passed on to local companies, negatively impacting their ability their competitiveness.

The counter-argument is that for steel, at least, the import parity price (IPP) reflects the best international price, assuming no domestic capacity existed. The key risk is that if there is no IPP system, there is a higher probability that the domestic supply of steel (which has many other convenience factors attached to it) could decrease due to the unattractiveness of domestic margins. Since IPP is an international practice, South Africa needs to balance the competing interests of value-added to the economy versus retaining higher margins for basic metals or downstream products.

The downstream market has the most potential for multiplier effects in terms of job and innovation but the basic metals sector was set up at high cost and it would be economically unfeasible to resurrect it, should it get into serious financial difficulties. Although efforts have been made to incorporate a rebate for exporters, what is of concern is that these measures are not extensive, and do not apply to manufacturers for the domestic market.

Low technology, labour-intensive sub-sectors such as the hand tools sub-sector is also affected by import parity pricing. Here, margins are tight and import penetration is growing. In this scenario, companies complain that they are forced to buy steel at prices 40% higher than the landed price of similar Chinese products. Import parity pricing undermines sub-

expansion such as Brazil (Posthuma, 1995, cited in Black:2001) and Argentina (Miozzo, 2000, cited in Black:2001).

sectors such as these that do not have the clout to negotiate rebates for domestic sales. It would be of interest to examine recent price negotiations around such inputs in other sectors, such as the automotive sector.

4.3.2 Logistics

Logistics also poses a big short-term challenge for the automotive industry as a result of the following:

- South African's distance from both its source markets (imports) and sales market (exports) affects in-bound and out-bound logistics.
- The distances between automotive production hubs within the country. This offers opportunities for intra and inter-sector optimization and consolidation of transport.
- Inefficiencies that exist within the transport sector locally (road, rail and air) (AIDC, 2002).

Companies have claimed that the transportation and logistics prices of Spoornet and Portnet are blunting competitiveness, as in many cases the cost of transporting components from the Reef to the coast is almost as much as transporting them from the port to Europe.

4.3.3 Domestic demand increases

Many producers in the metal products and fabrication sector expect growth to be fuelled by the plethora of investment projects, often infrastructure based, which have been announced in recent months.

The planned Turbo project at Sasol would be a definite driver for this sub-sector. This is part of an effort by Sasol to make its production processes more environmentally friendly. The project is expected to produce up to R1.5 billion in demand for the sector, in the form of tanks, pressure vessels and various forms of structural steel, such as racks, pipes, supports etc. The project commenced in 2003 and is expected to run until 2006. Project Turbo consists of multiple phases, which comprise several smaller projects. The completion of the R280-million skeletal isomerisation plant in Secunda will provide input materials for an existing tertiary amyl methyl ether plant in order to produce a blending stream for unleaded petrol. This is a building block in Sasol's ambitious plan to phase out the lead in its petrol. Sasol has just started engineering the second smaller project, the R125-million C3 Splitter PPU4 (propylene purification unit number four) at the Natref refinery in Sasolburg. Sasol is trying where possible to utilise local companies and this may prove to be positive trend driver, by increasing local demand. An impediment to the optimisation of this would be a lack of

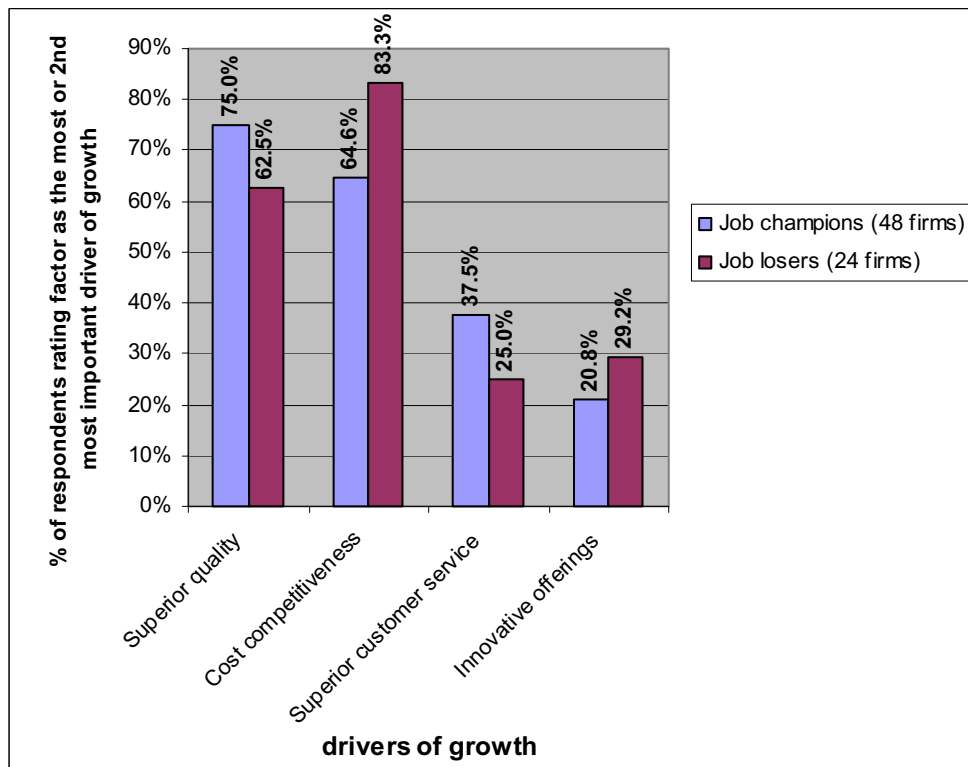
management or technical skills to roll out projects. If it proves necessary to import skills, it is uncertain whether the new Immigration Bill would be able to facilitate this. This would prove to be a negative trend driver. Sasol projects in the region currently total R51.5-billion-worth of projects in various stages of implementation. A portion of this will be absorbed by the metal construction and installation industry. The Coega aluminium refinery project is expected to provide further domestic work for the industry in a similar fashion, with two-thirds of the contracts expected to be awarded within South Africa, but work is not expected to commence in any significant way until 2004.

In general, the sector appears set for increased public and private construction/building spending, with platinum, coal and gold mines doing well. Platinum mining is attracting housing, and general infrastructural development. Firms believe there is still a lot of potential in the commercial sector and that there is huge potential for low cost SMME work such as security installation. Transport recapitalisation is also expected to increase, with upgrades to rail networks and further construction of toll roads planned. Examples of the level of domestic activity occur in the following areas: road construction, water supply and sanitation, housing renewal, airports, ports, and bridges. Other examples of government and parastatal spending include the roll out of Coega, Eskom's R50 billion capital expenditure over the next five years, the R105 billion infrastructure allocation in the 2003 budget, Gauteng's Blue IQ project (including the Gautrain) and prisons expansions. This growth in demand, together with regional growth noted above, should provide a rise in employment within this labour intensive sector.

