AUTOMOTIVE NOW

Issue 2/2014

Heavy load
What Western truck manufacturers have to deal with in Asia

Cape of declining hope
Why automotive manufacturers are considering pulling out of South Africa

Seeing the bigger picture is crucial
Why customers are frequently dissatisfied with the service from dealerships

KPMG
cutting through complexity

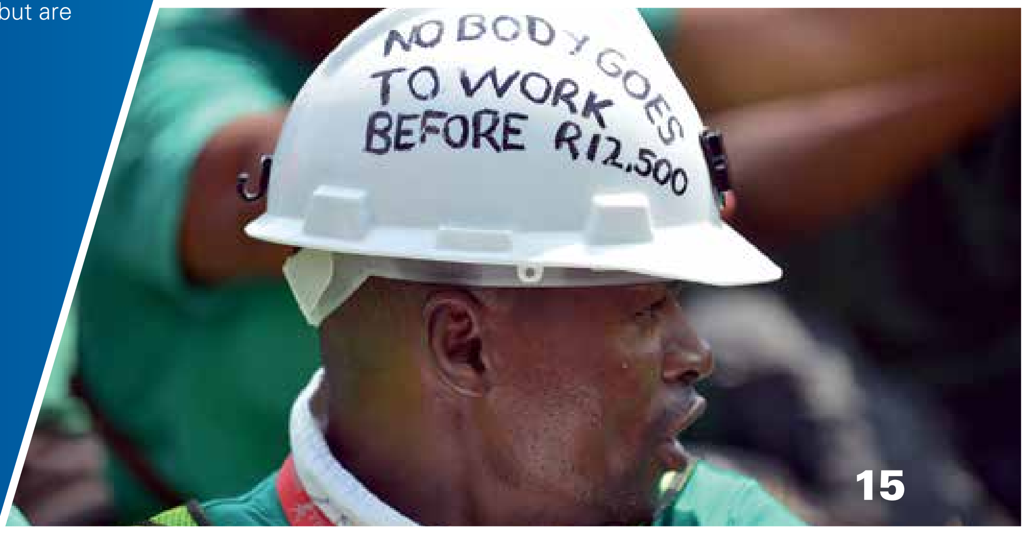
Competition between East and West

It seems paradoxical: While the Chinese market ensures the very survival of European premium automobile manufacturers, trucks from renowned Western producers don t stand a chance in most parts of the "Middle Kingdom". Their market share is a mere six percent. In India, local truck providers also dominate the market, occupying more than 90 percent. However, one thing is clear: Commercial vehicle manufacturers that do not have a viable strategy for the booming emerging economies, may not survive without partners in the long term.

Experts predict 40 percent growth in road traffic due to international trade by 2050, resulting in increased demands on infrastructure and supply chain management. In addition, the introduction of higher security standards and emissions controls could provide a competitive advantage over local producers. Thus, there are certainly opportunities for Western manufacturers – they just need to be smart in exploiting them.

There has been no shortage of attempts to establish a presence in these countries, but all those who have dared to try have initially suffered heavy losses. Yet despite it being an expensive lesson, the findings remain; without the careful adaptation of products to the target market involved and a high degree of localization, the enterprise could fail. Those who want to keep pace must develop robust, easily maintainable products. However, most importantly, price counts more than any nice-to-have features that may match Western standards but are expensive and prone to fail.

Dieter Becker
Partner,
Global Head of
Automotive
KPMG International



Contents

04 Title story: Local strengths
In emerging markets competition is fierce for Western truck manufacturers. This is why more and more of them are choosing to cooperate with local brands and to offer simpler models. Is this the right way to go?

10 Business partners: "Things are happening in the follower markets"
Daimler has developed trucks under the "BharatBenz" brand especially for the Indian market. Daimler manager Marc Llistosella, who was involved in the development of the concept, talks about the new strategy.

12 Know-how: New humility
The monitoring of compliance processes has increased greatly in China. Western companies should bear this in mind in order to prepare themselves for these changes.

15 Country focus: Cape of declining hope
South Africa has a long history of car manufacturing. Yet due to rising wages and the unpredictability of trade unions, some manufacturers are now considering withdrawing.

18 Best practice: Seeing the bigger picture is crucial
In the majority of car dealerships the walls dividing sales and aftersales have still not fallen and thus customer satisfaction is suffering.

21 Expertise: At the precipice
Despite the currently positive situation, European automotive suppliers should not become complacent. Things could get very tight for many companies in the next crisis.

23 Exit lane: Minibus armada
Social life in South Africa could collapse without the country's 250,000 shared taxis. However, it's a tough business and the death toll is high.

Photos: B. Krishnamurthy/Picture Press; mauritius images/Alamy; Getty Images; KPMG

Masthead

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KPMG AG Wirtschaftsprüfungsgesellschaft
Klingelhöferstraße 18
D-10785 Berlin

KPMG Editor and project manager
Dominik Staiger
T +49 89 9282 6190
dstaiger@kpmg.com

Editing, design and production
corps. Corporate Publishing Services GmbH
Kasernenstraße 69
D-40213 Düsseldorf
T +49 211 54227-0
info@corps-verlag.de

Editor-in-chief: Florian Flicke

Editorial board: Mirko Hackmann

corps project manager: Simon Flohr

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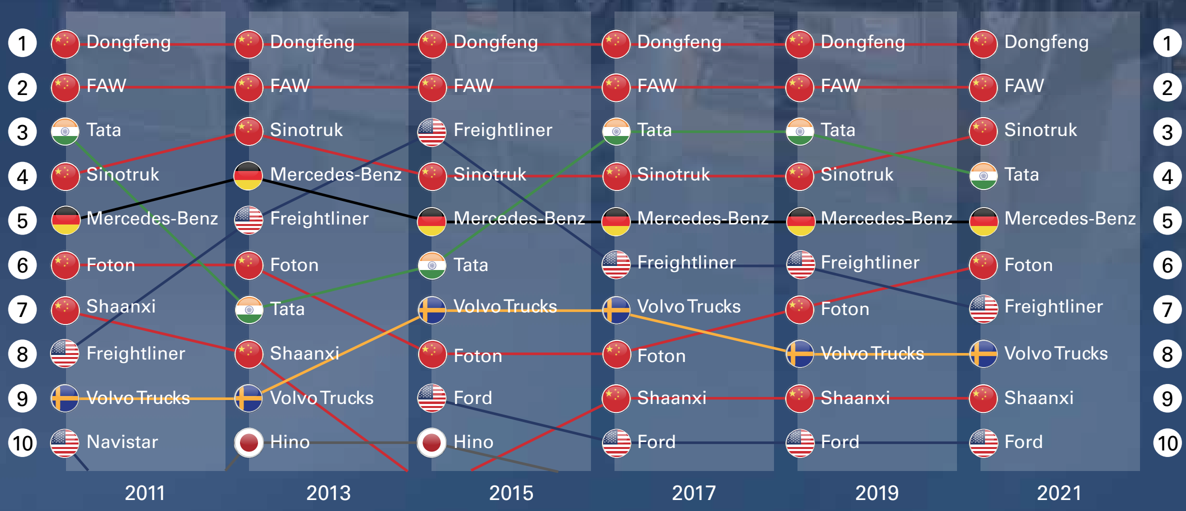
Local strengths

The commercial vehicle market is growing, especially in emerging markets. In these regions, Western manufacturers face tough competition from local firms, which have tailored their sturdy and inexpensive trucks to suit the needs of the Chinese and Indian markets and are now also successfully selling their products into Africa and the Middle East. The only way for Western competitors to compete is to use local brands and simple models. **Text: David Selbach**

Top 10: Sales ranking of the best-selling truck brands worldwide



Source: KPMG Competence Centre Automotive, LMC

China in the lead: Global ranking of the top 10 commercial vehicle brands in the medium and heavy duty truck segment (> 6 tons).

Tailor made for the Indian market: Daimler has been producing trucks under the BharatBenz brand name at a plant in Oragadam since the end of 2012, based on the Mercedes Benz Axor platform and adapted to Indian requirements and road conditions.

