THE TRANSNET MARKET DEMAND STRATEGY (MDS) AND CONTRADICTIONS ARISING FROM ITS IMPLEMENTATION - IMPLICATIONS FOR GOVERNMENT POLICY

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ABSTRACT

The MDS to which Government has committed an unprecedented 300 billion Rands is central to the South African government’s New Growth Path and Industrial Policy Action Plan with expected outputs being, among others, job creation, increased national capacity to manufacture, creation and development of indigenous supply chains. Kingsburgh conducted a survey of component suppliers to one of Transnet’s divisions and investigated among other things how the MDS was perceived among suppliers. The findings revealed unexpected results. A key finding and concern is that while Transnet is building its capacity to become a manufacturer of choice for the future, it appears not to be developing its supply chain accordingly. This raises the question whether the current approach to implementing the MDS even if successful in terms of meeting quantities targeted is aligned to the spirit and intentions of Government expressed policies indicated earlier. This paper argues that that there is deviation in purpose pointing to vagueness and inadequacy in Government policy that allows possible conflicting interests. This has important implications for Government policy regarding how conflicting interests can arise from implementation of policy and how the unintended consequences need to be managed.
1 INTRODUCTION

The Market Demand Strategy is a massive and unprecedented expenditure program of R300 billion allocated to Transnet by Government as part of its National Development Plan. The aim is to spend on major national infrastructure that will create an impetus to drive economic development, while addressing unemployment, poverty and inequity.

The MDS is located within Government policy documents which include the National development plan, the New growth path, the Industrial policy framework, and the Industrial policy action plan. These policies reinforce each other, providing a set of integrated frameworks for guiding decision making from the overall vision stage to implementation stage. There is much anticipation within Government, Transnet and the public at large that much progress in the economy will be achieved through the MDS, including the much needed reduction of unemployment.

1.1 The problem

The volumes, frequencies and variety of transactions involved in implementing the MDS are significantly higher than any handled before by Transnet due to the massive resources injected by Government. Transnet is expected to grow rapidly to absorb new labour into its internal infrastructure while at the same time facilitating the creation of employment within its external infrastructure involving suppliers.

A key component of the job creation strategy with regard to suppliers is the development of local suppliers. However a recent survey by Kingsburgh [1] found that a significant number of component suppliers that were surveyed felt neglected or ‘shut out’ by Transnet with regard to the MDS. This suggests that there is a conflict between Government policy and the implementation of the MDS even though the documentation on both sides is clearly defined and harmonised, with keen oversight by Government, there is a possible grey area that needs to be investigated. This has implications for Government policy regarding areas that should inform its implementation particularly if it is a massively funded project such as the MDS.

2 LITERATURE REVIEW

2.1 The economy and employment imperative

The South African (SA) economy is the largest in Africa with a GDP of around $384.3 billion in 2012 [2] and a total estimated population of about 53 million people in 2013 [3]. However, its estimated GDP growth in 2013 was low at 1.9%, having declined from 3.5% in 2011 and 2.5% in 2012 [2]. This was sluggish growth compared to an average GDP growth of 5% in the period 2003 to 2008 [4]. During this period the population growth averaged about 1.2% in the ten years from 2002 to 2012 [2]. Meanwhile, unemployment increased from 23.5% in 2008 to 25.2% in 2009 and remained largely at that level for the subsequent four years to 2013 [5]. Unemployment has been relatively high for several years, in spite of Government interventions to bring it down and this is of great concern to Government [4]. An unemployment rate of 25% is high compared with data of other upper middle- income countries in which South Africa is categorized [2].

Referring to the status of the economy in his budget speech, the Finance Minister reported that the World financial crisis of 2009 affected the economy of SA from which it is still recovering. It led to a collapse in commodity prices, sharp declines in international trade and a crisis in financial markets, during which the SA economy contracted by 1.5 per cent in 2009 and nearly a million jobs were lost [4]. Against this background SA needs to grow at a rate between 4% and 7% per annum so as to employ an additional 5,000,000 people by 2020 [6] or 11,000,000 people by 2030 in order to lower the unemployment figures to 14% by 2020 and to 6% by 2030 [7].
According to the Minister of Finance great effort has already been made by Government through its budget expenditure to create jobs, “Government has spent more than R100 billion on employment programs over the past five years, including municipal and provincial spending. More than 4 million job opportunities were funded over this time. Allocations will continue to grow strongly and 6 million job opportunities will be created over the next five years” [4]. Among the projects mentioned by the minister include public works programs in which Government has invested billions of Rands in order to provide employment to more South Africans.