4.3.4 Company strategies

Figure 96 illustrates that the company strategies that are prioritised by job champions in this sector emphasise superior quality and customer service. Considering that this group was shown to have a higher export propensity, suggests that focusing on quality and customer service is necessary to compete successfully on international markets. In contrast, job losers focused on cost-competitiveness, which can result in price wars, which in turn impact negatively in the profit margins and subsequent growth of such companies. Interestingly, job losers rated innovative offerings as more important than job champions, but it must be borne in mind that this rating does not imply that a higher level of innovation is actually occurring in such companies.

Figure 96: Job champions and losers by drivers of growth



The size of the South African market and the volume of production taking place locally create opportunities for niche products that often cannot be economically integrated into the much larger production facilities overseas. The low production volumes utilise production equipment suitable for shorter production runs, more frequent product changes, etc. Existing equipment being used in the automotive industry worldwide is usually designed for considerably larger production runs and this gives South Africa an advantage.

The less capital-intensive hand tools sub-sector reported growing import penetration and has adapted to this trend in a similar way. Manufacturers are now exploring African export markets, where they feel that they are equipped to deal with the product runs and specific difficulties involved with exporting to such markets. This echoes the view of the plating companies in the sector and mirrors the experience of other sub-sectors within the Metals and Engineering sector where the ability to adapt to particular end-customer demands have underpinned continued competitiveness and job retention.

Labour brokering is most evident in the metal construction, metal fabrication and metal products industries, as the practice now forms an effective solution to the problem of hiring within a project-based industry or an industry that experiences inconsistent volumes.

Sectoral co-operation

A key success story is the capture by South African tank container manufacturers of almost 60% of the international market by 2001. This success is based on the level of co-operation that has been displayed by the association, operators and the manufacturers of tank-containers, as well as the raw material suppliers (Engineering News: 27/02/03). This resulted in the formation of the South African Tank Container Association (SATCA). The tank-container investment companies were the first to promote the idea of combining the efforts of all those in the domestic industry, SATCA aimed to bridge the mistrust in the industry. Launched in 1998, SATCA brought together - in what was a first anywhere in the world - rival investment management companies, manufacturers, the Southern Africa Stainless Steel Development Association and the Department of Trade and Industry (dti). A constitution and code of ethics was drawn up which allowed the industry to speak with a common voice (Engineering News: 27/02/03).

SATCA began discussions with the dti, South African Revenue Service (SARS) and the Reserve Bank. It put in place the regulatory structure to allow the local industry to secure leadership for South Africa in the global market. SATCA initiated the reduction of the imported content of tank containers from 65% in 1997 to about 20% in 2002 and introduced standardisation in components and materials, thereby reducing lead times and allowing manufacturers to hold less stock. At the same time, Columbus Stainless (a South African stainless steel producer) met with the principal manufacturers in the tank-container industry to start a process of co-operation. As a result, Columbus Stainless increased its share of stainless-steel consumption from 25% in 1997 to 95% in 2002. By co-operating, a domestic world leader industry was created.

Mechanisation

Companies in many sub-sectors have embarked upon retooling and development of increased capital capacity. This is in order to expand production and increase quality and technological ability. It was noted by many companies that current employees had been retrained on the new machines. This has at least led to labour retention. The heavy and light engineering sector, but in particular the automotive sub-sector, experienced fairly high levels of investment driving the mechanisation of plants during the mid 1990s. Companies are convinced that the investment costs are viable over the medium-term and can be written off steadily. The high cost of investment can however place financial burdens on companies if they do not secure constant orders. But once again, it is worth repeating that all respondents in the areas where automation has occurred do not appear to have had much choice in terms of satisfying customer specifications. However, most companies believe that the process of labour mechanisation has now peaked and that levels of employment have been optimised.

Companies now expect that new orders will lead to increased hiring, albeit at a slower rate. Unfortunately once such a process of labour mechanisation has been implemented, new labour demand always remains lower than in the pre-mechanisation era. Thus although the industry is still growing, it should not be expected to become a major absorber of labour.

The majority of companies interviewed in the qualitative survey claim to be running at around 65% of capacity. As a result, although most sub-sectors are expecting growth to remain fairly strong in 2003 and 2004, they expect to be able to absorb the increased demand by utilising current staff and machinery in the short-term. Therefore increased demand over the short-term may not result in immediate employment growth.

Design

The Automotive Industry Development Centre (AIDC) believes that greater production of automotive components in South Africa may be facilitated by an expansion of the scope of manufacturing through an advanced design component (Engineering News, 29/01/03). AIDC warns that South Africa will needlessly remain primarily an assembly industry and secondly a manufacturing industry unless it undertakes component design and engineering. The AIDC already focuses on design engineering and testing. As an initial strategy, the AIDC is looking specifically at the special-vehicles market, which is a fairly substantial activity in South Africa. Thus, although component design and engineering is not currently a driver of performance in the sector, it may well underpin future expansions.

5 IMPEDIMENTS TO EMPLOYMENT GROWTH

5.1 Introduction

Figure 97 indicates the ranking that companies gave to several impediments to job creation. Government support schemes and labour legislation rank as the most important obstacles, a finding which is consistent with other sub-sectors within the Metals and Engineering sector. Interestingly, both job losers and champions prioritised work methods and process efficiencies over external conditions such as tariffs. This correlates with the experience of a sub-sector that is both exporting successfully (automotive) and experiencing low levels of import penetration (metal products).

Figure 97: Perceived importance of various factors in facilitating growth, by job champions and job losers