Photo: Bharat Benz

Western truck manufacturers have been trying in vain to crack the Indian market for a long time. Until a few years ago, Daimler, Volvo and MAN suffered the same fate as US auto motive group Ford in the 1980s, which, fol lowing an unsuccessful market entry, was forced to admit that its trucks were too expensive and not tough enough for the Indian subcontinent. The roads in India are narrow and full of potholes and trucks are chronically overloaded. The one man haulage firms, which are common in the country, either do not want or cannot afford a Mercedes Actros, MAN TGS or Volvo FMX. These vehicles, devel oped in the West are easily damaged in the harsh environ ment of everyday Indian logistics. In addition, a truck mechanic in rural India is usually not capable of repairing these high-tech vehicles. The Indian market is dominated by domestic companies such as Tata, Ashok Leyland and Eicher. Together they accounted for over 90% of sales in 2013, with vehicles that are indeed nowhere near the state of the art and which lag behind the West by one or two decades. That said, they are considered extremely sturdy and are easy to repair. Above all, Indian trucks are unbeatably cheap.

However, the situation is changing, abeit slowly. The German Daimler Group has recognized the problem and is testing a new strategy in India (see the interview on page 10 with Daimler manager Marc Llistosella): Since September 2012, the Germans have been building trucks that are tailor-made for the Indian market under the brand name BharatBenz at a plant in Oragadam, near Chennai ("Bharat" means

On the way to the top of the world: The Manali-Leh Highway in the Himalayas rises to a height of over 5,000 meters and places great demands on trucks.

"India" in the national language). The vehicles use the same platform as the Mercedes Axor and the Canter, manufactured by Daimler subsidiary Mitsubishi Fuso. However, there are no complicated electronics such as Emergency Brake Assist or driver alert systems. The springs have to be harder to deal with poor road conditions and the usually heavy loads. The control units are specially sealed due to water often gets into the engine compartment during the monsoon season. The roofs are reinforced because Indian drivers often secure luggage on top of the cab. The batteries have anti-theft protection and the fuel tanks are easy to replace. In fact Indians like to retrofit extra-large tanks. "It is a successful synergy of Indian engineering know-how and German DNA," says Erich Nesselhauf, CEO of Daimler India Commercial, describing the BharatBenz. "You can only succeed in this market by offering local products." BharatBenz is now one of the top five brands in the Indian market. It is true that the Daimler subsidiary is currently facing sales problems, just like all the other truck manufacturers in India. Demand in the country is weakening; companies are putting off capital investments because of galloping inflation. However, in the long term, India remains a growth market for truck manufacturers. Current market analyses of the KPMG Competence Center Automotive indicate that by 2020, every tenth commercial vehicle could be sold in India. The Chinese market will also expand dynamically, accounting for considerably more than a third of the global truck market by 2020. In contrast, European sales are limping along. In order to be successful in the long term, manufacturers have to deal with China, India and other emerging markets.

Freight volumes are continuing to grow

There can be no doubt that commercial vehicles will remain the backbone of modern economies for the foreseeable future. "Road transport due to international trade will increase 40 percent by 2050," forecasts José Viegas, General Secretary of the International Transport Forum in Paris, an OECD think tank. "Freight volumes are rising worldwide and all of these goods have to be transported from the ports to their final destination – which almost always happens by truck." Growth is particularly dynamic in China, according to Viegas, because factories are being relocated further and further inland. With a rising standard of living in emerging markets, towns and cities are also growing and more and more goods have to be transported to these conurbations. "This requirement will be primarily fulfilled by trucks," says Viegas. Up to now, no alternative has been in sight.

However, road conditions, habits and willingness to pay differ in every country. There is currently no prospect of a "world truck" that would appeal to customers in China, India and Malaysia just as much as in the USA, Europe and Japan. The logistics in emerging markets are more complex than in Europe, states Barbara Lenz, Head of the Institute of Transport Research at the German Air and Space Travel Center (Deutsches Luft- und Raumfahrtzentrum - DLR) in Berlin. While in the West multimodal transport chains are the norm, standard containers are in widespread use, and the number of empty journeys has been markedly reduced thanks to modern planning tools. In developing economies, infrastructure and supply chain management still leave a lot to be desired. Con-

Photos: Colourbox.com; Getty Images

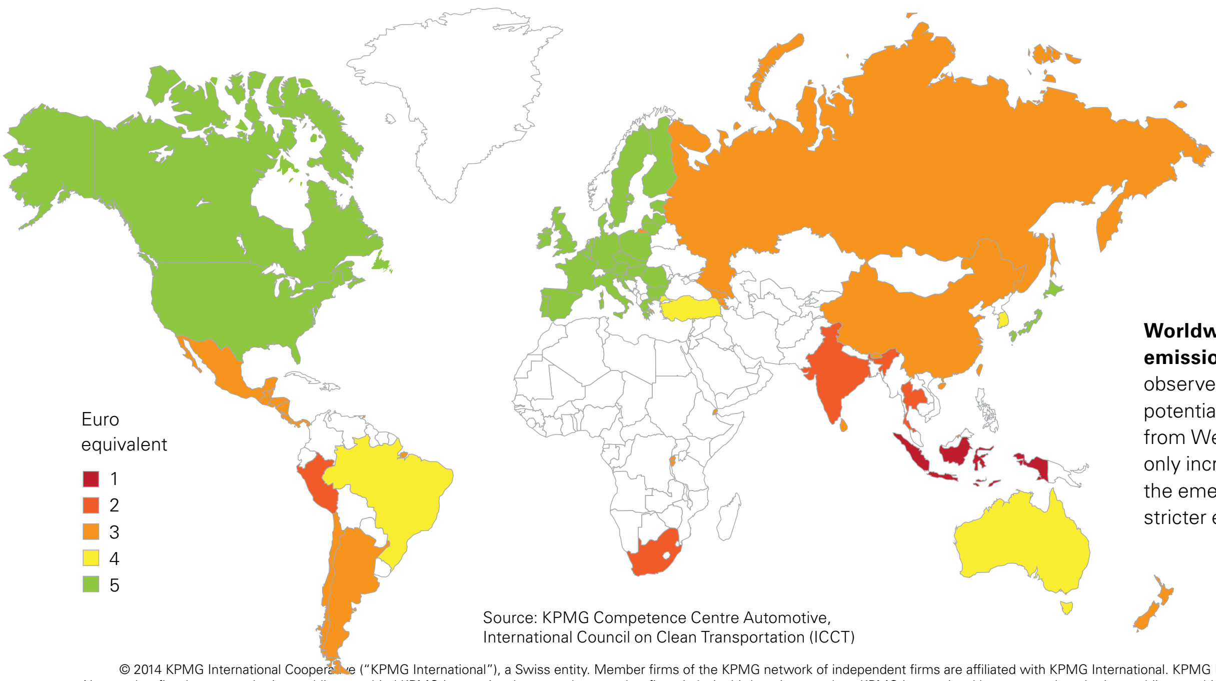
tainers are rarely used in India, and the same applies to China.

"Most trucks carry loose or bulk goods so they are often overloaded," says Siva Sriraman, Professor of Transport Economics at the University of Mumbai. In addition, there are country-specific peculiarities, such as those in India. Thanks to state credit subsidies, anyone who can afford 20 percent of the purchase price for a truck can get a loan, explains logistics researcher Sriraman. This is one of the reasons why sole proprietorships dominate the market, because new entrants are thronging into the haulage business, where it is relatively easy for a startup to become established. "The industry is characterized by low prices and a lack of efficiency," says Sriraman, "so the vehicles have to be inexpensive." In China, most of the trucks also belong to small entrepreneurs, says Tom Callarman, Director of the CEIBS Centre for Automotive Research based in Shanghai. Estimates range from 700,000 to a million transport companies. "Most of them have only one or two trucks," says Callarman. These owner drivers want vehicles that are profitable even with low mileage. They do not need any of the elaborate telematics or fleet management services with which Western truck manufacturers make a significant portion of their revenue. Callarman admits that the infrastructure in China has changed dramatically in the last ten years. The government of the People's Republic has built more than 100,000 kilometers of new freeway. However, this does not change the fact that heavy-duty trucks usually have to stop outside the town because the streets in the town centers are impassable to them. "From there, the goods are transferred onto smaller commercial vehicles," explains the Shanghai expert. "However, the logistics are extremely uncoordinated, empty trips tend to be the rule rather than the exception and scheduling is problematic."

Repairs made easy

If you want to be successful in selling trucks in China or other emerging markets, says Callarman, you have to be able to offer vehicles that are easy to repair – and do not depend on special authorized workshops if at all possible. The consequence of these requirements is that Chinese providers such as Dongfeng or FAW clearly dominate the market. "Given their lead it will be very difficult to catch up with them." The Indians and Chinese are undisputed

From ship to road: Container loading at the port of Qingdao. Truck freight volumes are growing particularly dynamically in China because manufacturers are relocating further and further inland.



