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DEFENCE INDUSTRY

BACK

South Africa's defence industry is financially constrained, but resilient

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The role of the South African defence industry (SADI) in the national economy was recently underscored by Trade, Industry and Competition Minister **Parks Tau** in a keynote address he delivered at the start of the recent Defence Industry Lekgotla, held at the Council for Scientific and Industrial Research's International Convention Centre, in Pretoria, from July 20 to 22.

"South Africa's defence industry is not a niche sector standing apart from our industrialisation programme," he highlighted. "It is one of its most advanced expressions. It sits at the frontier of manufacturing precision, systems engineering and technology sovereignty."

Despite difficulties, the SADI retained capabilities in the air, land, sea, space and cyber domains. These capabilities ranged from Level 2 (component manufacturing) to Level 5 (producing integrated systems). The industry was now composed of more than 600 companies, of which more than 250 had a major defence focus, and more than 350 supplied components and services into the defence value chain.

The country had been ranked (by the Stockholm International Peace Research Institute) twenty-first in the world in terms of major conventional arms exports, from 2018 to 2023. Local industry associations estimated that the SADI exported to more than 115 countries, of which more than 40 were in Africa.

However, he also highlighted how the industry had shrunk over the decades, due to defence budget cuts in South Africa. While the defence budget had been R26.2-billion in 1989/90, it had fallen to R850-million by 2018; defence research and development spending had fallen from R6.1-billion to R500-million over the same period (these figures were in constant terms). The SADI had contracted from about 3 000 companies, employing 130 000 people, to today's 600-odd, employing some 13 000 people. The surviving SADI now accrued 80% of their total revenues from exports.

"Behind these numbers is a loss of depth as well as breadth," he lamented. "Skills have left the sector, particularly as instability at State-owned entities such as Denel has pushed experienced engineers and technicians elsewhere. Once expertise leaves, it does not return quickly. This is the central risk we must arrest."

Meanwhile, around the world, the deteriorating international environment was causing countries to rebuild both their industrial and defence capabilities. Africa was no exception.

The continent's defence acquisition market was, he reported, forecast to total some $136-billion, although he did not say over what period.

"Countries that retain sovereign design, manufacturing and maintenance capability will capture that demand," he affirmed. "South Africa should not be a bystander to this cycle. We have the base to compete. What we lack is coordination."

The SADI was becoming more important, not less.

Resilient Industry

The representative body for the SADI is the South African Aerospace, Maritime and Defence Industry Association (AMD).

"For many years, the [SADI] has continued to innovate, manufacture, export and compete under circumstances that have often demanded resilience far beyond what many industries are ordinarily expected to endure," emphasised AMD executive director Sandile Ndlovu.

"Yet despite those challenges, the one characteristic that has consistently defined our industry has been its refusal to surrender. We did not surrender our ingenuity. We did not surrender our engineering excellence. We did not surrender our ambition. Most importantly, we did not surrender our belief that South Africa possesses one of the most capable defence industries in the world."

He reaffirmed that the SADI was an innovative technology sector, which engages in advanced manufacturing, exports, develops skills and undertakes research. It is thus a strategic sector for the country and contributes to national resilience.

Every deal struck by the SADI maintains factories, highly skilled jobs, creates opportunities for young engineers and generates foreign exchange. Each defence product – and they range far beyond weapons – is supported by an entire ecosystem of suppliers, ranging from large original-equipment manufacturers to small businesses. They are also supported by a research ecosystem that embraces science councils, universities and technical colleges.

The industry has proven its ability to compete globally and, consequently, its future is not going to be narrowly constrained by the size of the South African defence budget. But, he warned, the global defence market is increasingly competitive.

"Competitiveness is no longer determined solely by the quality of the products we manufacture. It is increasingly determined by the efficiency of the ecosystem within which those products are conceived, developed, certified, financed, marketed and exported," he explained.

"For South Africa to strengthen its position within the global defence marketplace, we must continuously improve every component of that ecosystem."

And the government organ that forms one of the most important parts of that ecosystem is the National Conventional Arms Control Committee (NCACC). This has to approve all South African defence exports.

Ndlovu was not asking for it to be weakened; he wanted it to work properly. (During last year, the NCACC met only seven times, and there was a three-to-four-month period in which no meetings were held. On top of this, from the start of January this year, its online permit system was down for a period of several weeks.)

"What industry seeks is a regulatory environment that is predictable, responsive and internationally competitive," he explained. This would reinforce the country's position as a responsible defence exporter.

"Customers expect certainty. Programme schedules are often measured in weeks rather than months. Production planning depends upon predictable approval processes. Delivery commitments influence future contracts. In such an environment, delays, however well intentioned, carry commercial consequences. An export opportunity postponed is often an export opportunity lost. The international marketplace does not pause while administrative processes are completed. It simply moves on."

