

TRANSNET



SUPPLIER DEVELOPMENT PLAN - BROCHURE

April 2010

Table of Contents

1.	What is CSDP	3
2.	CSDP Approach and Opportunity Identification	5
3.	CSDP Implementation	9
4.	Measuring CSDP	11
5.	Involvement in CSDP	12

Table of Figures

Figure 1: CSDP Opportunities	6
Figure 2: Determining Degrees of Complexity	8
Figure 3: Initiative Ranking	8
Figure 4:DOA Methodology	11

1. What is CSDP?

In January 2007 Cabinet adopted the National Industrial Policy framework (NIPF) which sets out Government's broad approach to industrialisation, the implementation of which is detailed in an Industrial Policy Action Plan (IPAP). A process of intensive consultation and analysis – led by the Minister of Trade and Industry – has culminated in a revised IPAP for the 2010/11 – 2012/13 Financial Years (Cabinet approved the first: 2007/8 IPAP in August 2007 which reflected chiefly 'easy-to-do' actions).

Localisation, employment and capital leakage issues are constant themes throughout IPAP that are a direct result of the key structural challenges within the South African economy:

- Structural imbalances in South Africa's current growth path;
- Manufacturing;
- Employment;
- Low relative profitability of manufacturing;
- Cost and allocation of capital; and
- *Failing to leverage procurement (CSDP focus area)*

IPAP outlines certain key focus sectors that affect Transnet directly:

- Capital Equipment, particularly arising from large public investment; and
- Components.

Within IPAP, the Competitive Supplier Development Programme (CSDP) is a means by which government can achieve its broad approach to industrialisation. CSDP was established by the Department of Public Enterprises (DPE), which involves "*procuring in such a way as to increase the competitiveness, capacity and capability of the local supply base, where there are comparative advantages and potential competitive advantages of local supply*" (DPE draft Practice Note on CSDP, December 2007).

In 2007 Transnet notified the DPE that it wishes to participate in CSDP. CSDP is an ambitious initiative that is designed to allow the State Owned Enterprises (SOEs) to improve its commercial terms in the long-run by developing competitive local industries in its supply chain through procurement. The essence behind the CSDP approach is to use the procurement function of SOEs such that procurement performs a direct industrial development role by developing a competitive domestic supplier base.

Transnet chose to participate in CSDP as this would release Transnet's suppliers (of imported manufactured goods and services) from participating in the National Industrial Participation Programme (NIPP) for tenders issued after February 2007. NIPP was an import offset initiative that required suppliers to invest 30% of its contract value in a non-related industry for an imported contract greater than \$10m. The penalty of non-compliance was negligible and was often built into the price given by suppliers. As a result NIPP brought no immediate benefit to the SOE as investment was targeted toward non-related industries and it created price premiums.

CSDP addresses these concerns as it designed to be beneficial to the SOE. In particular it has the following benefits:

- increases its security of supply;
- reduces the cost of goods and services supplied to the SOE through either increased competition or reduced logistics costs and

- will reap the potential benefits of local supply versus imports, which includes:
 - removal of exposure to foreign currency fluctuations in terms of pricing;
 - lower stock level requirements;
 - greater responsiveness;
 - ease of communication; and
 - shorter delivery times.

A by product of CSDP is that by pursuing these initiatives the SOE will improve its commercial terms whilst helping government to achieve its;

- ASGISA goals of poverty reduction, employment creation and skills development
- Aims of reducing capital leakage associated with its large infrastructure spend by focusing on building, competitive and sustainable local industries.

CSDP is a procurement practice that contributes towards competitiveness by leveraging SOE procurement to develop a competitive local supplier base indirectly by placing influence on the multinational to develop downstream suppliers. In cases where the SOE directly develops local suppliers (not via the primary supplier) where the majority of the content is local, are not considered to be CSDP opportunities. These transactions are defined as pure Supplier Development (SD) or Enterprise Development (ED) opportunities and should follow the existing channels for SD and ED in the SOE.