Source: KPMG Competence Centre Automotive, International Council on Clean Transportation (ICCT)

Worldwide comparison of emissions standards: Market observers predict that the sales potential of commercial vehicles from Western manufacturers will only increase significantly in case the emerging markets impose stricter emissions regulations.

market leaders in their respective home countries and forecasts suggest that this will remain the case.

Data from the Chinese Automobile Association (CAAM) show that foreign truck brands only achieved a market share of around six percent of medium-duty commercial vehicles in 2013. For heavy-duty commercial vehicles the figure was even lower – just one percent. The major European manufacturers, such as MAN, Volvo, Scania and Mercedes, sell premium vehicles, primarily to industrialized nations, though with moderate growth rates. Consequently, from a global perspective, more trucks from Dongfeng, FAW and Sinotruk are already registered than from Mercedes-Benz or Volvo. Even in the midst of the economic crisis when production collapsed among Western manufacturers, their Chinese competitors were still enjoying positive growth rates and return on sales of up to seven percent.

Impressive developments

Most importantly, the Chinese are no longer just selling their vehicles in their own country. The FAW Group from Changchun in the northeast of the country now has production plants in Pakistan, South Africa, Russia and Iran, and is already supplying heavy-duty trucks to Southeast Asia, the Middle East and Eastern Europe. Dongfeng has also set its sights on both developing and emerging markets and exports its trucks to Southeast Asia and the Middle East.

The China National Heavy-Duty Truck Group (Sinotruk), whose first Chinese-developed truck came off the production line in 1960, recently concluded a cooperative agreement with the Dangote Group based in Nigeria. From 2015, the joint venture will build Sinotruk vehicles in West Africa. Initial plans are to produce 5,000 vehicles per year. The Chinese appear extremely self-confident: "Sinotruk's overseas activities have attracted the attention of international truck heavyweights," explained Ma Chunji, Chairman of the Chinese commercial vehicle manufacturer, some years ago. "This shows that the developments we have made are making an impression."

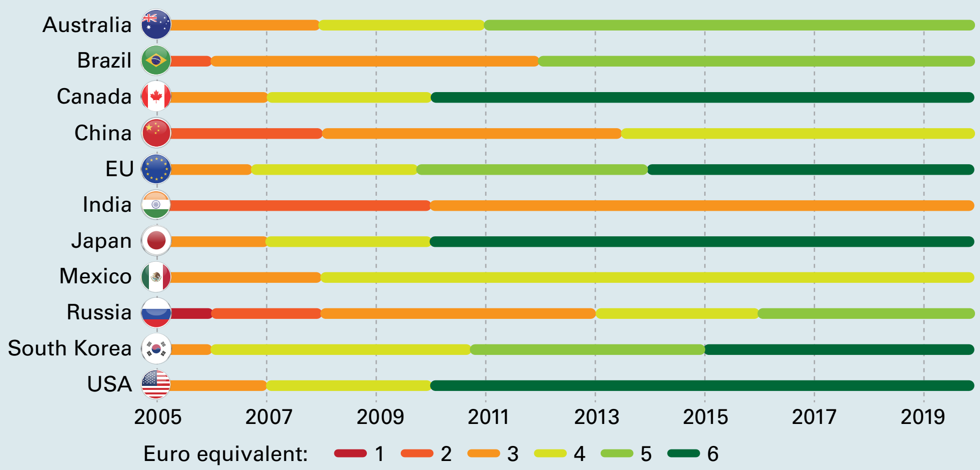
Great hopes for Africa

Similar sounds are coming out of FAW. The company grew by 20 percent in 2013 alone, explains CEO Ji Quingchun proudly. "This makes us one of several manufacturers with growth rates considerably above the industry average." Just a few years ago he had plans to export to Europe in the medium term. However, concentrating on the medium- and low-price segments in China and other emerging markets proved to be a much more promising strategy. Even Indian manufacturers are active in other emerging economies. For example, according to its own information, Ashok Ley-

Long march: Tanker truck on a road in the autonomous region of Xinjiang. The Chinese government has built more than 100,000 kilometers of new freeway.

Photos: mauritius images / Photononstop; CEIBS

Emission limits as an advantage and a disadvantage – a barrier to entry in both directions?



Precisely because of the comparatively lax emissions standards in the emerging markets, local truck manufacturers are currently more than competitive in their domestic markets when compared to established manufacturers. The latter are capable of achieving remarkably low emissions figures thanks to their highly developed technologies. However, because of the necessarily higher purchase costs, they are in most cases unaffordable for the typical emerging market customer. Conversely, strict emissions standards have a positive effect for established manufacturers in their domestic markets, as they protect the top dogs from competition from the Far East.

Source: KPMG Competence Centre Automotive, International Council on Clean Transportation (ICCT)

land exports to more than 30 countries worldwide; it considers itself well established above all in Sri Lanka and Bangladesh, as well as in the Middle East. Rajive Saharia, Executive Marketing Director of Ashok Leyland, expects new stimuli resulting from international expansion over the next few years. "Growth is coming from new markets such as Africa, the ASEAN states, the CIS and Russia." Ashok Leyland has set its sights on catching up with the world's 10 biggest truck manufacturers. In 2013, the Indians were already ranked among the world's top 20 in terms of the number of new vehicle registrations.

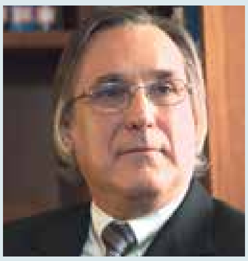
Emissions standards define the game

Vehicles such as the "Kingrun" from Dongfeng or Ashok Leyland's "Boss" model are currently in the lead in the markets with the highest growth rates. Stricter emissions standards will stimulate growth in the mid-range segment. The requirement is for vehicles that, on the one hand, are sturdy and simple enough to survive in price-sensitive markets and, on the other, can meet the rising emissions and safety standards that are increasingly demanded in these countries.

"China is adopting European emissions limits," confirms CEIBS researcher Tom Callarman. However, it is by no means that easy to comply with them, in his opinion, because the quality of Diesel fuel in China is far worse than in the USA or in Europe. Therefore, trucks would not only have to be capable of running on lower-quality fuel but also of doing so economically and with low emissions. This is where Indian and Chinese manufacturers reach their limits. It is also one of the reasons why FAW has recently been offering natural-gas-powered vehicles.

However, this will remain a niche product at best because of the lack of infrastructure. The Daimler Group has also been producing trucks in China specifically for the domestic market, with the Chinese manufacturer Beiqi Foton. The heavy-duty "Auman" trucks are built in a plant in Huairou, a suburb of Beijing. According to Daimler, the joint venture sold around 103,000 trucks in the first full financial year. The intention is for Auman to gradually adopt Daimler's advanced technology. According to press reports, Auman trucks will soon be able to meet the Euro V emissions standard, giving them a clear competitive advantage over local manufacturers.

In India, new heavy-duty commercial vehicles are now meeting emissions standards comparable to Euro III; China has already reached Euro IV level. However, experts expect that the opportunities for Western manufacturers will not improve significantly until emerging markets issue even stricter emissions regulations.



"China is adopting European emissions limits."

Tom Callarman, Director of the CEIBS Center for Automotive Research

"Things are happening in the follower markets"

Since 2012, the German Daimler Group has been manufacturing sturdy, simple truck models in India for the emerging markets under the brand name "BharatBenz". However, it is true that the concept has not yet achieved final breakthrough on the subcontinent. Yet BharatBenz is one of the top five brands in the Indian market. Daimler manager Marc Llistosella talks about the special elements of the strategy. **Interview: David Selbach**

Experts say that Western manufacturers have never been able to compete in India with local companies such as Tata or Ashok Leyland. Do you agree?
Well, one Western manufacturer was virtually the cofounder of the Indian truck market. The first truck produced in India was a Mercedes-Benz in 1954. It was built and sold in cooperation with Tata, under the name Tata-Benz. But it's also true that the truck market has been dominated by a virtual duopoly of Tata and Ashok Leyland for the last 40 years. In some of the northern Indian states, Tata currently holds a 90-percent share of the market. There has been some movement in the market in the last few years.

