



**A Risk Based Approach In Order To Improve Trade Facilitation And  
Enhance Its Customs Enforcement.**

By

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**Submitted in partial fulfilment of the requirements for the degree of  
MASTERS IN BUSINESS ADMINISTRATION**

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**June 2004**

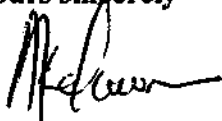
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**Yours sincerely**

A handwritten signature in black ink, appearing to read 'A. Khelawon', written in a cursive style.

**A Khelawon**

**DECLARATION**

**This research has not been previously accepted for any degree and is not being currently submitted in candidature for any degree.**

Signed..........

Date.....30 JUNE 2004.....

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## **ACKNOWLEDGEMENTS**

**My sincere gratitude to the following persons, each of who helped in one-way or another to bring this project to life:**

*My wife Prish, for her support, encouragement and patience, who made this project a reality.*

*To my mum, thank you for creating the foundation in my life that has enabled me to pursue my career.*

*To SARS, under the leadership of Commissioner Pravin Gordhan, bringing about transformation that provided the opportunity and resources for the fulfilment of this project.*

*Professor Elza Thomson, thank you for the guidance and the encouragement.*

## **Abstract**

The World Customs Organisation (WCO) predicted that the 21<sup>st</sup> century will bring with it major challenges. The former Commissioner of the United States Customs, Raymond, W, Kelly also remarked in the symposium for the America's 2000, a common dilemma for customs will be how to manage the "exploding volumes", of trade with declining or static resources. Globalisation has brought with it an influx of international trade. Production facilities being spread over different continents creating one virtual market place. This has brought about the need for increased Trade facilitation. Customs being the major role player in the supply chain process needs to provide efficient and effective release of cargo while at the same time ensure that it eradicates smuggling and protects its fiscal base. This responsibility that customs authorities are placed in makes it impossible to conduct high levels of physical interventions, as a result this has created a need for the use of a more strategic tool. The Risk Management Model is such a tool which if used effectively can provide value to Customs as well as the client's, it serves.

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## **Chapter One: Introduction**

### **1.1 Introduction**

In the past years the South African Customs have tried to manage the continuous growth of International Trade by implementing computer based procedures and controls, especially those related to customs clearances.

The Cape System, an electronic system implemented over 10 years ago was the first system to integrate customs control of seaports, airports and land border posts, allowing for the automatic calculation of duties payable and selection of entries for the purposes of compliance checks.

Recently the Customs authorities introduced more automation in the form of electronic manifest submissions and electronic data interchange which has increased the efficiency in the processing of clearances and acquittal of cargo while consequently eliminating the use of paper documents. From the customs point a significant change has occurred as the introduction of the “integrated Customs Risk Analysis Solution” (ICRAS), a program that allows for the selection of operations to be examined in three different levels i.e. high, medium and low risk.

Although this system has been useful in providing faster turn around times, this model has been unable to guarantee the quality of selections made for the purposes of inspection. This system is dependant on the need for human intervention in generating and updating the risk parameters, the present model has no longer been able to respond promptly to recent practices of fraud and smuggling. Besides demanding continuous monitoring and update, one of the main obstacles in providing adequate quality selection criteria comes from the fact that focus is on the transaction and not upon the assessment of the probability of non compliance on a specific operation.

As a result of this, efficiencies are compromised in the supply chain due to clearances being selected that should have automatically been cleared. This in turn compromises the quality of the

examination, as the work force is sacrificed with a volume of work that is additional which may demand the constant presence on clearance activities instead of auditing ones.

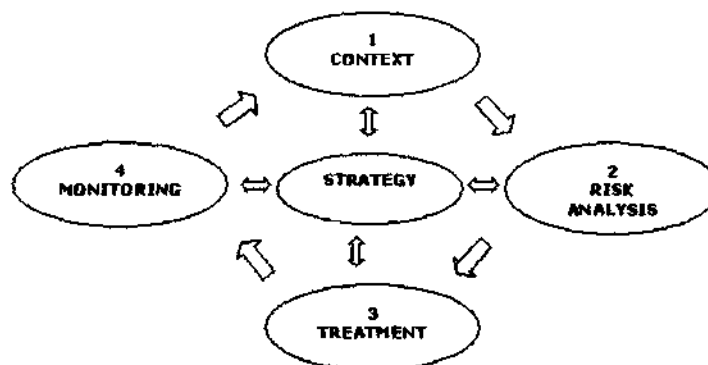
Due to the reasons explained above it is evident that there is a need to adopt a consistent Risk Management Model that guarantees a better selection of operations with greater emphasis on the probabilities of fraud and smuggling, as a result allows for the selection of fewer volumes without compromising the security of controls.

## **1.2 Literature Review**

Risk Management is a technique that systematically identifies risk and implements measures necessary to limit the risk. Customs with the onerous task of continually managing and controlling the movement of goods has to ensure that the controls imposed are proportionate to the risk levels. Risk management therefore requires a balance to be maintained between cost and benefits. This actually means that affective criteria should be utilised to determine acceptable levels of risk.