The emphasis of CSDP is on '**Competitive**' Supplier Development, i.e. development that results in a supplier base that can:

- Ensure security of supply to the SOE;
- Contribute in the reduction in operating costs of the SOE;
- Reduce the reliance on imported products;
- Enhance the local IP and skills base; and
- Eventually be competitive to market its goods in the international market leading to increased exports.

Certain repeat spends (capex and opex related) can offer CSDP opportunities, these cases are defined where repeat spend is characterised by a high potential for capital leakage and where procurement offers a steady demand that contributes to the sustainability of the supplier. Transnet's long-term objective in applying CSDP will be to increase both shareholder and societal value through sustainable localisation of its supply chain by using its expenditure to promote South Africa as an off-shore site of choice for OEMs and multi-national procurement personnel.

The overall goals of the CSDP are:

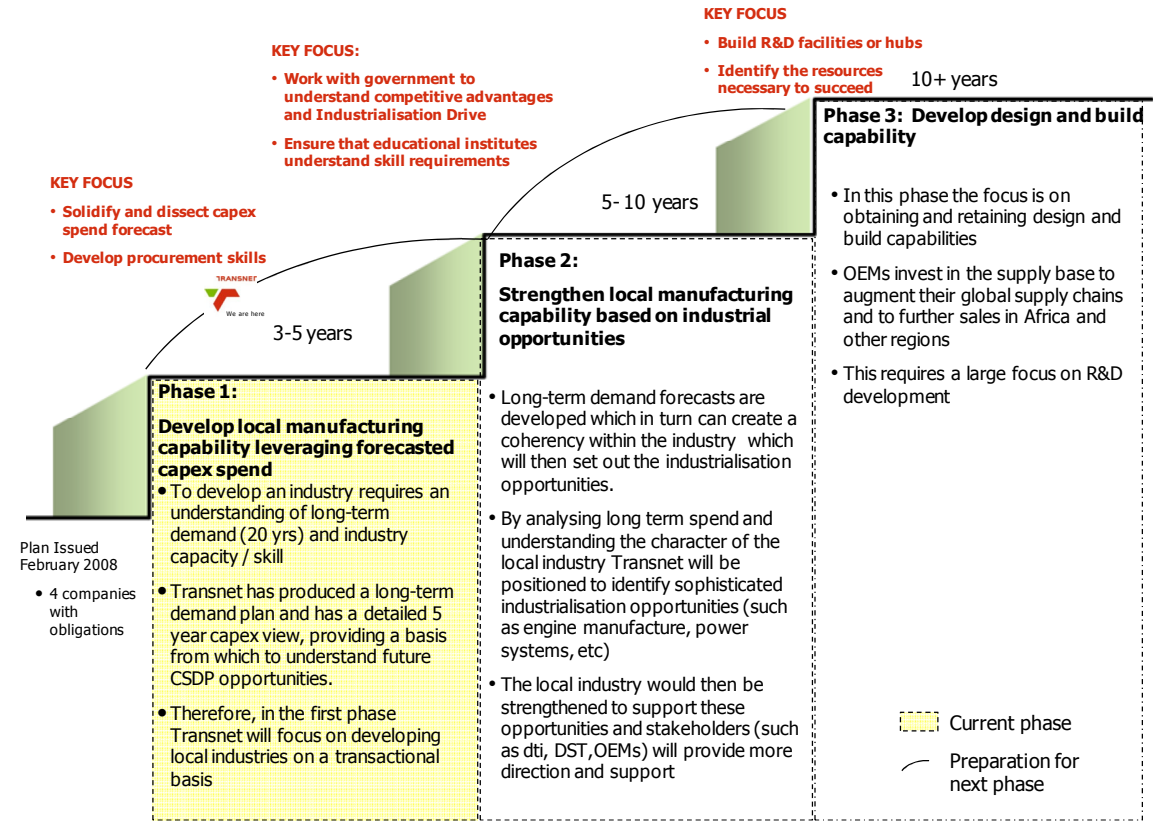
- To contribute to the ASGI-SA aims of increasing economic growth, employment creation, skills development and BBBEE;
- To develop local industries to supply the SOEs with high quality, globally-competitive goods and services;
- To improve the quality, efficiency and cost effectiveness of the services provided by the SOEs, as a result of their obtaining more competitive goods and services from local suppliers;
- To improve the profitability of the SOEs as a result of savings from sourcing from innovative, responsive and more competitive suppliers;
- To avoid capital leakage; and
- To attract foreign direct investment.

