STARSTRUCK: Economic impact of DaimlerChrysler on the Eastern Cape

Brakes may be put on foreign direct investment if the Eastern Cape region takes its eyes off competitiveness, writes JO LORENTZEN.

What do croissants have to do with Mercedes Benz C-Class luxury cars? This unusual question was posed to participants at a workshop in East London in March 2005. Managers of automotive component suppliers, representatives of DaimlerChrysler and education and training institutions, and a consultant to the Eastern Cape Development Corporation (ECDC) met to discuss the impact on human capital of DaimlerChrysler's investment in the province.

Some industry representatives were members of the East London chapter of the South African Automotive Benchmarking Club (SAABC), but for many the workshop was the first occasion to share their concerns about economic development in the province with other stakeholders.

The Overseas Development Council (ODI), a development think-tank based in London, led the project, which was funded by the UK Department for International Development (DfiD). DfiD contracted the HSRC to do a case study of the automotive industry in South Africa.

We know that when multinational firms shop the globe for investment locations, one factor they consider is local capabilities. Smart regions are likely to attract more sophisticated foreign technology than those with limited capabilities. Once firms have invested, they start training workers in-house and contract with public and private education providers to improve the skills profile along the supply chain. Presumably, this has an effect on prospects for local and regional economic development. In a nutshell, this is what the ODI project tried to establish empirically.

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The research leading up to the workshop was in two parts: The London-based team leader, Dirk Willem te Velde, analysed the relationship between capital inflows and school enrolment rates in 111 developing countries from 1970 to 2000. The HSRC team looked at the role of the two luxury carmakers, BMW and DaimlerChrysler in South Africa (DCSA).

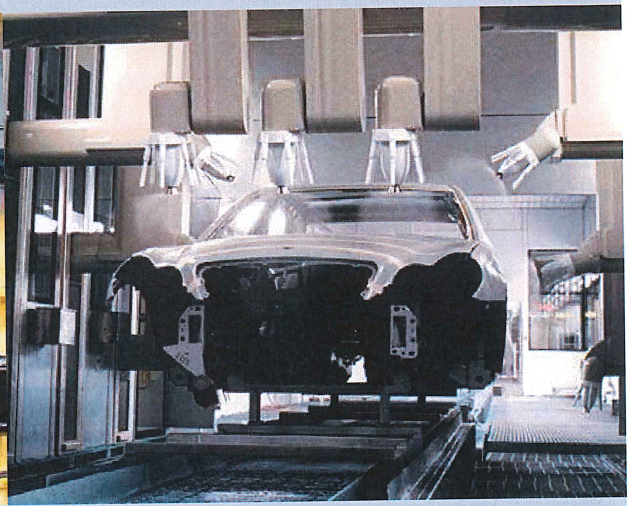
We chose these two manufacturers because of their upmarket focus and because, following the government's Motor Industry Development Plan (MIDP), the German assemblers had aggressively developed their local operations into export platforms. This obviously puts a premium on skills and competencies, without which world-class quality and continuous improvement – essential requirements of automotive assembly for world markets – remain elusive.

At the workshop, Dirk presented the global study. It finds that inflows of foreign capital and school enrolment rates are indeed related, which suggests that the presence of foreign capital raises the returns to education.

Justin Barnes, the Managing Director of the SAABC, illustrated with data from Benchmarking Club members that component suppliers in East London tended to have worse human resource performance indicators than automotive firms in the rest of the province, the country, and other parts of the developing and developed world.

In presenting my case study, I showed that in the five years since DCSA had first produced C-Class cars for export, the car manufacturer had profoundly affected the skills and competencies of its workers and managers, and those of its suppliers. The consequences were visible even outside the automotive sector, because insights from advanced production processes in car assembly had been transposed to other industries, including unrelated ones. That was the good news.

The bad news was that economic planners in the municipality and the province had never given any thought to what might happen to the region should DCSA ever decide to shut down its East London plant. Not only would this put some 10 000 jobs at risk, it would waste the skills, work practices and tacit knowledge accumulated by local human capital, thanks to its exposure to a demanding global value chain.



Whenever I had broached the subject during interviews for the research, development officials denied that this was even a remote possibility. It appeared as though the people from the ECDC believed their own glossy brochures, according to which the Eastern Cape is a competitive hub like no other. They totally discounted the threat from higher-growth markets in China and India; the looming phase-out of the MIDP, which will undoubtedly make South Africa a less attractive production site; and competitiveness problems afflicting the ECDC in a global car market with a perennial surplus capacity.

The development officials' optimism contrasted with a more downbeat assessment by the director of the local Chamber of Business, Les Holbrook, who quipped that when DaimlerChrysler leaves, would the last person to leave East London please turn off the lights.

Local stakeholders had the last word in the matter. Sean Ellis of the SAABC had put together a panel to kick off a debate on the relevance of our research and the larger questions it raised. The first contribution came from Gareth Evans, Production Manager of the local subsidiary of Leoni, a German manufacturer of wire harnesses that employs about 400 people right across the street from the DCSA plant. He confirmed that supplying harnesses for the C-Class had led to an upgrading of skills and competencies on the shop floor and across management.

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He broke the news that Leoni had lost the successor contract for the new C-Class model in favour of Botswana-based Delphi, and that he would essentially be winding down the operation over the next year and a half. He and his colleagues were at a loss as to what would happen to the workforce, although he had no doubts that much of the human capital created over the last few years could in principle be utilised in other productive activities, even outside the automotive sector.

Brian Harmse, Owner-Manager of Fabkomp, a manufacturer of a wide range of components for DCSA's truck division located in a township near King Williams Town, underlined the need for diversification away from the automotive sector to achieve a more balanced risk exposure. He explained why it is difficult for small firms to figure out opportunities for international contract manufacturing and cautioned that skills at medium and high levels were always a constraint.