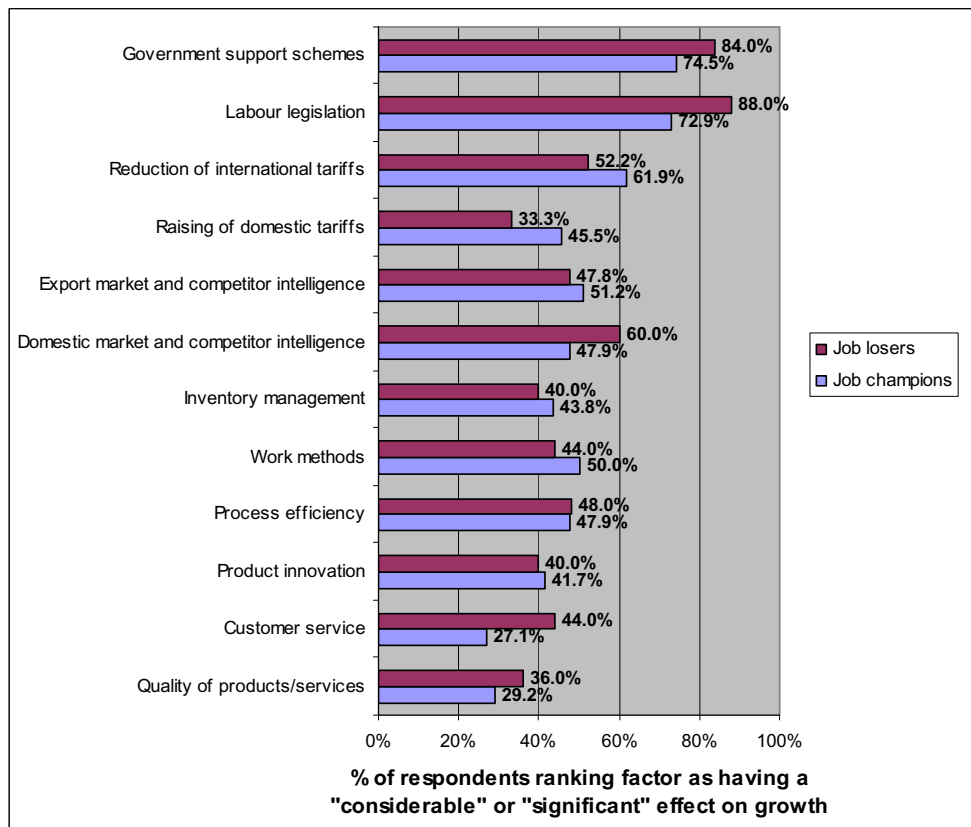
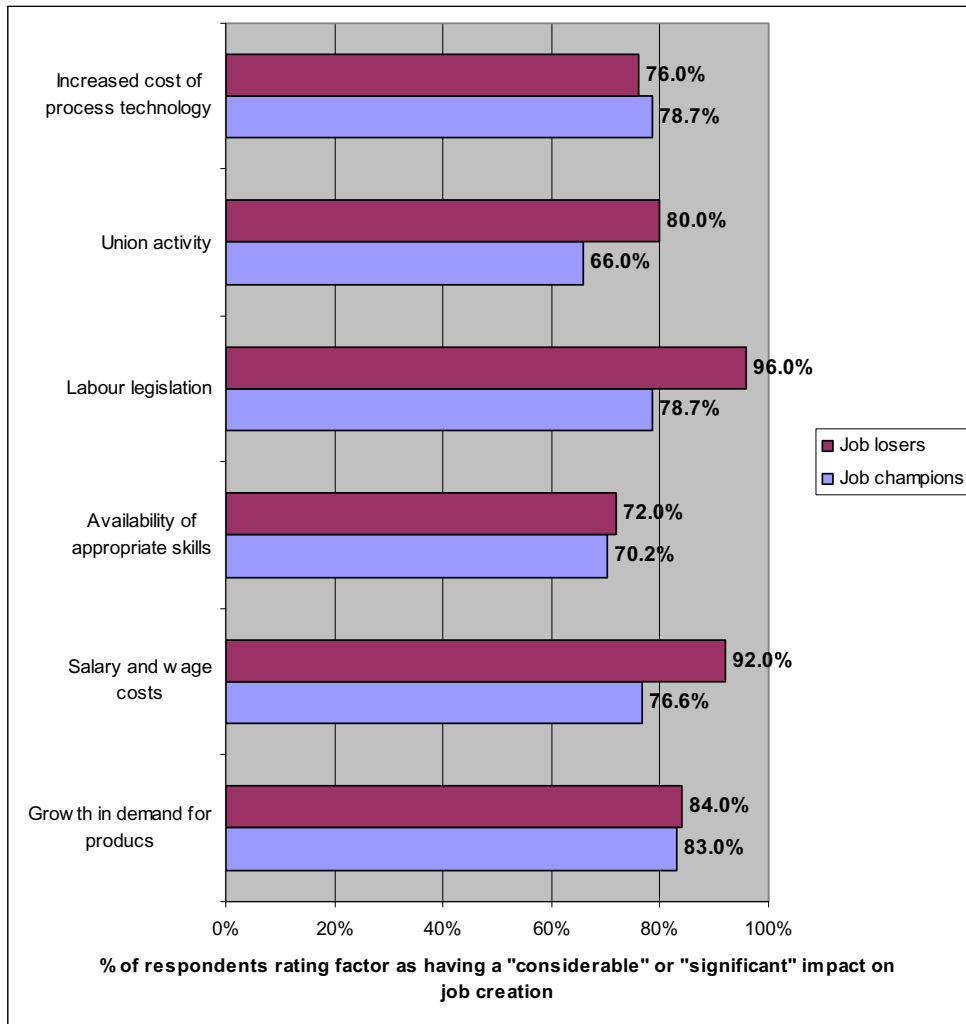


Figure 98 shows how job champions and job losers perceive the relative impact of various factors on their decision to employ additional workers. Job champions and job losers tended to have similar views, except with respect to union activity, labour legislation and salary and

wage costs, which job losers perceived to have a relatively greater impact on job creation than job champions.

Figure 98. Perceived impediments to job creation by job champions and job losers



In an assessment between small medium and large companies regarding impediments to growth, (Figure 99) a number of additional insights are gained. A first observation is that large companies, who are in general more exposed to international trade and competitiveness has a much higher level of awareness of continuously improving in most areas relating to competitiveness. This indicates that there is still some way to go for SMMEs to become competitive in many areas although it is recognised that much progress has been made over the last decade. The need for market and competitor intelligence by large companies is echoed in the analysis of exporting versus non-exporting companies. What is of interest is that there is not much difference between responses from the two categories of firms,

meaning that the dynamics behind job loss and job gain are not restricted to one single factor or experience, but are experienced as constraints by both types of firms.

Figure 99: Perceived importance of various factors in facilitating growth, by small, medium and large companies