He stressed that excellent regulation and commercial competitiveness are not in opposition to each other. Regulatory processes, however, have to be predictable, efficient and responsive.

But the industry's current export success should not obscure two major problems.

The first is the lack of a significant domestic customer. The South African National Defence Force (SANDF) was so short of funds that it could not afford to properly maintain its current equipment and execute its constitutionally mandated missions, let alone buy new equipment.

Worldwide, winning domestic orders was usually a prerequisite for defence companies to successfully win export orders. This especially applies to those SADI companies that are 100% South African in ownership. Customers like to know that equipment – whether vehicles or radios, missiles or optronics – has been used and proven by a company's home country military.

The second was that the SADI could have even greater export success if its member companies could more easily access developmental and export financing.

It's Money That Matters

On paper, government has committed itself to increasing defence spending from the current level of some 0.7% to 0.8% of GDP to 1.5%. But it is clear that this is not going to happen soon.

Senior government officials who attended the lekgotla, at different times, included Defence and Military Veterans Minister **Angie Motshekga**, Deputy Defence and Military Veterans Minister and retired Major-General **Bantu Holomisa**, Secretary of Defence **Bereng Mthimkulu**, and Chief of the SANDF General **Rudzani Maphwanya**. All delivered addresses (Motshekga, the closing address). Not one of them announced a single contract, or project or any commitment of extra funding.

Tau alone struck a positive note, highlighting his department's already existing support initiatives for the SADI. These included the very successful Aerospace Industry Support Initiative, now in its twentieth year, which has helped local companies integrate into global supply chains.

Another was the National Industrial Participation Programme, which sought to use government procurement to achieve technology transfer and localisation, as well as creating exports. Then, created in conjunction with AMD, there was the South African AMD Export Council, to expand the industry's export markets.

Additionally, the department was considering the creation of an Aerospace and Defence Special Economic Zone Cluster in the Western Cape province, which was the location of a significant component of the country's commercial space, defence and aviation capabilities.

Meanwhile, the Industrial Development Corporation (IDC) was undertaking new investments in support of additive manufacturing, robotics, drone technologies, supply chain localisation and maintenance repair and overhaul capabilities, with many of these being dual-use technologies. The IDC had also a newly developed Defence Industry Development Plan. And the Export Credit Insurance Corporation was working directly with the industry on working capital, trade credit and invoice discounting products.

Holomisa focused his address on the possible benefits of public–private partnerships (PPPs). But he saw these largely as a means to address backlogs in the SANDF's built environment – bases, housing, other buildings and facilities – which would, in reality, not involve the SADI. Areas he identified in which PPPs could involve the SADI were training and support infrastructure and maintenance facilities.

Ndlovu also touched on the potential of PPPs.

"PPPs have become important instruments through which nations accelerate innovation, share risk, optimise investment and expand industrial capacity," he stated. "The objective must always be capability, strategic independence and sovereignty. Public-private collaboration should therefore become a catalyst for expanding South Africa's technological independence rather than diminishing it."

Money on the Mind

The question of easier financing for SADI companies was debated by the lekgotla's financing commission, one of the six commissions into which it was subdivided. The chair of the financing commission was Milkor VP: Africa Daniel du Plessis. The SADI had to move "from a financially constrained industry, which it is now, into a self-sustaining, export-driven engine for sustainable national economic growth", he stressed.

"Many of the industry players would know [that] if you go to a commercial bank and ask for bonds, payment guarantees, insurance guarantees or performance bonds when doing export contracting, you will be kindly shown the door," he pointed out. "And this is a problem that we have faced for a very long time and hasn't been addressed; however, that perception is now changing."

The good news for the sector included the reform of the IDC's responsible investment policy and the Treasury's amendment last year of its PPP frameworks. Further, there was an increasing appetite among commercial and private financiers for dual civil-and-military use technologies.

The finance commission drew up five resolutions. The first was to create a dedicated joint task team composed of members of AMD, the Department of Trade, Industry and Competition, the Department of Defence, and the Department of Science, Technology and Innovation, to actually implement the commission's proposals

The second was the need to create a new mechanism to ease access to already existing financing structures that were spread across different government departments; AMD should be central to this mechanism.

Third, the funding base of the existing, but underfunded, Defence Industry Fund, should be widened, to ideally embrace development finance institutions, commercial banks, private equity and venture capital; additionally, and essentially, a South African export-import bank should be created.

The fourth resolution was that a Defence Industry Development Agency should be created, which would serve to enable continual technological innovation, accelerate SADI growth, grow the development of critical skills and impel inclusivity and transformation, by means of dedicated tax incentives.

Fifth, measurable financing targets and reporting mechanisms should be developed, to allow the monitoring of progress, reinforce accountability, and make certain that funding initiatives really do result in industrial growth, increased exports and job creation.

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