CSDP transactions are triggered when:

- Capex transactional value is greater than \$10 million;
- Transactional value is repetitive and greater than \$3 million;
- There is an opportunity to develop a local industry;
- When a limited local supply base exists and the potential to develop existing suppliers is evident; and
- When there is a strong opportunity for IP and skills transfer to local suppliers.

2. CSDP Strategic Journey

Transnet has embarked on a strategic journey pertaining to CSDP. This journey is depicted below:



3. CSDP Approach and Opportunity Identification

The type of CSDP initiative chosen will have a direct socio-economic impact, which will largely be measured on factors that directly and indirectly impact on National Value Add (NVA). Transnet has recognised four main opportunities that have arisen through CSDP and their estimated impact on NVA which is illustrated in figure 1.

Socio-Economic Impact

Each type of CSDP opportunity has varying impact on national economic growth

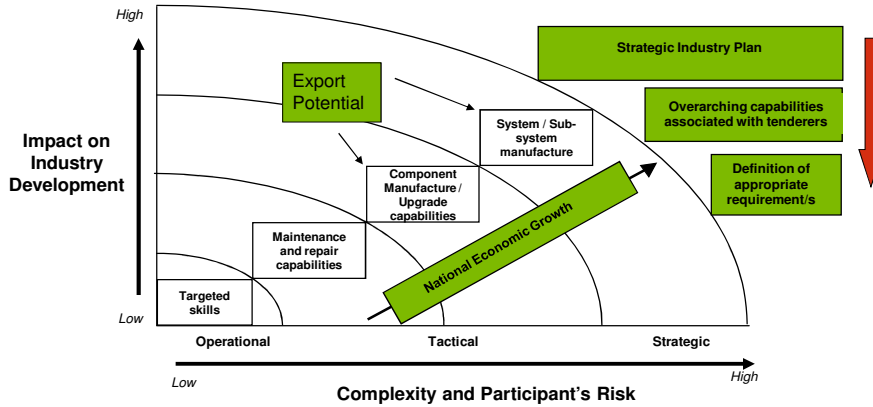


Figure 1: CSDP Opportunities

The four opportunities identified in figure 1 are:

1. **Targeted skills:** This refers to skill sets that our CSDP partners can provide particularly on improving our day to day operational requirements and improving ours and local supplier skills sets.
2. **Maintenance and repair capabilities:** In addition, to the day-to-day operational skills Transnet will require additional skills to maintain its capital associated with its investment programme (e.g. port equipment maintenance). It will need to develop the appropriate skill sets and capabilities to maintain its current fleet.
3. **Component manufacture/upgrade capabilities:** this refers to either local suppliers or Transnet Rail Engineering working with OEMs to manufacture or upgrade parts on the behalf of OEMs so that they ultimately become a part of the OEMs global supply chain or develop the necessary capabilities to supply this globally.
4. **System/sub-system manufacture:** This in particular refers to design and development of systems and sub-systems. While Transnet itself will not engage in design it recognises that other local suppliers might be and Transnet will support these initiatives.