The Risk Management Process (RMP) has as its central theme, “Risk Management Strategy”, which is depicted in figure 1.1, this is an on going process and has to continually be updated, analysed and acted upon.

Figure 1.1 Risk Management Strategy



Source: Standardised Framework for Risk Management in the Customs Administration of the EU, 2002

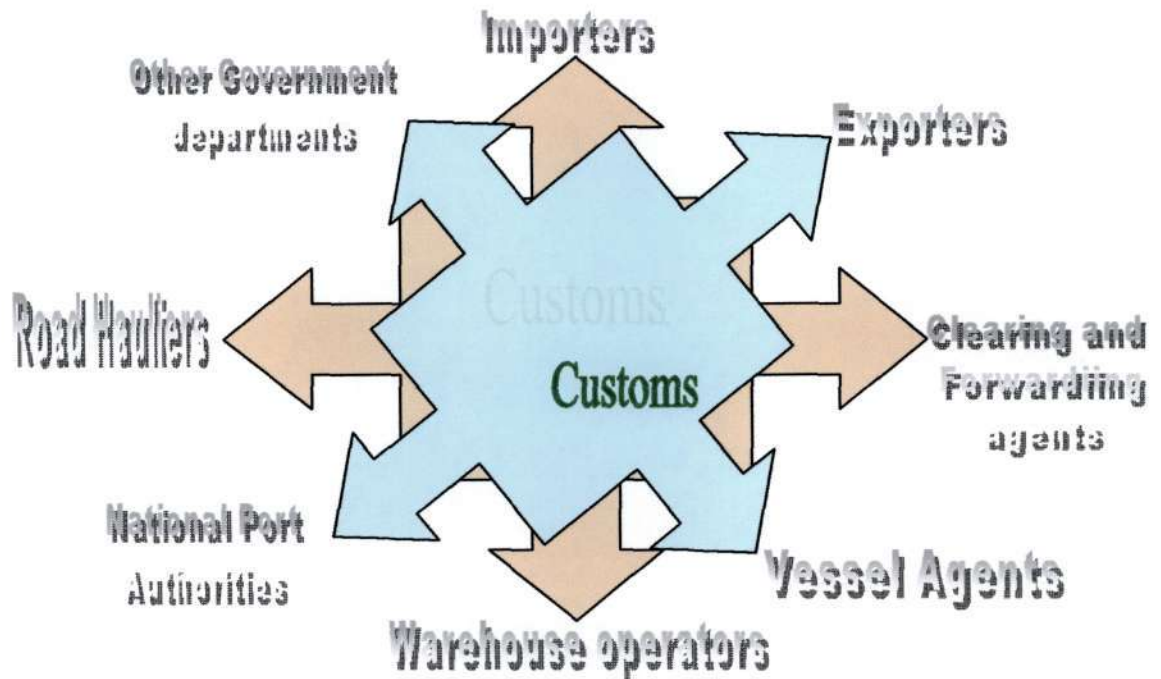
The mythology of the RMP adopted by the different Customs administration around the world is essentially the same. The “context” which primarily focuses on the environment within which each administration functions however differs. Factors such as the political, legal, economic and social elements of the environment affect the context of the RMP. The South African Revenue Services (SARS) is responsible for the facilitation of trade, movement of people, collection of revenue and protection of its society. SARS however has as it’s over arching goal, “the collection of the correct revenue”, as stated by the SARS Customs General Manager in the Customs National Forum, Bloemfontein, 2003. The over arching objective does not preclude the other objectives of trade facilitation, movement of people and protection of the society however has become the fore runner in establishing our risk parameters.

The activity of risk analysis in countries such as the United States Of America, the Chinese Taipei and the European Union are performed in great depth. Proper risk management requires effective, efficient and reliable approach to collecting data. The data collection method needs to also be statistically accurate. Accurate and reliable data forms a sound platform for effective data analysis.

Through the collection of data and information Custom are able to determine which clients are likely to be non compliant and the nature of the non compliance. The deployment of resources can be executed more strategically focussing on areas that will pose the greatest level of non compliance. Trade patterns and historical trends will further enhance Customs to understand its import and export environment (Braga, December 2001).

In analysing the risk we should understand the role players in the environment and the contribution they can make towards the Customs risk management process. The Risk management process is therefore an integrated approach encompassing all stakeholders and traders alike. For purpose of this research the role players are depicted in figure 1.2.

Figure 1.2 Customs Role Players



These stakeholders can bring valuable information to the RMP. An effective Risk management is not only the responsibility of Customs administration it also poses a burden on its stakeholders to effectively bring about integrity and transparency in their dealings with customs. The SARS recently introduced a program to accredit clients. These clients are considered as trust worthy clients and in so doing are intended to pose minimum risk in their dealings with SARS. SARS has enabled legislation in terms of section 64(E) of the Customs And Excise Act (Act) to allow the Commissioner to confer accredited client status on its clearing and forwarding agents in so doing it also has created a provision to enter into agreements with clearing and forwarding agents. The section also requires that the clearing and forwarding agents have good internal controls and have effective information systems available that can store data in terms of the period prescribed by the ACT. This information is valuable as it is a mechanism that can be used to feed information into the RMP.