What are the reasons why foreign brands fail?
That's down to a lack of adaptation to the market. In most cases, the models from the international range were simply imported or assembled locally. But the Indian market has its own rules. Integrated approaches such as Total Cost of Ownership (TCO) are only just beginning to take hold and the level of discounting is high. For this reason, Indian customers primarily look at the purchase cost. Therefore, a foreign manufacturer that buys its parts at European or Japanese prices and pays high import duties doesn't have a chance. Parts made in India cost around 30 to 50 percent of the price of parts from a premium European manufacturer. And no-one is prepared to pay for Western standards such as ABS (Anti-lock Braking System), ESP (Electronic Stability Program), air-sprung seats, electronic distance sensors or Euro 6 engines. So all this has to be "developed out" of the vehicle, or "de-contented". Then there is the unsafe condition of some of the roads and the habit of overloading the trucks by up to 150%. That is asking too much of most vehicles, which have not been developed to cope with such conditions.

You decided to try again with BharatBenz in 2012. What is different this time?
Right from the outset we have been guided by the requirements of the market. In 2007, a small project team of engineers traveled throughout India in local trucks, talking to transport companies, drivers and customers to get a feel for their requirements. We then looked at our Group portfolio and considered which might be the right platform for an Indian truck. Chassis and axles were strengthened and materials were adapted to make it easier to source them locally. Finally we localized the majority of parts with Indian suppliers, which we took on board for the first time and brought up to Daimler standards. This enabled us to source 85% of the parts locally. With this concept we are in a position to offer prices that are only marginally above those of the Indian high-volume products, but with a level of quality that is otherwise only to be found in imported products.

Photo: AFP/Getty Images

MARC LLISTOSELLA is Head of Sales, Marketing & Aftersales and a member of the Executive Board at Mitsubishi Fuso Truck & Bus Cooperation (MFTBC), and in that role he is responsible for the Indian market. Previously he was at Daimler India Commercial Vehicles (DICV), initially as a project manager and later as CEO & Managing Director. He headed up the Indian truck business for Daimler from planning through to plant construction, product development and market launch and ramp-up phase, and he was also responsible for establishing the BharatBenz brand in India. MFTBC and DICV cooperate closely under the umbrella of Daimler Trucks Asia in development, production and sales for the growth markets in Asia and Africa.

Indian trucks are technically very uncomplicated so they can be repaired in any local workshop with the simplest of tools. The same does not apply for complicated Western trucks. How did you solve this problem?

We built a solid, high-quality truck with low-wear components and longer service intervals, which does not need such a high-density dealership network. Right from the outset we established a network now amounting to 73 dealership and service support centers, all equipped with standardized, modern tools and diagnostic equipment and all with the same corporate design and building layout. Nothing like this had ever existed before in the Indian commercial vehicle segment. We also developed mobile service vans capable of solving almost 70 percent of the problems that normally occur on the road, right up to an on-site engine change. With this concept, we can promise to reach our customers within four hours, wherever they are in India.

The Indian logistics industry is still very underdeveloped. To what extent have you addressed this problem with BharatBenz?

It's true that international retail chains like Walmart and Carrefour do not have a presence in India yet. Hub and spoke models, which are normal in highly developed markets, are still a rarity in India. For that reason, all-rounder models are much more common than specialized trucks such as semis or light delivery trucks. That is why we offer rigids, i.e. chassis cabs, tipper trucks for the construction and mining industries and semi-tractors. But there are also some things that we deliberately do not offer. For example, it is usual in India to sell a truck chassis without a cab, to which the customer then has a wooden cab fitted at a local body manufacturer – these are known as "cowl" trucks. This is a cheap option, but it has negative consequences in terms of safety, weight and fuel consumption.

Will you now also be developing other emerging markets, following the pattern of BharatBenz?

A separate brand and specifically tailored products only make sense in a vast market like India. Of course there are clusters of countries that have very similar requirements, therefore it makes total sense to develop products for these markets and produce them at one or more production hubs. You can do that all on your own – as we have in India – with the advantage that you are in control of the entire value-added chain. Alternatively, you can do it as part of a local joint venture, which shares the costs and acquires local know-how but which of course also increases dependency on the partner. One thing is clear: In the coming decades there will be developments in the truck business in what are known as the follower and developer markets – in India, parts of Asia, Africa and South America. A company that doesn't have a concept for this will find it difficult to survive as an international manufacturer.


The age of luxury gifts is coming to an end: Workers on scaffolding putting up a Rolex advertisement in Beijing.

New humility

The battle against corruption and infringements of competition law are the key compliance challenges facing German companies in China. The prosecution of offences has increased greatly in recent times. Western companies have to keep this in mind in order to prepare themselves for the new situation.

Text: Andreas Feege, KPMG in Germany

The shopping centers of Hong Kong, Shanghai and Beijing are still offering sparkling luxury watches, exclusive bottles of wine and gleaming fountain pens. However, for some months now, these luxury items have tended to be left untouched in the shop windows of China. The sale of expensive watches, which accounts for more than a fifth of the Chinese market for luxury items, fell by 27 percent last year. Many of these items have until now been used as gifts in business operations, and recently there has been a lack of takers for these "courtesy gifts".

Under the leadership of President Xi Jingping, the new government is acting with greater conviction than its predecessor against the rampant corruption in the country. In the first eleven months of last year, investigations were initiated in more than 27,000 cases against a total of 37,000 functionaries because of suspicion of corruption. These included high-ranking functionaries such as the Rail Minister, the Mayor of Nanjing and most recently, the security chief of Beijing. The aim is to stem the growing resentment of the population against corrupt cadres. The current publications in Western media of offshore accounts belonging to numerous prominent Chinese government officials, are particularly inopportune in this situation.

Revenue crash at premier hotels

As part of of the new state campaign with the official title "New Humility", the leadership also no longer tolerates excessive state spending in the party and government apparatus for travel, hospitality and official cars at the cost of the taxpayers. These measures have had an immediate effect. Luxury cars with military number plates are now rarely to be seen, drinks manufacturers and restaurant operators are experiencing a serious loss of revenue, and the hotel sector reported a drop in turnover of 25 percent for 2013. Many hotels are applying to be downgraded to four stars, as government employees are now forbidden to stay or eat in five-star hotels.

For that reason, the state compliance offensive is of particular relevance at the moment. This new wave of anti-corruption measures is affecting not just functionaries but also companies, and in many cases Western firms. The accusation in many investigations is that they have used corruption to gain a competitive advantage in the country. For example, it is claimed that the bribery payments of a European medical and pharmaceutical group (GSK) to hospitals, doctors and representatives of local authorities have amounted to 400 million euro over the years.

Lack of internal controls

In addition to the compliance area of corruption, competition law is also increasingly coming into the sights of wide-ranging investigations by the Chinese antitrust authority in order to exert better control over inflation and high prices for consumers. These antitrust investigations are currently targeting the medical, the technology and pharmaceutical industries, telecommunications firms, banks and automobile manufacturers. Following penalty payments already imposed on foreign manufacturers of infant formula and even LCD panels because of forbidden price-fixing, US chip giant Qualcomm now faces a fine of more than a billion dollars. The accusation leveled is the abuse of a dominant market position, along with the associated excessive

Photo: imago

Typical corruption cases in China

500 500

- Gratuities in the form of gifts or vouchers, accelerated deals (also including agents), especially for the issue of licenses and the acquisition of property rights and construction measures and approvals
- Business invitations (entertainment)
- Trips abroad to popular tourist attractions
- Requests for sponsorship
- Appointments, internships and postings of family members
- Slush funds resulting from the payment of counterfeit invoices or fictitious standing orders (for example, disguised as an insurance premium)
- Reimbursements from inflated purchase agreements
- Issuing free samples

license charges. In such a case, the authority could impose a fine of one to ten percent of annual revenue.

For the foreign observer, such investigations against Western companies could be seen as a welcome means of giving a Western competitor a black eye. From the perspective of the authorities, investigations against foreign companies are above all much easier and less complicated to perform, as the risk of uncovering a corruption case that extends far into the political sphere is lower and more calculable with foreign companies.

One major problem for compliance in general relates to the continuing lack of internal controls within companies. Management skills are generally less well developed compared to Western peers, with the result that complex management processes such as budgeting, cost calculation and risk management are frequently difficult to implement. Complex and highly developed ERP (Enterprise Resource Planning) systems with separation of duties are not yet the rule.