Each of the opportunities listed above will have a direct or indirect effect on NVA. To maximise the socio-economic impact a CSDP initiative may focus on either a single opportunity or a combination of opportunities depending on the state of the local industry. Therefore a successful CSDP initiative is one that is designed by taking into account both the current business environment (local industry capabilities and Transnet's needs) and the impact it will have on National Value Add (NVA). Transnet has identified three initiatives that might arise:

1. **Local Expansion:** this type of opportunity will occur when a supplier, based on the increased Transnet spend, is able to expand current capability that not only meets the Transnet requirement but that also allows it to take on other customers. It will mostly involve a foreign company partnering and investing with a local (preferably empowerment status) entity. These types of interventions are mainly focused on

targeted skills and *maintenance and repair capabilities* but they could also include *component manufacture/upgrade* for the local market.

- 2. Increased Export Capacity:** in this instance, a local manufacturer or foreign entity expands capacity to provide Transnet requirements and overseas demand. This will usually be done at the company's own expense and risk. Our award allows the supplier to project demand, but also to provide a stable economic view for foreign investment. These types of opportunities generally focus on *component manufacture/upgrade* but will also require *targeted* skills training.
- 3. OEM Manufacturing:** this opportunity is specifically aimed at promoting South African businesses as offshore suppliers of choice for OEM companies. We would broker deals with foreign suppliers to partner with local manufacturers who are capable of competitively manufacturing their capital equipment spares under licence, thus ensuring local source of supply for spare parts and an increased export base. These types of opportunities generally focus on *component manufacture/upgrade* but require *targeted* skills training to ensure that capabilities are built in the local industry.

In short, CSDP initiatives should be designed to maximise National Value Add but this will intrinsically be bound to the capability and capacity, responsiveness and competitiveness of local supplier industries (business environment). A specific target or the type of initiative that Transnet is looking for will not be established upfront as Transnet is looking to suppliers for innovative responses based on their capabilities. However, Transnet will have annual targets based on their capex spend.

Industrial Complexity of CSDP Opportunities

In determining whether any of the expenditure categories identified above is suitable for a CSDP localisation supplier development opportunity, the ranking system detailed in Figure 2 below, gives one an understanding of the complexity, suitability and resources required by multinationals to localise parts of their supply chain.

Each localisation opportunity can be evaluated in terms of its ability to be a CSDP opportunity.

In applying the concepts detailed in Figure 2 to Transnet's spend analysis, the following conclusions can be drawn, as to the most appropriate focus areas for CSDP opportunities for Transnet to investigate:

The degree of industrial complexity must be determined and the relevant stakeholders engaged