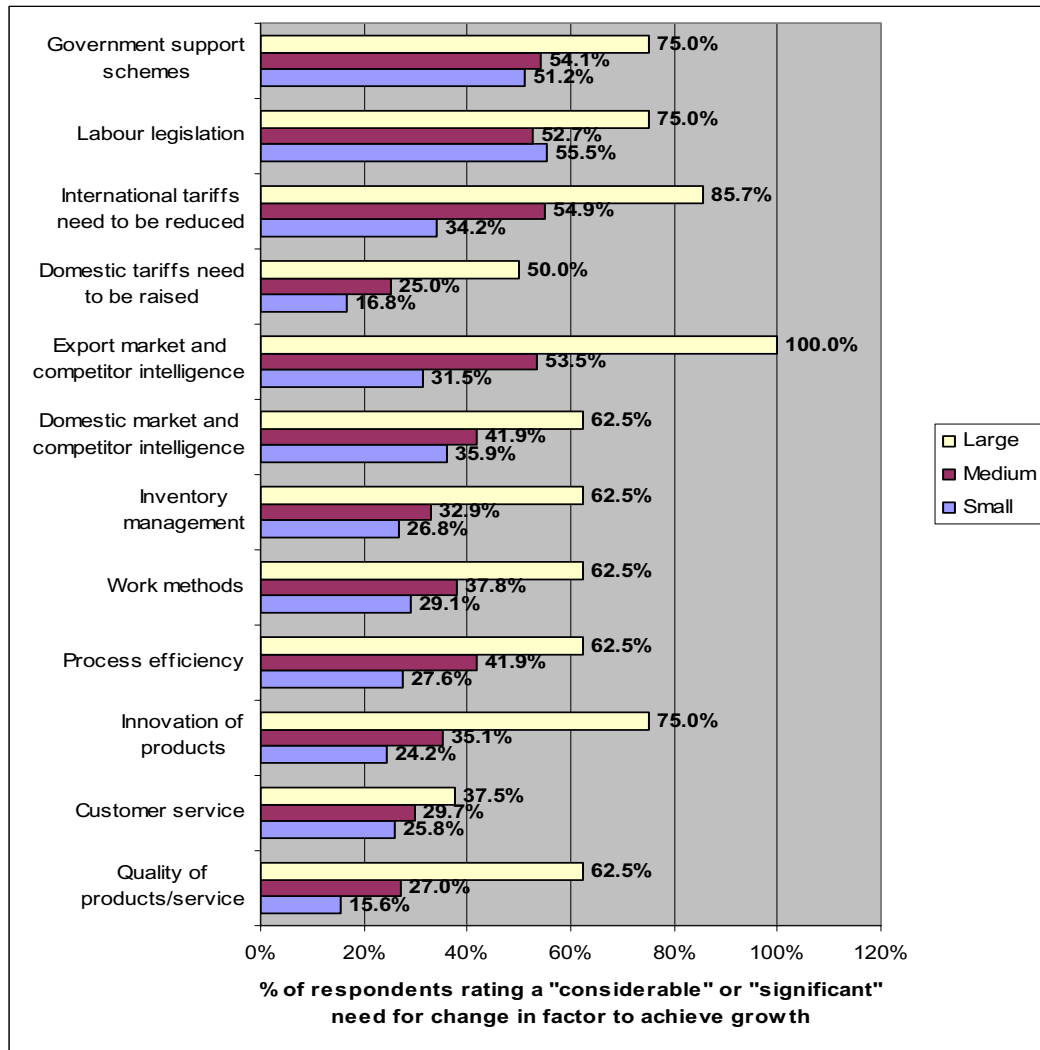
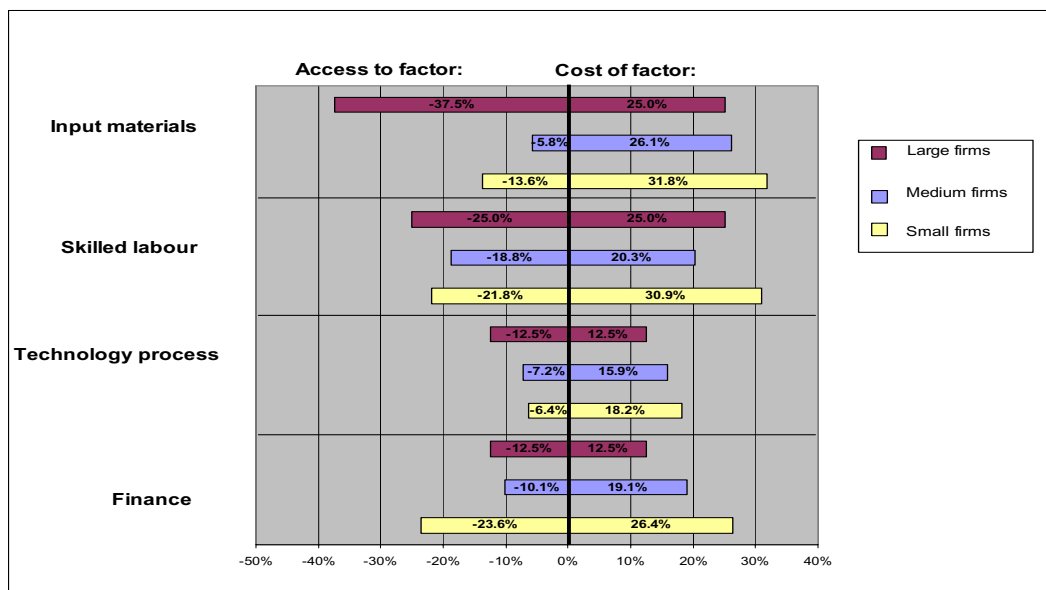


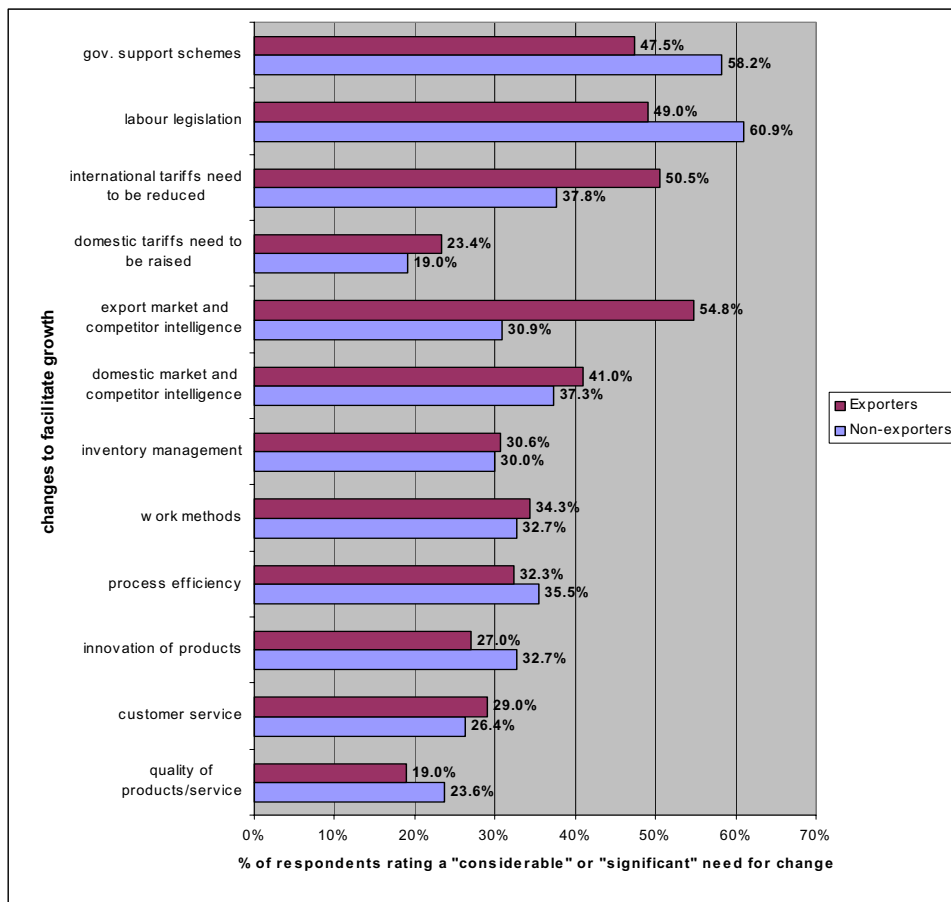
Figure 100: Small, medium and large companies' view on the accessibility and cost of various factors on their competitiveness



In terms of factors inhibiting competitiveness, two issues come through strongly, namely the importance of access to and cost of raw material, for larger companies, and the access to and cost of finance for small companies. The first is dealt with extensively elsewhere in the report, but the second requires further exploration. The need for capital investment in technology upgrading in order to achieve competitiveness (quality, efficiency etc.) was identified as important factor in this sector. If small companies are experiencing significant problems in accessing finance, it becomes an inhibiting factor for future growth and subsequently employment. A fair degree of awareness of the SMEDP was found and some uptake of the support scheme is taking place, suggesting that it could play a meaningful role in addressing these impediments.