Predominantly local, poorly integrated ERP systems are used. In many cases, structural and procedural organization lags behind strong economic growth.

Complex personal networks

The consequences of the above are unclear communication, inadequate governance structures, the lack of a risk management system and a lack of internal auditing. It is not uncommon for discrepancies to exist between internal accounting and other financial information, in particular the tax statement. High staff turnover

Legal regulations relating to competition law (anti-monopoly law) forbid any …

… horizontal agreements
between competitors with regard to:

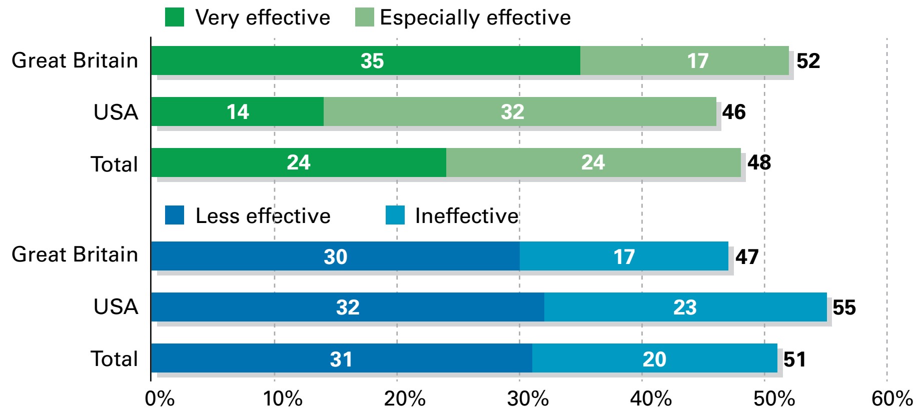
~~price and delivery~~ ⟷ ~~limitation of the offer~~ ⟷ ~~adaptation of new standards or technologies~~

… vertical agreements
between market participants in a chain with regard to:

~~the fixing of a retail price~~ ⟷ ~~price discrimination and market restrictions in the case of market dominance~~

Effectiveness of compliance audits in the fight against corruption

In the course of the Global Anti-Bribery and Corruption Survey 2011, KPMG surveyed 214 companies from the USA and Great Britain on how effective they judged compliance audits to be in stemming corruption.



Source: KPMG Global Anti-Bribery and Corruption Survey 2011

and the minimal degree of loyalty in the middle ranks frequently also lead to a lack of qualified managers. Relationships between employees in the company and with customers and suppliers are also varied and manifold. This results in complex personal networks – especially in purchasing, which traditionally has a powerful status. State business deals and public procurement play a major role. Unclear official competences and state access restrictions can also impede or restrict business activities.

Managing compliance

Assistance is provided by compliance management systems (CMS). As a result of the differing sizes and organizational forms of companies and corporate groups, these systems always have to be adapted to the individual circumstances and the relevant legislative areas of the company in question. The checking of a CMS must also be precisely tailored. It can extend from the forensic examination of an individual case, to a simple snapshot of the CMS with a gap analysis, to an effectiveness check.

As a benchmark auditing standard, IDW PS 980 includes a framework for the examination of a compliance management system by the respective auditor, which can also be applied to foreign audits. An appropriate audit report provides the company with evidence that it has fulfilled the duties of supervision, care and organization with regard to the CMS. According to the auditing standard of the Institute of Auditors (IDW PS 980), an effective CMS is comprised of eight elements: compliance culture, compliance targets, compliance risks, compliance organization, compliance program, compliance communication, and compliance monitoring and improvement.

Due to the importance of the Chinese market for many German companies, it is also well worthwhile to establish and maintain higher compliance standards in China, compared to the Chinese competition. In this way, the probability of reputation-damaging scandals, reinforced by the strong position of the social media in China, can be reduced or accusations can be more easily refuted.

The sustained commercial losses or even personal consequences for the management and supervisory staff are considerably higher than the supposed quid pro quo of a luxury watch or short-term price maximization.

Legal position

Local anti-corruption regulations: Non-compliance with country-specific regulations, for example in the event of misappropriation or acceptance of bribes, may result in penalty payments, fines, imprisonment and confiscation of assets according to locally applicable legislation. The offering of bribes may, in particularly serious cases, result in life imprisonment.

The burden of proof in investigations relating to competition law often rests with the company itself. If a company has a high market share or takes measures to restrict availability, or fixes standards or the retail price, this can be considered behavior likely to influence competition. The company's revenues are usually considered when setting the penalty.

Local employment law: A company can terminate the employment of an employee who pays or accepts bribes without notice and without payment of compensation. However, this possibility must usually be recorded in the employment contract or expressly mentioned in the employee manual. Receipt and acknowledgement of the manual must be confirmed in writing to be effective. In addition to the employee manual, training is also required. The problem is that investigations are only carried out after being reported to the police. Most companies do not take this step in order to avoid putting their own public reputation at risk.

Liability risks for board members of foreign companies: The liability of foreign executive board members can have criminal consequences. Members of the executive board, members of the supervisory boards and senior managers who in the execution of their official duties are found to be in breach of legislation (including fiduciary duties), administration standards or the articles of incorporation and have thus harmed the company, are liable to the company for damages.

The end of restraint: Striking Ford workers outside the plant in Pretoria, carrying posters demanding a wage increase.

Cape of declining hope

South Africa has a long history of car manufacturing. Following the end of apartheid, the industry has developed better than any other. However, rising wages and the unpredictability of the unions are causing some manufacturers to consider fallback plans.

Text: Wolfgang Drechsler

If you set out in search of the roots of the South African automobile industry, your travels will inevitably lead you to the province of the Eastern Cape – the home of Nelson Mandela. Between 1778 and 1878, no fewer than nine wars were fought between the white settlers and the Xhosa people. At the same time, Scottish missionaries established the first educational institutions for the African population. Thus, on the one hand, the Eastern Cape was Europeanized early on, while on the other, the combination of education and poverty created an explosive mixture which still dominates local companies to this day.

Right here, in the stronghold of African nationalism, the 1920s saw the emergence of the center of the South African car industry. Investment incentives, along with the ports of Port Elizabeth and East London, were responsible for the fact that first Ford (1923) and then General Motors (1924) built production plants in the Eastern Cape, followed shortly after the Second World War by German car manufacturers Volkswagen and Mercedes Benz. BMW and Nissan came later, establishing production facilities in the interior of the country, while Toyota based itself in the coastal city of Durban.

The choice of location may be astonishing in itself, but even more remarkable is the fact that so many car manufacturers came to the southern tip of Africa to build their own factories. After all, due to its isolation from the world's markets, South Africa is of only limited suitability as a production location. Furthermore, only a couple of years ago there were few local suppliers, which is why for a long time more than two thirds of the components had to be imported, making the manufacture of cars a very expensive business.

Unlike mass markets such as Brazil, Mexico or India, South Africa has a limited number of customers. Of its 50 million inhabitants, hardly 20 percent can currently be seen as potential car buyers. The precariousness of the situation is demonstrated by the current sales figures. In view of the high debt burden of many private households, this year's production figure of 550,000 vehicles could well be some ten percent under the forecasts at the start of the year, at best reaching the level of the previous year. However, the setback did not come as a surprise because 70 percent of all new

Photo: Getty Images

Modern production technology: A worker at the Hyundai truck assembly plant putting together a truck engine in Johannesburg's industrial district of Benoni.

cars in South Africa are purchased by private buyers.

Given the many obstacles, it is astonishing that the car industry in the Cape has developed so much more successfully than almost all of the country's other industries since the end of apartheid 20 years ago and the reintegration of South Africa into the global economy, indeed, car manufacturers have taken on a pioneering role in many regards. One reason for the success of the industry lies in the fact that the car manufacturers have encouraged some major suppliers to set up here: The Polos built by VW in the Cape are now made up of 70-percent South-African-produced parts. The higher proportion of local content has gradually reduced the once very high costs. Nevertheless, vehicle prices in the Cape are still above European levels.

In order to justify the continuing existence of their own factories in spite of the comparatively high costs and low volumes, all the car manufacturers based in the country have now fully integrated their South African subsidiaries into their international production networks. This has led to a sharp increase in the number of vehicles intended for export. 80 percent of all the cars built in South Africa today are shipped for sale abroad. The production figures, which have already risen quite considerably, are set to close to double again by 2020 to almost 1.2 million vehicles. "Yet as a result of the downturn in the global economy and the more difficult working environment in South Africa, these forecasts might well not come true," says South African economist Azar Jammine, expressing her opinion.