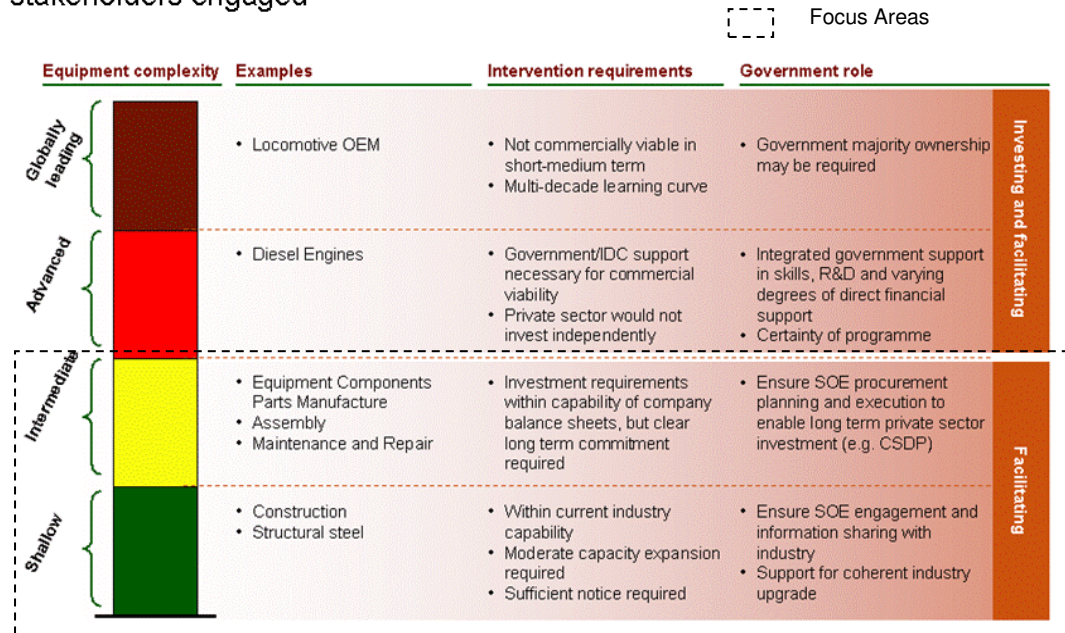


Figure 2: Determining Degrees of Complexity

Shallow	Intermediate	Deep
<ul style="list-style-type: none"> Local capability <ul style="list-style-type: none"> not likely to export or already have export capability Enterprise Development Empowerment 	<ul style="list-style-type: none"> Barriers to entry Technological impact Centres of Excellence (COEs) export quickly 	<ul style="list-style-type: none"> Requires government intervention (in order to pursue the private sector to build new capability) High barriers to entry (such as high capex and/or R&D costs) PPP

Figure 3: Initiative Ranking

- **Shallow industrial complexity spend items** (i.e. construction valued at R40 billion over five years): The sources of supply are already based locally and this should best be supported through supplier development actions, such as Enterprise Development and increasing the Preferential Procurement drive.
- **Intermediate industrial complexity spend items** (i.e. assembly, equipment components, parts manufacture and maintenance and repair): The sources of supply are international firms which own the design, however there is local potential to manufacture to design. Part of Transnet’s five-year spend on rolling stock and port equipment (and to a lesser extent infrastructure and pipeline) falls into this category being best suited to CSDP opportunities.

Changing the source of supply to the local market on these items will be subject to certain barriers to entry. Such barriers should be overcome by the private sector investing in capacity and capability upgrades to become part of a multinational localised supply chain. A prerequisite to such private-sector investments is that SOEs should execute their procurement in such a way as to underwrite (indirectly) their tier-2 suppliers' investments, by a clear long-term contractual commitment with an overseas multinational, containing localisation obligations to local suppliers investing in capacity and capability upgrades.

- **Deep industrial complexity spend items** (i.e. improving local manufacture of tug boats, manufacture of diesel engines or establishing a multinational for locomotives): The localisation of deep industrial complexity related commodities will require joint private- and public-sector long-term investment to overcome the even higher barriers to entry. Transnet's first SDP will not be looking at such opportunities.

4. CSDP Implementation

Over the last two years significant progress has been made with regards to Transnet's supply chain. The beginning of this journey saw CSDP moving from conception to the actual implementation of CSDP within Transnet, namely;

- Establishing CSDP organisational and governance structures;
- Developing the guiding CSDP process and relevant controls;
- Developing appropriate CSDP components for RFx documentation;
- Developing a 'toolkit' of CSDP artefacts that CSDP representatives across Transnet can access for their information and use;

As a result of this implementation Transnet has successfully been able to identify CSDP opportunities and go to market with their CSDP requirements.

Parallel to this, a group supply chain strategy has been defined and is in the process of being implemented, highlighting the need for an operating model that includes a supplier development Centre of Excellence (COE). The COE's mandate will be to provide guidance and expertise to all Transnet operating divisions on the execution of CSDP strategic imperatives in the short term and Enterprise Development (ED) /Supplier Development (SD) in the long term.