Figure 101, which compares the factors of exporters and non-exporters, re-iterates the key factors that have consistently been identified as important to companies. It re-enforces the importance of market intelligence to exporters and perceived impediments associated with labour legislation and government support schemes. Another key issue that has emerged from this study for the whole of the metals and engineering industry is the importance of the domestic market and perhaps an over-emphasis from government's side on export-led growth. It was established that companies who focused on the domestic market are not experiencing the same level of government support as their exporting counterparts, especially in light of the delays in getting the Competitiveness Fund operational (many domestically focused SMMEs are still grappling with fundamental competitiveness issues such as quality and efficiency).

Figure 101. Exporters and non-exporters' views on the need for change in various factors to facilitate growth



5.2 Import penetration

As noted above, import penetration in the automotive sub-sector has been offset by rapidly growing exports. Accordingly, the import penetration currently experienced by the sub-sector is unlikely to have negative consequences in the near future. However, should exports wane in the absence of the MIDP; it is likely that these high levels of import penetration may translate into job loss.

Companies in the metal products sector have reported growing import penetration and indicate that they have experienced intensified competition from imports over the last two years, with particular emphasis on China and India as culprits. Chinese imports used to only compete in terms of price, however, across sectors, companies noted that Chinese imports have started to improve in quality and sales service. This is seen as worrying by domestic companies, because import competition will now probably intensify. This is a negative trend driver. Companies in low technology sectors thus face the choice of moving into more value-added sectors or expanding their exports amidst decreasing local market share. Alternatively, they have to find new methods of increasing competitiveness. Although imports have not

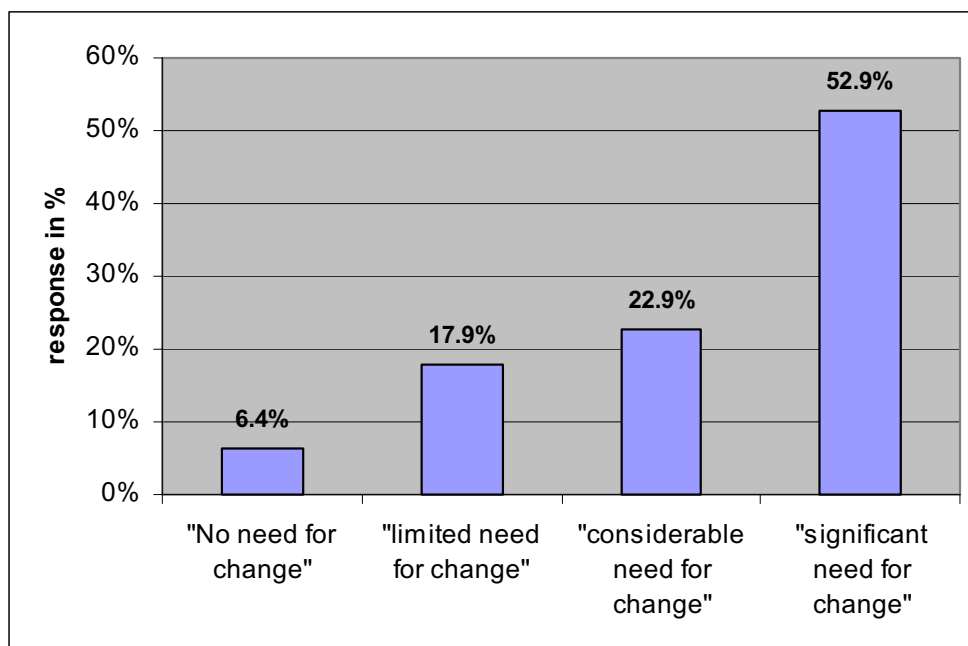
become a serious threat in more than a few sub-sectors, companies expect this trend to continue as China and India pursue paths of industrial competitiveness upgrading.

With regard to illegal imports and dumping, the potential threat to local manufacturers is not uniform across the heavy and light engineering sector, with some industries such as wire and wire products experiencing problems in this regard. Where allegations of dumping have been made, respondents stated that customs and excise capacity is too low and perceived a high level of corruption among staff. Anti-dumping capacity nationally is seen as low, with the slow process of approving dumping allegations undermining the actual levels of protection afforded to players.

5.3 Export markets

The metal products sector has over the last 10 years been increasing its competitiveness to the point where many sub-sectors are now exporting. However volumes and margins in many areas are very small. Further, the metal products industry is also characterised by many SMMEs who have only recently started exporting. For many, the currency depreciation over the last 2 years has been an incentive to export, because for the first time their products are both acceptable in terms of quality and cost. Accordingly, it is unsurprising that the majority of respondents have identified a significant need for change in levels of information about export markets as they seek to optimise their entry into these markets, as shown by Figure 102. Assistance in the target country would also benefit exporters.

Figure 102: Perceived need for change in information regarding export markets



It is likely that this response also reflects a desire by domestically owned auto component manufacturers to be able to service markets other than OEM's located in South Africa.

South Africa does not yet seem to be targeted as a high priority market by China etc. because the volumes are quite small and because China has not fully considered the African market, so South Africa is not yet seen as a 'springboard'. In most product ranges, Chinese goods are not yet able to compete with domestically produced products in terms of quality and technology, so local import distributors are only able to compete at the bottom end of the quality/cost overlap. South African manufacturers have sufficiently geared up in terms of competitiveness in most sub-sectors to defend most of their particular market. However, some areas are obviously under threat, e.g. the hand-tools sub-sector.

However, employment growth as a result of exports has been slight, due partly to the global economy and partly to the under-utilisation of capacity and the less labour-intensive nature of the light and heavy engineering sector. Both of these manufacturing process factors are ironically a result of the restructuring that occurred in the sector during the 1990s. Although they could also fuel fairly rapid export growth - global conditions permitting - the growth would have to be sustained in order to have a significant effect on employment. Possible impediments to the optimisation of exports as a positive trend driver are the uncertain future of the Rand and likewise the global economy, as well as the capacity of the South African light and heavy engineering sector to sustain such growth, both in capital and labour terms.

Exporters were anxious however that they would not be able to compete against other developing countries, especially India and China, if the exchange rate continued to improve. The effective devaluation of the currency over the last two years has boosted exports. However, sharp drops in the exchange rate were also seen as unhelpful, as they increased uncertainty and placed strain on annual costs and forecasts. Exporters were fairly uniform in identifying an exchange rate band of R9 to R10 to the dollar as ideal for exports.