New hurdles for investment

Even more important for the continuing existence of the automotive industry are the subsidies granted by the South African government. More than any other factor, they seem to have induced the car manufacturers in the country to expand and modernize their factories. It is all the more astonishing that the government left it to the last minute to replace the "Motor Industry Development Program" (MIDP) - which expired at the end of 2012 - with a new program. The MIDP permitted companies that produced a lot of cars for export to import components and models not produced in the country duty-free in return.

The old program has now been replaced by the new "Automotive Production and Development Program" (APDP), which will run at least until 2020 and gives the industry a certain degree of planning security. However, the important "African Growth and Opportunity Act" (AGOA), which the USA concluded with 40 African countries in 2000 to regulate the duty-free import of African products into the USA, still hangs in the balance. North America was the South African car industry's most important sales market in 2012, with an export value of 20 billion rand (1.4 billion euro). The current program is due to end in September 2015 and will then be extended by another 15 years.

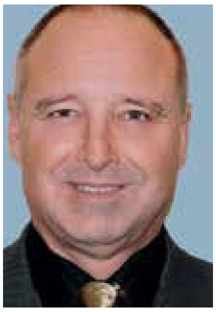
However, there can be no guarantee that this will happen, simply because South Africa has lost a lot of sympathy as a result of recent moves, including laws that erect new barriers to US investment in the Cape. The unilateral termination of bilateral investment protection agreements with European countries has also caused serious resentment. "At a time

Photos: Bloomberg Finance LP/Getty; General Motors; KPMG when costs are rising dramatically, trade relaxation can be the key factor in determining whether a location remains competitive or not," warns David Furlonger, South Africa's leading motoring journalist.

The announcement by some African states that they intend to impose trade restrictions on the import of new cars from South Africa is causing the car manufacturers at the Cape some concern. For example, Nigeria – the most populous country on the continent with 175 million inhabitants – hopes to encourage the establishment of its own car industry in this way, even though there are no local suppliers so far and all previous attempts by the automotive industry to gain a foothold in Nigeria have failed spectacularly.

However, the biggest obstacle for car manufacturers in South Africa is the trade unions: They are becoming more and more radical in the Cape, with the strikes frequently having less to do with working conditions than with general politics. Above all, the already weakened car manufacturers were noticeably shaken by the most recent strike at the automotive suppliers in July, which could become a turning point. Even Bodo Donauer, the ever conciliatory boss of BMW in South Africa, is now making more strident noises. In his view, the trade unions in the Cape have lost all sense of proportion. "Unlike before, they are now making demands that must be met straight away," says the long-time company boss, who will shortly be leaving his position. In his view, what is missing is a common goal and the recognition that success is only achieved by working together.

BMW has now responded to the confrontational course taken by Numsa, the metalworkers' union, and in view of the lack of reliability among the protagonists at the Cape, it has now announced that it will no longer expand as planned in South Africa, deciding not to proceed with the scheduled award of a new model series to the plant in Pretoria. The fact that many car manufacturers are reaching the end of their patience is also evident in the reaction by General Motors (GM): Only at the end of August, Mario Spangenberg, GM President for Africa, announced that because of the strikes his company would invest no more money until further notice and create none of the new jobs that South Africa, with an official unemployment ratio of over 25 percent, so urgently needed. "The country cannot expect large companies here to operate like charitable organizations," said Spangenberg. It currently seems as if the demands of globalization, including a flexible and reliable working environment, are in direct opposition to South Africa's rigid labor and social legislation, the aim of which is to eliminate historical inequalities in the Cape. To achieve this, the government is almost always on the side of the trade unions, with which the authorities are also politically allied. On the other hand, the companies are continually plagued with new constraints and quotas.



"The country cannot expect large companies here to operate like charitable organizations."

Mario Spangenberg,
GM President for Africa

Sub-Saharan Africa, with around 1.1 billion inhabitants, could turn into a fantastic growth market, and South Africa could be the springboard for this, according to Vincent Kobee, Head of the Datsun brand at Japanese car manufacturer Nissan. This is why the group is also considering producing cars intended for Africa from its planned entry-level model, the "Datsun Go", in the Cape. However, the management team in Japan is still hesitant. "South Africa has everything needed to become the production center for the whole of Africa," says Kobee. "However, there is a big difference between theory and practice. Only when all those involved are pulling towards the same direction and the economy gets moving again we can create the necessary ecosystem."

Gavin Maile,
Head of Africa Construction, Industrial & Automotive, KPMG in South Africa
gavin.maile@kpmg.co.za

APDP as the great hope

The automotive industry in South Africa has achieved slow but steady growth in recent years. However, in 2014, a drop in sales of between five and six percent is expected in comparison to the previous year.

This drop is mainly attributable to consumer confidence, the above-inflation increase in vehicle prices resulting from the weak exchange rate, rising unemployment figures and the upward trend in the interest rate cycle. Other important negative factors include productivity and wage costs. Strikes recently led to a halt in production – in 2013 production was at a standstill for seven weeks. Other negative factors include energy and logistics costs.

One positive factor is that production is expected to achieve an increase in volume in 2014 compared to the previous year. This is attributable to a reduced number of work stoppages. In addition, after a period of reduced activity in which the production lines were changed over to new models, some OEMs have resumed production.

One of the factors that keeps automotive manufacturers producing vehicles in South Africa is the APDP (Automotive Production and Development Program). This offers incentives to manufacturers and suppliers alike to invest in equipment and increase the level of production, thus achieving a minimum annual production of 50,000 vehicles per platform.

The South African market is dominated by imported vehicles. Over two thirds of the vehicles sold in South Africa are imported and more than half of our production is exported. The upturn in these "saturated markets" is good news for our exports.

The whole picture counts

The luxury goods industry exemplifies what is still the exception in the automotive trade: cross-departmental customer care programs covering the entire customer journey. Yet the barriers between Sales and Aftersales have still not fallen in the vast majority of car dealerships. This has serious negative consequences for customer satisfaction.

Text: Frank Theis, KPMG in Germany

Photos: dpa/Westend61/M. Brown

Let's assume that your wife reminds you that your lease agreement expires in three months, and at the same time she raves to you about the new SUV from your preferred brand. Then you remember that the multifunction display has been telling you for several days that the next service is due. Because you always like to kill two birds with one stone, you call your local dealership and ask to speak to a suitable contact in Sales. The test drive is booked in no time - after all, a lucrative follow-up deal beckons. However, for the service appointment, the sales advisor gives you the phone number of his Service colleagues.

OK, so you call the dealership again and make a workshop appointment with the service advisor. On this occasion, you also ask him straight away for an inspection report on your current vehicle because after all the date is approaching for the return of the leased car. The service advisor now refers you back to his colleagues in Sales for the inspection report. When you ask whether he might be able to set this in motion at the same time, you receive his friendly yet firm rebuff: "I'm sorry but I'm not authorized to do that." This sort of experience might make you smile in a DIY store. But at a car dealership?

Multilateral communication

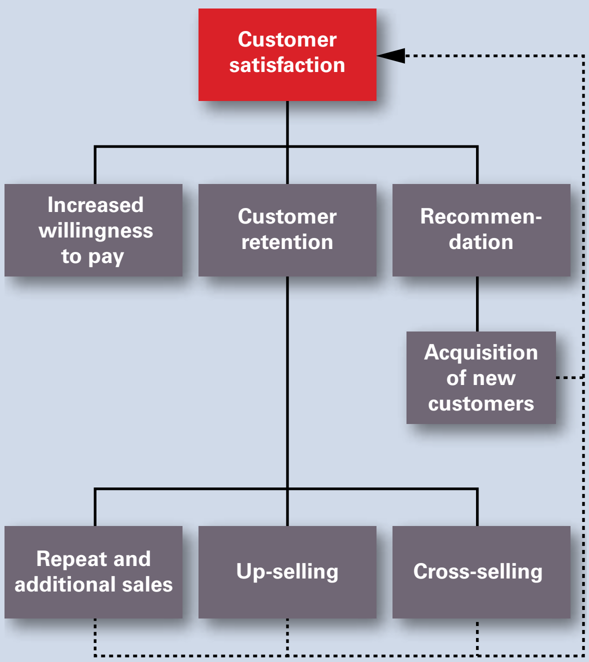
Poor service wastes time and frays nerves. Even more importantly, poor service also has an immediate negative effect on customer satisfaction. When the mood changes to one of dissatisfaction, even the most "service-oriented" company faces far-reaching negative consequences.