The drive to economic growth and job creation was given impetus by research done by Government and provided in a guideline document [8]. The recommendation given was that the growth rate needed to achieve the country’s social objectives was around 5% on average between 2004 and 2014. A realistic assessment of the capabilities of the economy and the international environment, two-target phases were set. In the first phase, between 2005 and 2009, an annual average growth rate of 4.5% or higher was sought. In the second phase, between 2010 and 2014, an average growth rate of at least 6% of gross domestic product (GDP) was sought. In addition to these growth rates was the need to meet social objectives. All these required new businesses to proliferate and expand and improving opportunities for creating more labour absorbing activities [8].

2.2 Relevant Government Policy

The SA Government has enacted policies to deal with the challenges of unemployment through industrialization, which is a vehicle used by nations to achieve economic development while at the same time resolving the challenges of unemployment [9, 10]. Unemployment is a key consideration for Governments and a major challenge to both developed and developing nations [11]. Generally an economy should be able to absorb labour. In South Africa, the ‘New Growth Path’ framework and the ‘Industrial Policy Action Plan’ framework have been instituted to tackle the challenges of unemployment and industrialization respectively. Both being part of an integrated set of frameworks that derive from a broader, more encompassing national plan document called the ‘National Development Plan’.

2.2.1 The National Development Plan (NDP)

In November 2011 the SA Government proposed a vision for the country, and its long-term plan for the next twenty years is declared in ‘the National Development Plan (NDP)’ document, stipulating the nature of the ideal state to be achieved by 2030 [12]. The overriding theme is the elimination of poverty and inequality. It states that “poverty is still pervasive … millions of people remain unemployed … many of these are young people … it is important to understand why these problems persist and to fix them … we require urgent measures to address our most pressing needs, particularly high levels of unemployment, especially among the youth” [12]. The creation of employment is therefore given a very high priority in the Government’s list of priorities. The document further says with regard to poverty and inequality that the elimination of these two aspects should be “the guiding objectives of the national plan over the next 20 years. All elements of the plan must demonstrate their effect on these two goals” [12], and the national plan makes reference to the growth and development plan of Government. While launching the NDP implementation, Minister Trevor Manuel said “The main change we seek is an economy that is more labour absorbing. We need to create more jobs, and make progress in broadening ownership of the economy” [13]. The report of the National Planning commission states that one of the key challenges to eliminating poverty and reduction of inequality is that “too few South Africans work” [14]. President Zuma in handing over the NDP to parliament says of unemployment “Given our struggle against unemployment, a scourge that renders many...
families restless and in distress, we are encouraged by the long-term employment creation proposals, which are in line with our New Growth Path framework ... we believe that it is an achievable goal if we ... enable (the economy) ... perform in a manner that will enable growth and job creation" [15]. From the NDP document and comments made by the President and Minister responsible, it is clear that employment is a key issue for Government policy. It can be ascertained therefore that the 'spirit' of Government as discerned from speeches of top Government officials and the primary national plan document, is to effectively create employment, in the short term, medium term and long term.

2.2.2 The New Growth Path (NGP)

Government adopted the NGP as the framework for economic policy and the driver of the country’s jobs strategy [16] and in his address at an anniversary of the governing political party President Zuma reiterated the commitment of Government to “identify areas where employment creation is possible on a large scale ...”[17]. The president also promised the youth that Government would work to create opportunities for jobs in general that includes them [18]. The policy framework dealing directly with creating employment is the NGP.

The NGP [19] identifies the key drivers in Government policy to be the creating of jobs, the reduction of inequality and the alleviation of poverty. It can be assumed that the creation of jobs helps address the problem of poverty and to some extent inequality. In this paper, creation of jobs is therefore the main component discussed.

The NGP proposes strategies to strengthen the domestic and international market segment by growing employment, increasing incomes and undertaking other measures to improve equity and income distribution. It says, “if we can grow employment by five million jobs by 2020 (around three million more than the anticipated growth if we extrapolated from 2002 to 2009), over half of all working-age South Africans would have paid employment and narrow unemployment would drop by 10 percentage points from 25% currently to around 15%” [19].

According to the NGP document, two key variables that affect the target of five million new jobs are the rate of economic growth and the employment intensity of that growth (or rate of growth in employment relative to the rate of growth in GDP). It urges for maximising growth and ensuring that it generates more employment, mostly in the private sector in order to reach the national employment target. The NGP framework recommends targets for the employment intensity of growth and for the rate of growth in GDP [19].

The NGP document identifies two key job drivers as (i) substantial public investment in infrastructure to create employment (including manufacturing the required inputs) and (ii) targeting more labour-absorbing activities across the main economic sectors (including manufacturing and services). The document also identifies priority areas it will promote such as enterprise development through promoting small business and entrepreneurship.

The NGP document assures that Government’s medium term expenditure framework (MTEF) and annual budget are to be guided by the need to support the NGP through appropriate spending on infrastructure, skills, rural development and economic programs. Local and provincial governments are to undertake similar work, all which involve considerable resources [19].