Within Transnet, the SD COE is made up of:

- **Enterprise Development (ED):** focuses on investing resources (including funds) into small, micro and new suppliers who currently (or can through development) provide goods and services to Transnet.
- **Competitive Supplier Development (CSDP):** involves the localisation of Transnet's supply chain by encouraging foreign direct investment from international suppliers into local businesses (or empowerment partners) so as to assist in expanding their capability and capacity to provide goods and services not only to Transnet but as well as to export markets.

The focus of supplier development is to create local **competitive** suppliers that can:

- Ensure security of supply;
- Contribute to the reduction in operating cost;

- Reduce the reliance on imported goods;
- Enhance the local IP and skills base; and
- Eventually be competitive to market its goods in the international market leading to increased exports.

The reasons for including ED and CSDP under SD are:

- **Enterprise Development:** ED forms part of SD as its focus is on developing QSE's / SMME's in terms of time, money and training with the aim of creating a local competitive supplier.
- **Competitive Supplier Development Programme:** CSDP forms part of SD as it uses governments procurement spend to indirectly influence the development of local competitive suppliers.

In the Supplier Development Plan that was released in February 2008, **Preferential Procurement (PP)** was included under SD, however, preferential procurement, which can be defined as maximizing expenditure with those suppliers who have the most-optimal combination of technological capability, price and BBBEE status (accreditation), thus empowering less-advantaged suppliers; is not focused on creating local competitive suppliers but rather maximising Transnet's BBBEE scorecard and now falls under Transnet's Compliance function.

As part of the supply chain management SD COE, a diagnosis of current ED / SD practices within Transnet needs to be undertaken in order to properly define its future state. Part of defining this future state involves developing:

- ED/SD strategies;
- Policies / directives; and
- Toolkits etc.

In the coming months Transnet will start a process of embedding CSDP and defining their SD strategy:

a. Rolling out the foundation work deliverables to the OD's

- Holding CSDP orientation workshops with the divisional CPO's and CSDP representatives;
- Rolling out of the CSDP process at the divisions;
- Defining the roles and responsibility of the divisions versus group; and
- Implementation of the supplier tracking methodology.

b. Following up on the identified CSDP opportunities

A part of the work completed in the foundation phase was to identify possible CSDP opportunities across the divisions. For tracking purposes these opportunities have been mapped into a CSDP roadmap showing potential start and end dates. Identified CSDP opportunities need to be tracked against this roadmap.

c. Define SD strategy

A clearly defined and articulated SD strategy needs to be developed that governs and guides CSDP and Enterprise Development within Transnet.

5. Measuring CSDP

Due to the fact that CSDP is a government initiative, Transnet as an SOE needs to report to government on a quarterly basis. The Degrees of Attainment (DOA) reporting methodology forms the basis of tracking CSDP initiatives at Transnet. It provides a detailed picture of an initiatives progress from the initial setting of the aspirations through until bottom line impact is achieved, enabling bottlenecks to be identified in advance. This high level of visibility encourages progress, accountability and enforces a level of adherence to the timelines set. It also enables Transnet to build a robust repository of information for use by both group and divisions to enable continuous learning.

The figure below outlines the six steps to the DOA methodology, namely;