With a corporate communication program that is decided, planned and integrated at group level, along with extensive cross-media campaigns, many car manufacturers present their existing and potential customers with a consistent image of their products and services, raising customer expectations still further in the process. All too often, this is followed by disillusionment at the point of sale.

Consistency often has its consequences. Because car sales advisors never "had to" make service appointments in the past 20 years, they consistently decline to do so today. Why should they? Their job is to sell cars, after all. However, today's customers see things differently. The trend towards the establishment of additional sales channels and the switch from bilateral to multilateral communications now requires 360-degree support for the automobile customer throughout the entire customer journey, from the sales phase via the in-use phase through to resale.

Why good customer care pays off

Satisfied customers are more loyal than dissatisfied customers, which has numerous positive effects:



Source: Institut für Automobilwirtschaft (IFA)

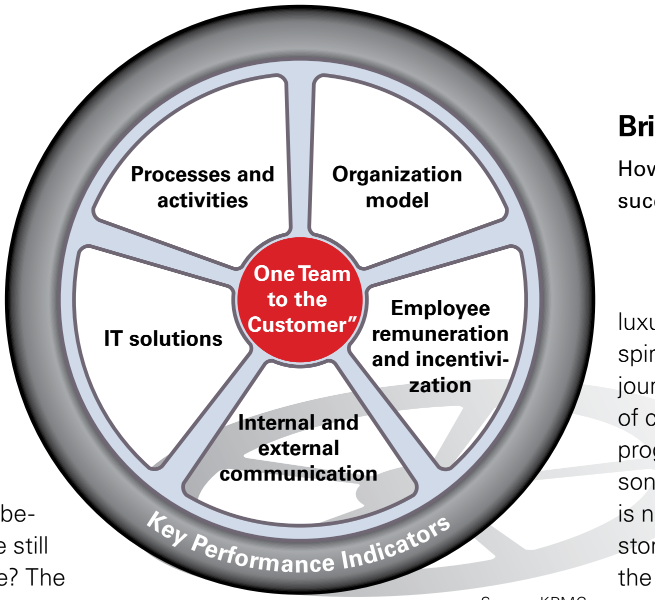
Moreover, customer satisfaction always means satisfaction with the overall performance of a service provider – for example, of a car dealership. Customers do not distinguish between their satisfaction with Sales and their satisfaction with Service, or even their satisfaction with the cooperation between the two departments.

Pulling in the same direction

For this reason, car manufacturers have been trying for years to link the Sales and Aftersales departments more closely together. After all, department walls are not consistent with a uniform customer experience. However, most of them have still not managed to intensify and professionalize the operational collaboration of the two departments so they are still prone to delivering an inconsistent customer experience, possibly leading to far-reaching consequences for customer satisfaction.

When department walls are dismantled, the obvious result is an increase in effectiveness and efficiency, as well as consistency in the service and sales process, leading ultimately to the maintenance or even enhancement of customer satisfaction. Customer service is not an end in itself but serves to establish and maintain competitive advantages.

After all, satisfied customers are more loyal than dissatisfied ones – an absolutely essential starting point for repeat and additional purchases, as well as for exploiting cross-selling and up-selling potential. As customer satisfaction rises, so does the willingness to pay, along



Source: KPMG

Bringing the walls tumbling down

How cooperation between Sales and Aftersales succeeds

with the number of recommendations for the company and hence the number of potential new customers. The possible economic benefits are considerable.

So why is it that the barriers between Sales and Aftersales have still not fallen in the automotive trade? The reasons for this are multi-layered. Elementary tasks and processes in the two departments are very different for historical reasons: The sales advisor sells cars; whereas the service advisor deals with the use of workshop capacity and the sale of spares. Their workplaces are usually physically separated from one another and the IT systems used in each case are often heterogeneous (Customer Relationship Management vs. Dealership Management System). The requirements and objectives also differ in the two departments. The monetary incentives take correspondingly different forms. Sales advisors are usually very performance-driven and their remuneration is to a large extent variable. Service advisors, on the other hand, often have fixed remuneration. Last but not least, the employees of the two departments often have entirely different personality profiles and motives. There is simply a lack of motivation to pull together in the same direction for the benefit of customer satisfaction.

There is a lack of motivation

Therefore, when you consider the predominant sales and service processes in the automotive trade, you get a picture of a two-lane motorway on which no-one changes lane – not because it is forbidden but because of a lack of motivation. Lane-changing concepts which the manufacturers do indeed prescribe to but do not exemplify, raise a quiet smile at best in the automotive trade – i.e. at the point of sale. Therefore, before the walls between Sales and Aftersales can be brought tumbling down, they must also be dismantled in the group and in the distribution companies.

The wheel does not have to be entirely reinvented. Other industries have long shown how cooperation between Sales and Aftersales can be intensified and professionalized. For example, the concept of "One Team to the Customer" has already become established in the luxury goods sector. The team is made up of sales and service advisors to whom a particular customer base is exclusively assigned. The members exchange relevant customer information across departments at brief daily team meetings.

As a result of the harmonization of the IT solutions in use, customer data can be retrieved, amended and modified across departments. Individual key data sets are used to measure the success of the team, on the basis of which the incentives for both Sales and Aftersales employees are calculated. You can search in vain for department walls. The sales advisor involves the service advisor in relevant customer interactions and vice versa, and the "lane-changing" process is properly documented. In the end, this creates a team spirit, so that employees from both departments can all pull in the same direction for the benefit of optimum customer satisfaction.

Focus on customer experience

This exclusive type of customer care has its origins in the area of luxury goods, among others, and is certainly due to the customer expectations that are prevalent in this segment, which do of course go beyond the usual basic requirements. The luxury clientele simply wants to be inspired throughout the entire customer journey. The successful implementation of cross-departmental customer care programs in which the focus is on the personal and individual customer experience is no longer restricted to the flagship stores of prestigious luxury brands. With the increasing digitization of the retail trade, cross-departmental customer care is also gradually finding its way into the consumer goods industry outside of the luxury goods segment. When a product is bought online, the personal contact with the customer is often not established until the "in-use" phase, for example during servicing. It is quite obvious that a sales advisor will be involved in this case.

Just like luxury goods, automobiles are high-involvement products; customers expend a relatively large amount of time and effort comparing products and associated services from various providers. It makes no difference whether the car is an imported compact or a premium SUV. In either case, the provider with the best overall offer usually comes out on top – and from a wider perspective this consists of not only a product, but also of an exclusive customer care package.

About the author

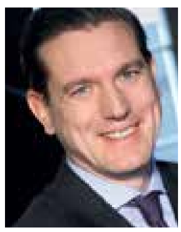


Photo: KPMG

Frank Theis has been a partner at KPMG in Germany since 2013 and is responsible for the advisory cluster made up of Sales, Aftersales & Marketing. Before this, he was a Consultant and Managing Director of TellSell Consulting, a management consultancy specializing in sales and service. TellSell Consulting is now part of KPMG. Frank Theis has over 20 years of experience in the aforementioned areas of the automotive industry, collaborating with major OEMs as well as independent networks and platforms in sales and service.

Danger: Slippery surface

An investigation into the default risks of automotive suppliers worldwide shows that companies in Europe are gradually losing competitiveness, while companies in the USA have consolidated and Asia continues to grow unabated. In the next crisis, many Europeans could quite literally be taken off the road. **Text: Andreas Bartels, KPMG in Germany**

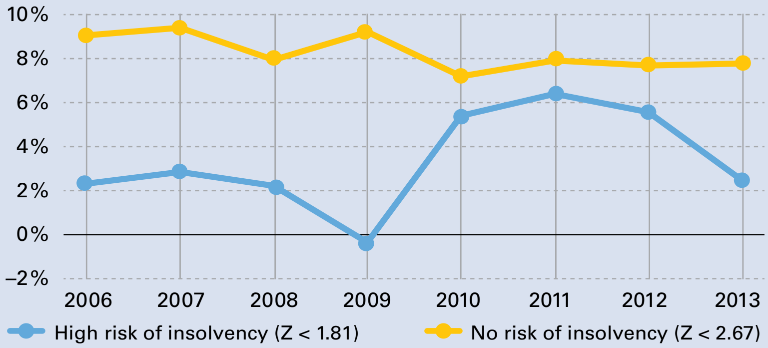
Photo: W. Bachmeier / VISUM

The situation looks good at first glance. The global automotive markets are recovering and suppliers' order books are filling up. However, the upturn in the industry is fragile, in the EU at least. Around 60 percent of new vehicle registrations in Germany are commercial vehicle registrations, of which 25 to 40 percent are one-day registrations by car manufacturers. Car manufacturers throughout Europe are undercutting each other with discounts. Growth stimuli from Spain are merely the result of a state scrappage bonus. And in the light of extremely high youth unemployment in the southern European countries, it is questionable where the car buyers of the future are going to come from.