Peter Miles, representing the ECDC, struck an optimistic tone. He held up the flag for the various development instruments in the province and found it a mystery that East London, despite its high quality of life, did not draw more professionals. The deadpan answer came from Voksie Vokwana, who had lived in (the real) London before becoming Assistant Director of the new East London campus of the University of Fort Hare, "Because," she said, "you can't even get a decent croissant in this town."

Voksie went on to raise the larger issue of the absence of an organised dialogue around regional development prospects between universities, technical colleges, firms, private sector associations and public authorities.

Her point was well taken. Human capital in the Eastern Cape has definitely benefited from foreign direct investment. But multinationals come and go, and hence their arrival must not be taken to mean that everybody will live happily ever after.

The challenge is how to harness the knowledge that foreign firms bring, whether they stay forever or just a short while. Investment in innovative activities that contribute to restructuring and diversification must come primarily from the private sector. But when competent and highly committed firms cannot individually overcome the kinds of information and co-ordination failures brought to light by our study, governments must engage with them to figure out jointly where new productive and profitable avenues for local capital lie, and to counter disincentives for exploring them.

This requires systematic dialogue, to which the workshop will hopefully have contributed.

Professor Jo Lorentzen is a Chief Research Specialist in the Human Resources Development Research Programme of the HSRC.

__Note__: The conversation between the HSRC and industry is ongoing. Len von Graevenitz, Vice President of the Human Resources Division at Toyota SA and a participant at the workshop, will introduce the launch of the HSRC's Innovation Club Jour Fixe on 14 June in Pretoria, entitled "The Leadership Gap: From Local to Global". (NB: Croissants provided – thank you, Voksie.) For further details, please e-mail media@hsrc.ac.za.

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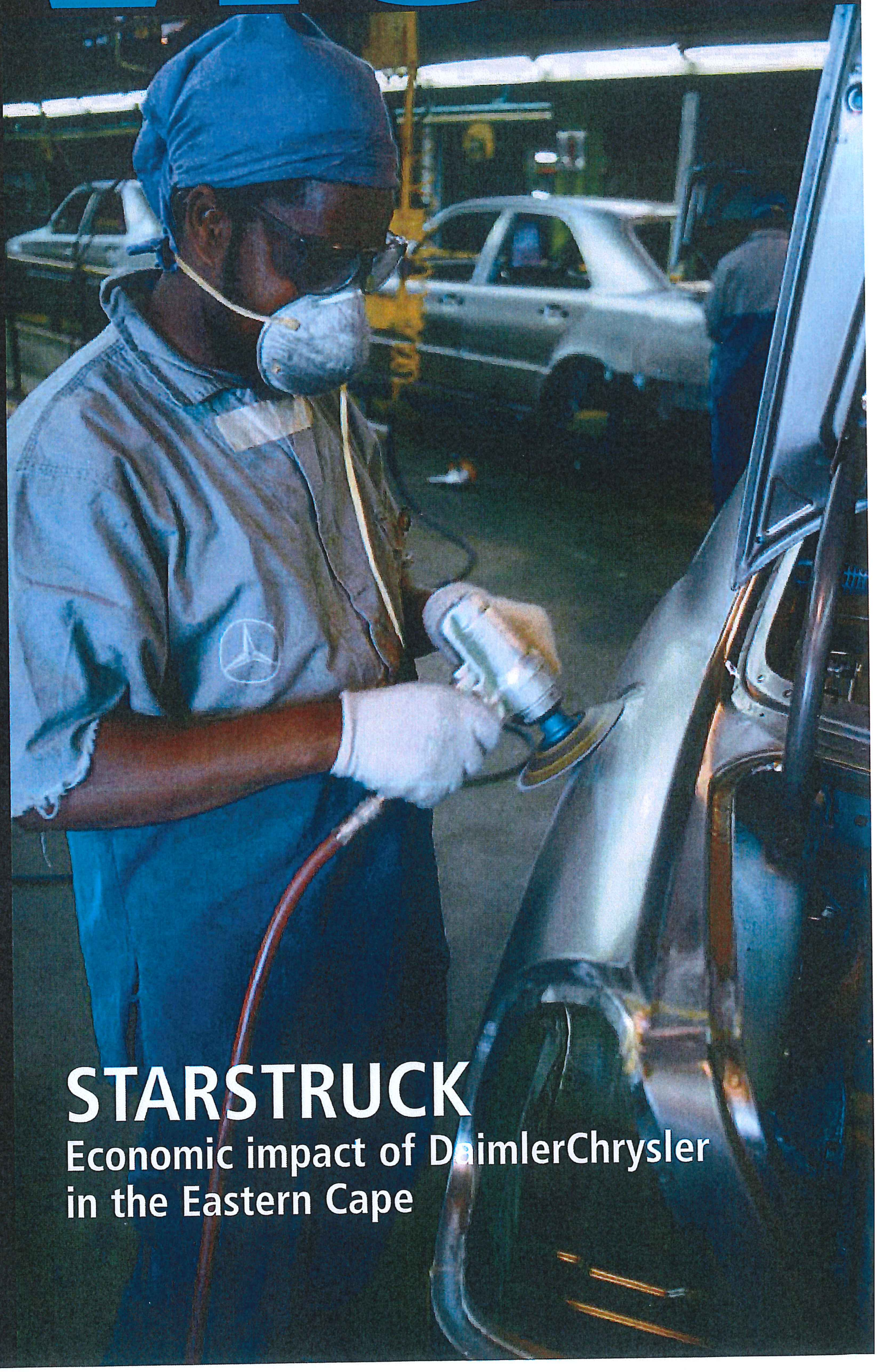

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