In the NGP document, a targeted number of jobs per year is indicated for various sectors including places of potential employment. Some of these are 250,000 jobs a year in infrastructure and housing through 2015 (including manufacturing of inputs for the anticipated infrastructural and housing projects), and anticipated interventions include “stronger local procurement to maximise the economic multiplier” [19]; 350,000 manufacturing jobs projected in IPAP2. The main drivers are given as the need to “focus on sectors that can generate
employment on a large scale and meet basic needs at lower cost in short to medium term, while sustaining development of more knowledge intensive industries for long-run growth” [19].

The NGP therefore provides a broad guideline on strategies to adopt, identifies priority areas to focus Government programs and recommends broad actions required to create employment through Government intervention at a national level. The NGP also indicates the active role that IPAP provides as a driver in creating jobs in the manufacturing sector.

2.2.3 Industrial Policy Action plan (IPAP)

The Industrial Policy Action Plan gives detailed key actions and time frames for implementation of the Industrial Policy. The National industrial policy framework (NIPF) gives a vision for South Africa’s industrialization route, which include facilitating diversification beyond the current reliance on traditional commodities, long-term intensification of South Africa’s industrial processes towards a knowledge economy and promotion of a more labour-absorbing industrialization path with a particular emphasis on tradable labour-absorbing goods and services. Tradable goods and services refer to exportable and import competing goods and services. Other goals of the NIPF include, promotion of a broader-based industrial path involving people from previously disadvantaged groups and contributing to industrial development on the African continent. [20].

The IPAP has three main components, namely: range of Sectoral actions, cross cutting actions of importance to industrial policy and measures to improve Government organization and Industrial policy. All the three components aim to give effect for implementation of the Industrial Policy. Hence IPAP aims to promote long term industrialization and diversification beyond the traditional commodities, expanding production in value-added sectors with high employment and growth opportunities [21]. This paper considers the possibility that the high employment drive through expanding production in value-added activities might contradict with the growth drive of organizations.

2.3 What is the procurement policy of Transnet?

Transnet is a fully owned Government parastatal and therefore its procurement policy is fully guided by that of the Government policy. The Department of Public Enterprises (DPE) has the responsibility to oversee all state owned enterprises or corporations (SOC), including Transnet, therefore Government policies originating from NDP and translated in the NGP and the IPAP are applicable to Transnet. To implement the policies of Government, the Department of Public Enterprises instituted the Competitiveness Supplier Development Programme (CSDP) as a guideline to be followed by all State owned enterprises with regard to developing their internal procurement policies. The CSDP requires that preference is given to local suppliers during procurement of goods or services provided they are adequately competent. This is aimed at increasing economic growth through improving national supplier industry competitiveness. According to DPE, this concept was supported by research which indicated that “a modest increase in the contribution of national industry (read: local suppliers) to the capex program will result in a large increase in the contribution of the capex programme to economic growth” [22]. It is therefore a guideline that state-owned enterprises are required to translate into their own procurement policies.

Transnet developed its internal procurement policy, the ‘Transnet Supply chain policy’ approved September 2013, that is aligned to the CSDP. Under this policy section 14 defines and addresses “Supplier Development (SD)” saying: “SD is an initiative of the Department of public enterprises supported by Transnet. The aim of the SD is to increase the competitiveness, capability and capacity of the SA supply base where there are comparative advantages and
potential for local or regional supply. This can be achieved through skills transfer, as well as building new capability and capacity in the South African supply base. In addition, the SD has its roots grounded firmly around the transformation of South Africa and the empowerment of previously disadvantaged individuals and enterprises” [23].

In a review of the overall implementation of local procurement via the IPAP, it is reported that significant progress has been registered with respect to localization and supplier development programs of some SOCs; most notably, Transnet, Eskom and PRASA. However, a significant proportion of Government procurement is still conducted on an ad hoc rather than a strategic basis and does not deliver adequately on either value for money, economies of scale or key industrial policy objectives. The report concludes that there is thus a need to develop a framework for a purchasing strategy that will directly address these policy issues [21].

This paper argues that in an important respect, aspects of the implementation of the Transnet procurement practice with regard to the MDS is not properly supporting the intended Government spirit with regard to supplier development and therefore not maximizing employment as intended.

2.4 The Transnet Marketing Demand Strategy (MDS)

The Transnet MDS was launched in April 2012, to spend R300 billion on capital projects for the next seven year period. This is in line with Government strategy to spend on infrastructural projects that increase economic growth and increase employment as stipulated in the New Growth Path. Up to 588,000 new jobs created in the South African economy are envisaged in the next seven years of which an additional 15,000 are direct jobs into Transnet including contractors [24].