The industry has to be ready for the next downturn at any moment – particularly as the global economy is also showing weaknesses – and there are numerous potential political trouble spots in the periphery of Europe. The only question is: Would automotive suppliers be able to handle a new crisis? KPMG examined around 400 automotive suppliers for that purpose and analyzed "Z-scores" for the years 2006 to 2013 (database: Capital IQ, focus: listed suppliers).

The gap is widening again

Average EBIT (Earnings Before Interest and Taxes) margins of European automotive suppliers



The "Z-score" was developed by Prof. Edward Altman of the Stern School of Business in New York in order to estimate the risk of payment default among industrial companies. Altman considers five factors: turnover, EBIT, current assets and retained earnings, each in relation to the balance sheet total, as well as the ratio of market capitalization to liabilities. A Z-score of greater than 2.67 means that default ist not likely. Values lower than 1.81, on the other hand, indicate a serious risk of default within the next 12 months. The EBIT margin serves as an early indicator. In the case of financially stricken companies, if the margin is too low, there are no funds to improve the situation.

Source: Capital IQ

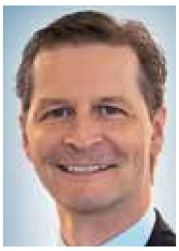
This performance indicator indicates the likelihood of payment default in the coming twelve months. In addition, the average EBIT margins of companies with a poor Z-score (high risk of default) and a good Z-score (no risk of default) were compared.

The result: Over seven years, at least 20 percent of the suppliers in the EU had a Z-score indicating a high risk of insolvency. In crisis year 2009, this figure was actually 66 percent. The proportion has now fallen significantly again. The revenue situation of companies in difficulty had initially improved following the crisis. However, since 2012 the average EBIT margins of the stricken suppliers have been falling again (see chart "The gap is widening again"). The gap in margins between healthy and stricken companies is growing alarmingly. This shows that an ever larger group of European automotive suppliers will not survive a new crisis. These companies simply do not have the earnings to improve their financial strength.

In Asia, on the other hand, the economic crisis has left the Z-scores virtually untouched. The proportion of companies with poor figures remains constant at between 20 and 30 percent and the margin gap between the two groups is stable. The markets there are simply growing so rapidly that economic cycles have hardly any effect. In the USA, the proportion of suppliers with good Z-scores has risen steadily since the crisis and is now at almost 60 percent. For comparison purposes, in the EU this figure is only around 45 percent. Furthermore, the EBIT margins of companies with poor Z-scores have continued to improve in the USA.

The fact is that automotive suppliers in the USA are well equipped for future crises. European suppliers, however, will have to be careful not to be taken off the road in the next downturn. In any case, it is too early for optimism. Companies with EBIT margins that are headed in the direction of three or two percent, or that have other financial figures that indicate problems, should make an effort to achieve greater competitiveness as quickly as possible, as the situation is more serious than it seems, if that's possible.

About the author



Andreas Bartels has been working in KPMG's Service Line Restructuring in Munich, Germany, for seven years, most recently as Director. His focus is particularly on automotive suppliers and other companies in the manufacturing industry. He graduated in engineering at RWTH Aachen University and also studied at INSEAD Business School, beginning his career in 1995 as a Management Associate with automotive manufacturer DaimlerChrysler (now Daimler AG). Four years later he switched to Goldman Sachs, the investment bank. In 2004, he became project manager at Porsche Consulting, the management consultancy specializing in lean management. He joined KPMG in 2007.

Photos: C. Moritz / laif

Minibus armada

Social life in South Africa would collapse without shared taxis. There are 250,000 of these means of conveyance making their way on the roads of the Cape. It's a tough business and the human toll is high. **Text: Wolfgang Drechsler**

George Milanzie slouches in his driver's seat, his right hand on the flame-red steering wheel, his left hand on the ghetto blaster with electro music booming from its speakers. A small crucifix hangs on the rear-view mirror between a pair of sunglasses and a red heart made of cloth. With a fleeting glance at the speedometer, which is already surging up in a frightening way after just a few yards, a certain amount of divine assistance would do no harm.

Even in the dense traffic of Capetown's evening rush hour, nothing seems to disturb the composure of the 31-year-old from Malawi. This may well be due to the fact that the journey to Sea Point is one of the most lucrative routes and far less stressful than a trip to the townships near the airport. His minibus is usually so full that he does not need to sound his horn to passers-by on the roadside, as his colleagues working other routes continuously do in search of customers. The journey costs seven rand, i.e. just under 50 cent, and the coins are handed to the driver in the front.

Eight years ago, after completing his schooling in a small village on Lake Malawi, Milanzie came to the promised land in the Cape. At home, prospects were poor. Malawi is an agricultural economy. There are hardly any jobs, and those that exist are poorly paid. In South Africa, Milanzie first worked as a day laborer on a farm, and later as a packer. Three years ago, he started in the taxi business as a driver for a friend: at least five, often six days a week, twelve hours at a stretch, for the equivalent of around 25 euro per shift. However, by the end of the month, he has barely earned twice the minimum wage.

The armada of shared taxis in the Cape now amounts to more than 250,000 minibuses. 15 million South Africans use them every day, which is almost one in three of the country's population. This wholly privately organized industry now turns over around 2.5 billion euro per year. The state has never had the money for a reasonable public local transport system.

However, this success story has its downside. Besides the bloody rivalries over the most lucrative routes, with sometimes dozens of deaths a year, the frequently unruly behavior of drivers, and the extended period with taxis that are not roadworthy have brought the industry into disrepute. The best demonstration of this is provided by the morning traffic on urban freeway N2. Just like in the city, the minibuses occasionally come to a halt without any warning to let passengers get in or out; or they drive so recklessly that other cars seek refuge on the median strip. The statistics confirm what your eyes lead you to suspect – shared taxis are involved in accidents much more frequently than other road users; statistics show there were around 70,000 incidents last year.

Photos: W. Drechsler

Global Key Contacts

Dieter Becker
Global/EMA Head of Automotive
KPMG in Germany
+49 89 9282 6720
dieterbecker@kpmg.com

Moritz Pawelke
Global/EMA Executive for Automotive
KPMG in Germany
+49 89 9282 1702
mpawelke@kpmg.com

Regional Key Contacts

ASPAC

Seung Hoon Wi
Samjong KPMG in Korea
+82 22 112 06 20
swi@kr.kpmg.com

Megumu Komikado
KPMG in Japan
+81 3 3548 5305
megumu.komikado@jp.kpmg.com

Danny Le
KPMG in China
+861 0850 87091
danny.le@kpmg.com

AMERICAS

Gary Silberg
KPMG in the US
+1 312 665 1916
gsilberg@kpmg.com

Jeff Dobbs
KPMG in the US
+1 313 230 3460
jdobbs@kpmg.com

Charles Krieck
KPMG in Brazil
+55 11 2183 3102
ckrieck@kpmg.com.br

EMA

Ulrik Andersen
KPMG in Russia
+7 495 937 4444
uandersen1@kpmg.ru

Laurent Des Places
KPMG in France
+33 15 568 68 77
ldesplaces@kpmg.fr

John D. Leech
KPMG in the UK
+44 121 2323035
john.leech@kpmg.co.uk

Fabrizio Ricci
KPMG in Italy
+39 02 6764 31
fabrizioricci@kpmg.it

Rajeev Singh
KPMG in India
+911243074000
rpsingh@kpmg.com

Additional Key Contact

Alana Mohan
Global Automotive Marketing Manager
KPMG in Canada
+1 416 777 3484
aamohan@kpmg.ca

kpmg.com/socialmedia

kpmg.com/app

Download on the App Store

kpmg.com

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