The industry associations do not appear to play a main role in marketing, analysis or policy support. They largely confine their activities to industrial relations and human resources. Exceptions are the automotive and stainless steel sub-sectors where the associations play an active role in analysing the industry, assessing drivers and attempting to build consensus around industry interventions among their membership. Such interventions have been highly successful in these sub-sectors, for example outstanding export growth in the stainless steel industry has been achieved just two years after the establishment of the Stainless Steel Co-operative Development Initiative (SSCDI) in 1999. The SSCDI aims at facilitating growth in the industry, identifying market drivers, managing relevant research, encouraging investment and supporting stainless-steel-related activities.

5.4 Labour legislation

Companies interviewed noted labour legislation as a deterrent to hiring permanent employees in that retrenchment legislation and costs are perceived as making it onerous for companies to consider hiring additional staff. This functions as an impediment to optimisation of fairly low labour costs. Companies would rather hire labour through labour brokers than directly through the company, as workers cannot be retrenched easily when production is slow. This leads to a decreased quality of employment through labour brokering. This is also not likely to lead to increased skills levels as labour brokers are disinclined to train their pool of labour. Current moves to regulate the labour brokering industry may put the onus for training onto the labour brokers, but with a wide variety of clients, training would have to be highly regulated to be effective. In addition, labour brokers do not pay benefits or pensions, leading to a poor quality of life amongst workers and an increased burden on the state and taxpayers.

Employer respondents across the board in this sector's qualitative interviews noted that in their opinion retrenchment clauses in the labour legislation are an impediment to hiring. Companies would rather utilise overtime or labour brokers than 'risk' hiring new staff. The actual financial costs of retrenchment are perceived to be too high. This may be because employers chose to retrench more long-service than recent employees in the large scale lay-offs in the 1990's, which forced them to pay high overall settlements.

Wage rates are ironically not seen as problematic, with very few respondents noting them as a negative trend driver.

5.5 Skills

Interestingly, this sector was the most positive across Metals and Engineering with respect to the availability of skills. This reflects the relatively undifferentiated nature of production in the sector that relies less on high-level design and engineering skills than it does on skilled production workers and artisans. Thus, unlike other metal and engineering sub-sectors, skills availability is unlikely to be a constraint in the short-term. However, companies interviewed noted that skilled workers were rapidly being absorbed by the economy and any increase in demand would result in an acute skills shortage.

Figure 103: Perceptions regarding skills availability

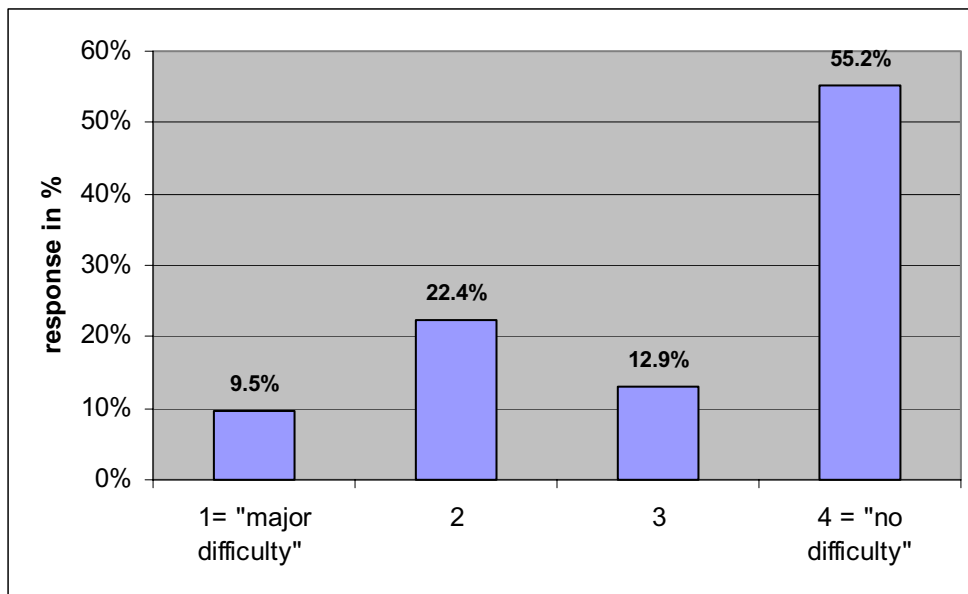
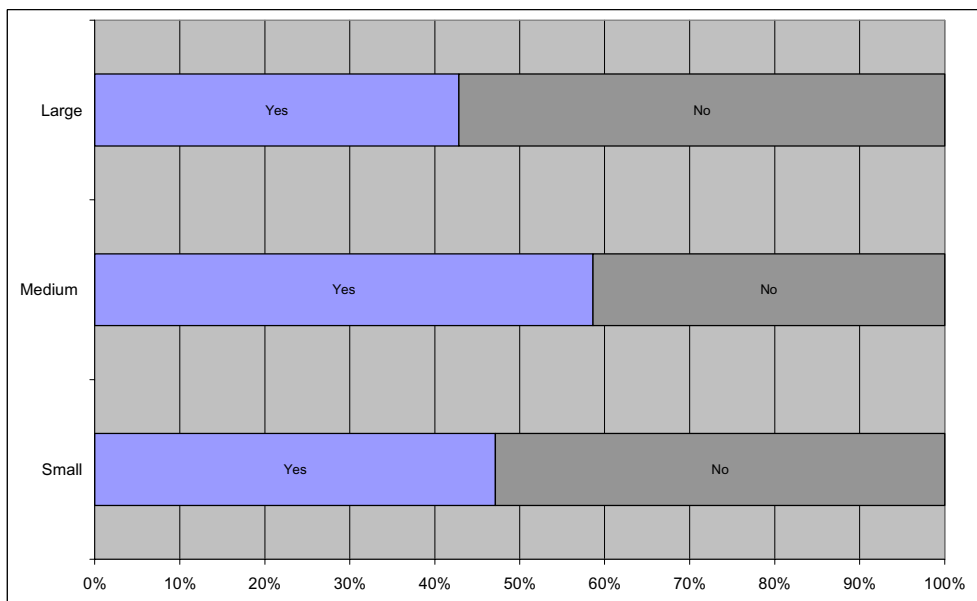


Figure 104: Respondent's view on whether the Merseita is effective



In the great majority of cases, the Skills Development Levy (SDL) is not utilised but rather written off as a tax. Employers cite inconvenience, ignorance, time and suitability as reasons for not utilising the incentive. Large employers describe it as inadequate for their needs, while small companies see it as cumbersome and not worth allocating administrative time and effort to. Admittedly most small employers were both unaware of the scope and benefits of the SDL and were also not actively training their workforce in the first place.