3 DISCUSSION

Given the various policy documents by Government, how does Transnet envisage achieving the objectives of NGP and CSDP through the MDS? This is clearly laid out in the documents available in the public domain on the MDS e.g. [24]. However it is instructive that a different perspective emerges when some suppliers to Transnet were surveyed and information regarding their experience with the MDS was obtained as indicated below.

An independent survey conducted by Kingsburgh [1] on the manufacturing strategy of component suppliers to Transnet, covering 30 suppliers, reported that 43% of the firms were not aware of the MDS and only 27% had communicated formally with Transnet regarding the MDS. Many felt alienated or ‘shut out’ by Transnet. This is a significantly high percentage, from the sample taken, that are not in touch with Transnet’s plans for inclusion in its supplier development program. Given the lack of contact and involvement, this paper assumes that the suppliers not formally communicated to by Transnet have been excluded from Transnet’s SD program. This apparent action by Transnet seems to contradict the spirit and intent of Government that desires to develop local supplier capacity. On the other hand, it is known that Transnet is developing its own internal capacity and capabilities [25] however it is possible that in its effort to grow internal capability Transnet may have developed an internally motivated agenda such as supplying the same components that it has been sourcing from local suppliers. This then fits with the observation indicated in Kingsburgh’s survey that Transnet appears to be relaxing on its supplier development [1] while it appears to be deepening its own manufacturing capability. Meanwhile, there are reports that component suppliers to Transnet are investing more in capacity in order to meet anticipated increased demand but nevertheless remain uncertain whether they will win contracts with Transnet [26]. The survey by Kingsburgh [1]
corroborates the view that local component suppliers are fairly uncertain of doing future business with Transnet and are unclear of what is going on regarding the MDS.

A question then arises, whether the MDS in particular and Government projects of this magnitude in general provide leeway for the SOC involved at this level of investment to take advantage of the situation and promote its company-specific interests.

The paper postulates that this is the case, particularly when the drive to develop internal capability is at variance with that of developing capability through suppliers (external capability), that the company will choose a path promoting its best interests. This can happen when the SOC realises that developing its internal capabilities reduces its transactional costs [27] compared to buying the same services in the market (suppliers). The economic considerations for the organization then become more important than other considerations, and decisions are made ‘in the best interest of the firm’.

The paper argues that due to mega-investments (R300 billion) into the SOC and a broad mandate given to management, the possibility of building its own internal capabilities (through training, research, resources acquisition and others) has been discerned or reached and having the mandate to do so yet also developing suppliers, the SOC has reached a point where it has to make the most suitable economic decisions for the organization. This paper proposes that based on Economic theory [27], faced with this option the company will make decisions based on ‘its best interests’ such as taking preference for ownership and control of skills, reducing costs of production, and reducing related transactional costs.

4 CONCLUSION

A key issue for Government is to create maximum possible employment in order to fulfil its promise made to the nation that it will reduce unemployment. In order to do this Government has committed large funds to be expended on infrastructural development both in the public domain and its SOCs such as Transnet, expecting that there will be spin-offs through permanent employment, skills development and supplier development, among several others. Transnet was allocated R300 billion with this plan to create jobs in mind, among other considerations. Through specific policies and guidelines, an important vehicle to fulfilling this mandate is the development of local suppliers through preferential procurement of goods and services. Through suppliers, additional people are employed directly or indirectly, leading to an even wider network of activities that also create jobs, and hence a multiplier effect of employment is achieved.

Nevertheless there appears to be a contradiction in implementation of the MDS as some suppliers have indicated signs of alienation by Transnet. One possible explanation is that Transnet is developing parallel capabilities that local suppliers could offer, and in the process is crowding out some suppliers. Since the mandate to build its capabilities is also given to Transnet this paper believes that the management of Transnet is encountering decision concerning the transactional costs due to growth of the company and associated increase in transactions in the market place. Williamson [27] predicted that increased transactions lead to decisions by management to control them, such as by favouring the development of internal capabilities compared to transacting in the market place such as through suppliers.

This paper argues that during implementation of the MDS aspects of it are deviating from the original spirit and intention of Government in the way it was envisaged to be the vehicle for creating a maximum number of jobs. Through the massive allocation of public funds towards capital expenditure, Transnet has grown rapidly while retaining its autonomy in making operational and tactical decisions, and has grown to the point where its increased transactions require management to make decisions that make economic sense in the best interest of the
organization. Such decisions may act against the interests of Government which desires to fulfil its promises.

The implication for Government policy is that massive injection of funds into SOCs can lead to contradicting interests between Government (the provider) and the semi-autonomous corporation (the implementer). Grey areas can arise that provide management of the SOC with flexibility to make decisions which may in the long run give strategic impact. Government needs to recognize these grey areas, study them carefully and provide guidance with appropriate monitoring and evaluation instruments.

5 REFERENCES