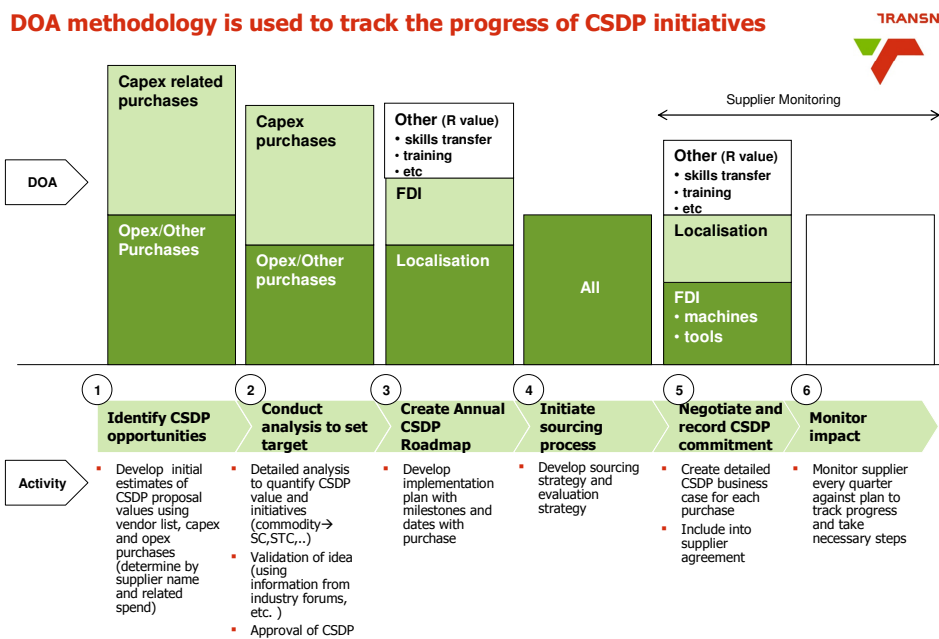


Figure 4: DOA Methodology

1. Identify CSDP Opportunities

The first activity in the DOA reporting methodology involves developing an initial list of potential CSDP opportunities using vendor lists, Capex and Opex purchases.

2. Conduct Analysis to Set Target

A detailed analysis of the initial CSDP opportunities is carried out in order to quantify and validate the CSDP opportunities and values.

3. Create Annual CSDP Roadmap

A CSDP roadmap (CSDP implementation plan) of targeted and validated CSDP opportunities is then created showing potential start and end dates.

4. Initiate Sourcing Process

A sourcing and evaluation strategy then needs to be defined for each CSDP initiative.

5. Negotiate and Record CSDP Commitment

Once a sourcing strategy has been defined, a detailed CSDP business case needs to be developed for each CSDP purchase (as defined in the roadmap). The CSDP component is then recorded in supplier agreement.

6. Monitor Impact

The final step involves monitoring the supplier against the plan on a quarterly basis to track progress and take appropriate mitigating steps where necessary.

6. Involvement in CSDP

There are various industry associations whereby local suppliers can join in order to obtain a view of Transnet's long term purchasing requirements. Some of these associations are able to benchmark relevant suppliers against each other on the basis of financial strength, capability, and skills and then recommend them as possible downstream suppliers to the appropriate multinational.

CSDP consists of demand-side and supply-side measures aimed at increasing the competitiveness, capacity and capability of the local supply base.

Transnet is working in collaboration with different government departments such as the Department of Public Enterprises (DPE), Department of Trade and Industry (DTI), Department of Science of Technology, the United Nations Industrial Development Organization (UNIDO), the Rail and Harbour Supply Chain Association as well as numerous local Supplier Industry Associations to achieve global competitiveness of local suppliers and making South Africa a more attractive destination for foreign investment.

These CSDP stakeholders play different roles to ensure the success of localization initiatives. The demand-side consists of the DPE which initiated CSDP and is responsible for approving the Supplier Development Plan (SDP) of Transnet. The supply side is represented by DTI which provides access to the local supply base while DST aims to close any technology gaps identified.

UNIDO which was commissioned by the DPE to be a part of this initiative and provides Supplier Benchmarking, Buyer and Supplier Matchmaking and Capacity Building for Supplier Development. UNIDO has established a UNIDO Subcontracting Partnership Exchange (SPX) which is a technical cooperation programme that aims to link the domestic enterprises in developing countries to the supply chains of large domestic enterprises or international companies. The relevant local Supplier Industries and their members are hosted on the UNIDO SPX.

A full copy of the Transnet CSDP document can be downloaded from the following website: www.rhsupplychain.com while further information on CSDP can be obtained from www.dpe.gov.za and www.unido.org/spx.