Companies have managed to accommodate the skills shortage to date but have been finding it increasingly difficult to locate skilled staff over the last two years. This trend is expected to worsen. This means that further economic growth will expose this as an increasing impediment to growth optimisation i.e. at present the real extent of the skills deficit is still to be felt in the light and heavy engineering sector, at current levels of growth. The metal construction sub-sector is among the first to note this deficit as a real constraint, especially in the area of lower to middle management as well as skilled artisans. Companies doubt their ability to roll out further public or private projects. It is expected that companies that have not embarked upon significant in-house training will find staff capacity to be an increasing constraint.

6 CONCLUSION

Along with sluggish domestic demand, skills shortages, exchange rates, legislation and import parity pricing are highlighted as the most serious threats to the continued growth of the light and heavy engineering sector. The performance of the automotive sub-sector and the influential role of the MIDP obscures to a large extent, an understanding of the rest of the heavy and light engineering sector that has had a dramatically different experience.

The metal products sub-sector experience contrasts with that of the automotive sector. While the automotive industry is undoubtedly volume driven, experiencing considerable import penetration as well as dramatically growing exports, the metal products industry has had a very different experience, trading on the basis of lower volumes. It would appear that both sub-sectors are beginning to enjoy some employment growth. However, there is little indication of rapid employment growth notwithstanding the relative health of these sectors. However in some sectors healthy employment growth has been recorded, such as stainless steel products. Construction and fabrication opportunities appear to be possible drivers of future employment. We now turn to analysing some of the impediments to growth in the sector.

The sector summit must urgently address the issue of import parity pricing as a priority concern and support the domestic downstream industry while it continues to upgrade its competitiveness. Along with skills shortages, exchange rates and retrenchment legislation are highlighted as one of the most serious threats to the continued growth of the light and heavy engineering industry. Addressing IPP will not encourage companies to be “lazy” as most have already made the mental transition to competitiveness upgrading. They have in fact been experiencing the fruit of such decisions, but will be unable to maintain this advantage in the face of current levels of IPP.

Government should encourage further investment in the sector, in order to sustain capacity through increased support for capital expansions via dti supply side measures. However, the capital intensive bias of the South African industry should be examined in order to establish whether there is a bias toward financing capital intensive production. Interest rates and current financing pipelines are also factors inhibiting investment as they lead to low rates of return and financial shortfalls respectively.

As noted above, the fact that companies are largely operating below capacity means that there will be a lag or perhaps six to nine months between increased demand and increased employment. This is an impediment to the optimisation of increased employment growth. Companies noted however that solid economic growth domestically would be the primary driver for new hiring. Export growth has been very useful in supplementing sluggish or flat

domestic earnings but most companies still record the majority of their earnings domestically. The incidence of labour contracting has also increased.

Growing export sales is still seen as the major route to employment creation in the South African economy. The export side of this equation has largely been achieved but employment growth has been disappointing. Research from this study and others indicates that companies have slimmed down, rationalised and improved labour productivity in order to export. This transitional phase has largely been completed, so it is possible that renewed export growth will now trigger employment growth. The bulk of exporting has also not been in particularly labour-intensive sectors. This means that the recent phases of employment decline, followed by jobless growth, could now give way to employment creation. A cautionary note should be struck however, in that the process of competitiveness upgrading, which occurred during the period of restructuring, has produced an industry less labour-absorptive and less labour-intensive. Technology and manufacturing processes have been changed to achieve export competitiveness and increase output with fewer workers, so a return to previous levels of employment is highly unlikely unless growth of over 6% is achieved.

Labour is still seen as costly in many areas, either through slow productivity increases, but primarily through the administrative, financial and CCMA cost of retrenchments. In many sectors work volumes are cyclical or project based and companies cannot afford to hire staff because it will be too expensive to retrench them when the cycle turns down or there is a lull between projects. Various solutions to this problem include automation, the use of labour brokers or overtime work. Companies will only hire when they have exceeded current machinery capacity and are not in a position to automate further. Capital outlays for automation are not seen as dangerous because the depreciation rate is seen as predictable, decreasing each year, whereas labour is seen as unpredictable and labour costs as rising each year. A concern is that with advances in technology, machinery costs are also falling, making automation increasingly viable even for smaller companies. In many cases, machinery also allows for consistent quality levels. However, it should be noted that in some sectors, such as automotive manufacture, automation is largely due to increased customer specifications in terms of quality and reliability, and is not predicated upon decreasing labour inputs per se.

In spite of the mixed status of non-automotive sectors, expectations are high in many sub-sectors that economic growth will continue to strengthen. Many areas of light and heavy engineering will also benefit enormously from the large number of sizeable private and public sector projects scheduled for commencement in many areas of the economy (ports, roads, mines, petrochemical, prisons, Blue IQ).

Many of the projects are already in the final phases of planning and some are being implemented from 2003. The employment boosting effects should be visible in all the downstream industries within light and heavy engineering and should continue for the next two to three years. If this coincides with favourable international growth conditions, then employment levels should rise moderately. Significant increases in employment may however only result once domestic growth reaches 6%.

7 KEY ISSUES FOR CONSIDERATION IN STRATEGY AND POLICY FORMULATION

In the previous section we looked at current situation, trend drivers and impediments to employment creation in the light and heavy engineering industry. The picture constructed is a multi-faceted one, but for the purposes of possible strategy formulation in order to intervene or guide development in the sector, the most common themes need to be isolated.

It is concluded that the heavy and light engineering sub-sector is one of the more stable sectors within the metals and engineering sector. The automotive industry is experiencing steady growth in sales and exports, albeit with a worsening balance of trade. This, together with a slight increase in jobs over the last 65 quarters, may indicate that the industry is likely to continue to hold opportunities for job creation in the short-term future. The metal products sub-sector is in many respects an anomaly within the overall sector. Sales, employment and balance of trade have all remained steady over the last decade and, given the relatively low level of import penetration, there is little to suggest that companies in this sub-sector are likely to be displaced in the near future. Given this context, we now turn to examining the key issues relevant to job creation within the sector.

Labour brokering - Labour brokering is most evident in the metal construction, metal fabrication and metal products industries. Presently, labour brokering is used as a solution to the problem of hiring within a project-based industry or an industry that experiences inconsistent volumes of demand. However, as a medium or long term strategy, it is likely to lead to lower skills levels, reduction in casual wage levels and a reduction in output quality within the client employer. No pension fund is provided and this together with the lack of training, traps workers in cyclical, short-term work with no real prospect of career development or retirement benefits. It places a greater burden on the state and the taxpayer. It also reduces union membership levels, as most labour brokers discourage union membership. It is an industry that requires effective regulation and will remain an attractive option for employers for as long as they feel unable to adjust employment levels quickly.

Outsourcing – Outsourcing has occurred across the entire industry, but is largely restricted to non-core functions or service functions, e.g. catering, and security. Most outsourcing seems to have occurred during the mid-to late 1990's and is now limited to occasional outsourcing of specialised functions. This may in part account for the increasing stabilisation of employment numbers since 2000. In most cases the employees were retained by the new employer. This may account for a component of the decrease in employment shown in the sectoral data. If this is the case, then a section of the workforce has not been made redundant, but has been 'recycled' through this outsourcing. However, in many cases, the

quality of employment is lower and it is not certain exactly how many outsourced employees were retained by new employers.

Skills Development Levy and Learnerships – These are areas of concern, given the consistent complaint regarding skills shortages by many sub-sectors. In the great majority of cases, the SDL is not utilised and is rather written off as a tax. Employers cite inconvenience, ignorance, time and suitability as reasons for not utilising the incentive. Large employers describe it as inadequate for their needs, while small firms see it as cumbersome and not worth allocating administrative time and effort to. Admittedly most small employers were both unaware of the scope and benefits of the SDL and were also not actively training their workforce in the first place. Those employers in the SMME category who had utilised it found it a useful and effective initiative. Large firms that incorporated it into their skills development plans did not find the actual system cumbersome, but the range of products/courses too limited.

Learnerships have not been used by the great majority of firms. They are either not aware of such an initiative, or feel it is only useful where the skills are portable, i.e. they are relevant for the learner in other segments of industry as well. Firms are also concerned that learners should have no claim to employment within the training firm. Firms were however mostly positive about the concept, although they were concerned that the initiative would only increase the skills of completely unskilled workers and would not provide high-level artisan training. Efforts to market this initiative would have to be carefully planned and rolled out through the industry associations.

Skills shortages – Companies from many sectors note that skills are increasingly in short supply. However companies do not seem to have problems sourcing skilled staff, it's just that the cost of hiring them has gone up and more time has to be allocated to recruitment. Respondents however agreed that the supply of skilled workers had decreased enormously and is only slowly being rectified by the Merseta. The firms are thus not incorrect in stating that skilled staff are still available; they point out that the recent long period of retrenchments over the last 10 years led to a pool of available workers, both skilled and unskilled. However, the pool of skilled workers has now been reabsorbed elsewhere in the Metals and Engineering sector, or by other sectors, or lost to emigration, and so as growth has picked up slowly over the last two years, firms have been finding it harder to source skilled staff. The metal construction sub-sector is among the first to note this deficit as a real constraint, especially in the area of lower to middle management as well as skilled artisans. Firms doubt their ability to roll out further public or private projects. It is expected that firms that have not embarked upon significant in-house training will find staff capacity to be an increasing constraint. Firms in the sector are divided as to the reason for this, with some noting the closure of the mines' training schools over the last 15 years and decreasing government

support, while others claim that skilled staff have been absorbed by other growth sectors of the economy during light and heavy engineering's period of poor performance over the last 10 years. Most respondents appear confident that the Merseta will address the backlog of skills development, but note that it may take a decade to address this fully. Firms in growth sectors state that they will be unable to roll out production and that this will limit economic growth, which will be negative trend driver.

Capital upgrading – Firms in many sub-sectors have embarked upon retooling and development of increased capital capacity. This is in order to expand production and increase quality and technological ability. It was noted by many firms that current employees have been retrained on new machines, thus employers did not need to hire more skilled employees. This has probably led to labour retention. This implies that capital upgrading does not directly result in retrenchments, due to the possibility of re-skilling the existing workforce. This could point to competitiveness as the principal underlying factor behind retrenchments. However unskilled workers were in the majority of those retrenched, meaning that a lack of skills makes workers more vulnerable to retrenchment. Statements by firms reveal that employers believe workers are quite capable of acquiring new skills, which could be a positive trend driver, namely ongoing skills development as a driver of increased competitiveness.

Raw material inputs – The case of import parity pricing needs to be effectively dealt with by sector summit discussions, because the current price of steel (and increasingly stainless steel as well) is seen by many firms as a serious negative trend driver. The negative trend in this case is increasing un-competitiveness as a result of rising input costs. Large and small firms across all sectors are complaining about this trend. In the last year alone, Iscor raised the price of steel by 47%. Consumers of inputs from the basic metals sector claim that the price hikes are unrelated to competitiveness at Iscor and Columbus and are merely attempts at profit taking. It is also possible that the price hikes reflect attempts by these firms to reinforce their attractiveness to potential or recent partners. What ever the reason behind this practice, the effect is the same, decreasing price competitiveness for downstream steel users at a time of currency strengthening and increasing global competition. For example, many firms note that competing imports come into the country at the price of Iscor's unfinished steel. Many firms state emphatically that they have already lost both domestic and export orders as a direct result of the recent price hikes. More serious for firms that rely largely on price for competitiveness is their medium-term survival. Firms in this predicament operate in arenas where quality or technology are accepted as a given and have been discounted as order-winning criteria. In these circumstances, sudden and steep price hikes such as have occurred due to Iscor over the last two years, pose a real threat to medium-term profitability of firms and have forced them to reconsider expansion plans as price hikes raise the cost of further factory construction. Steel consumers find that they cannot import steel, due to the

cost of landed steel and quality concerns. Most firms have already made the mental transition to competitiveness upgrading. They have in fact been experiencing the fruit of such decisions but will be unable to maintain this advantage in the face of current levels of IPP.

Isacor claims that it sets the IPP in line with the lowest international benchmark price. A thorough, independent investigation into the real cost structure of Isacor and other IPP practising suppliers would have to be made in order to balance the competing stakeholder groups and weigh up the relative merits in terms of competitiveness advantages and their spill-over impact on employment, balance of payments, secondary industries and intellectual capital.

Imports – Chinese and Indian imports are cited as an increasing threat to South African firms' domestic market share, putting some labour intensive, low technology sectors e.g. hand tools at risk. Chinese imports used to only compete in terms of price, however, across sectors, firms noted that Chinese imports have started to improve with respect to quality and after-sales service. This is seen as worrying by South African firms, because import competition will now probably intensify. This is a negative trend driver. Firms in low-technology sectors thus face the choice of moving into more value-added sectors or expanding their exports to offset a decreasing local market share. Alternatively, they have to find new methods of increasing competitiveness. Although imports have not become a serious threat in more than a few sub-sectors, firms expect imports to increase as China and India themselves pursue paths of industrial competitiveness upgrading. Respondents note that these countries do not hesitate to actively intervene and support domestic industry.

Anti-dumping and illegal imports – These potential threats to local manufacturers do not seem to be very significant in the light and heavy engineering sector, with the exception of certain pockets. However, where dumping and illegal importation has occurred, respondents stated that customs and excise capacity is too low and corruption amongst staff is seen as too high. Anti-dumping capacity nationally is seen as woefully low. Anti-dumping processes are seen as far too slow, with actual levels of protection being undermined by the very slow process of approving such actions. Firms are concerned that the full impact of the various recent and current Free Trade Agreements has yet to be felt and that government capacity to deal with a rise in dumping or illegal imports is insufficient, especially with regard to technical considerations such as rules of origin.

Exports – Exports have been steadily increasing throughout the sector, largely due to currency depreciation over the last two years. In many sub-sectors, competitiveness improvements forced on industry by the tariff reductions of the 1990's have also led to increased exports for those firms who survived the reductions. However, employment growth has not matched export growth, as firms have sought to follow a capital intensive route to