While SARS has made substantial progress in building a sense of responsibility within its stakeholders its accreditation process has not been expanded to include the other stakeholders mentioned in the diagram. The United States (US) Customs authorities have made use of a total accreditation program by means of entering into agreements with vessel operators as part of the



Vessel Operator initiative whereby vessel operators are obliged to report any deviations and inconsistency to customs immediately in return they enjoy certain advantages as being recognised as partners with customs. Further to this the US customs have integrated database that makes use of information from local police stations, health departments, immigration, Federal Bureau of Investigations (FBI) and registrar of companies that feeds into one stream to provide information that can be pro actively utilised to minimise risk.

Once you have collected and determined the risk, the risk need to be minimised while compliance need to be increased. Therefore an appropriate action needs to be devised and necessary resources dedicated to the risk (Braga, December 2001).

Prescribing action involves two processes:

- Identifying the cause of the risk e.g. lack of knowledge or wilful disregard for the import and export laws.
- Designing an action and assigning resources.

Over the past years customs have used various methods to promote compliance from promoting enforced to voluntary compliance.

The results whether positive or negative are correlated and reported back into the risk management process. This enables monitoring and corrective action to align targeting strategies. The feedback process is instrumental for the effective functioning of the risk process and can occur at any of the other three processes

In essence the risk assessment model requires you to have a holistic approach to trade compliance by utilising intelligence to identify and manage non compliance. The model further establishes that effective targeting increases facilitation while strategically targeting the correct consignments.

Globalisation is a fore runner and has serious consequences in governance and Customs activities. A systematic process such as the RMP can provide substantial benefits to Customs and the industry alike (Internet 1).

- ✚ Faster clearance
- ✚ Facilitation of a large quantity of low risk commodities
- ✚ Reduced delays for industry
- ✚ Accurate selection of high risk transactions
- ✚ Effective and efficient allocation of resources
- ✚ Provides a sound basis for customs decision making

### **1.3 Problem Statement**

The South African Customs has ever since it has been established, had as its main objective to be the collection of revenue and the protection of the economy. Customs having as its core function to include issues such as tariff classification, valuations, law enforcement activities such as narcotic interdiction, money laundering, export control and intellectual property infringement. The latest addition to the string of responsibilities now include following the September 11 invasion in the United States, antiterrorist activities (Baker, 2002).

The Customs administration uses a method to physically inspect a percentage of 5% or more of actual consignments entering or leaving the country, this was also supplemented by documentary checks giving customs a “hands on grip” on all consignments. This hands on grip is now slipping away as the explosion of international trade and South Africa’s integration into the global business world since 1994, makes increased real time intervention almost impossible to perform at previous levels.

In affect this means that most consignments will never be checked physically or through documentary review. Customs however is yet still responsible to ensure compliance and become less of a barrier in the trade facilitation process. Customs has introduced automation to improve production by means of the accredited client system, which allows certain clearing and

forwarding agents to benefit from improved trade facilitation as result of compliance to Customs policies and procedures. Stemming from the aforementioned Customs is faced with two major dilemmas that is:

- How to facilitate trade so as to ensure that it does not impact on the supply chain in a negative manner.
- How to improve compliance, so that illegitimate trade is identified and dealt with to the benefit of the economy and the environment.

It therefore stands to reason that the environment Custom operates in is very complex and is made even more difficult by the sheer increase in volumes that are taking place. The modernisation process for Customs around the world has been mainly to embark on a process of a “Risk” based trade compliance model to achieve a balance between trade facilitation and compliance.

The problem statement therefore is:

*What is the effectiveness of a risk based approach within the South African Revenue Service to improve trade facilitation and enhance its customs enforcement?*

#### **1.4 The Importance and Objectives of the Research**

Recent years has seen an overwhelming growth in aspects of business, Customs forming and integral part of the supply chain has experienced increased workload in all facets of Customs business. In coping with this accelerated workload to maintain effectiveness and efficiency in this constant changing environment calls for a strategy which will allow Customs to work smarter. The strategy delivering this needed improvement around the world in other customs authorities such as the United States and Brazil is the risk management approach to customs intermediation.

Benefits of risk management to the industry

- Faster clearance due to improved targeting of high risk cargo.
- Facilitation of low risks cargo's almost instantaneously.
- Reduced delay for industry, reducing cost of doing business.

#### **Benefits of risk management to Customs**

- Accurate selection of high risk consignments.
- Maximising the allocation of resources.
- Fast track international trade transactions, contribute to fiscus of the economy.
- Providing a sound basis for customs decision making to meet accountability requirements.

Therefore the objective of the study is to determine whether the trade compliance and risk management approach will be an affective approach to maintaining a balance between trade facilitation and enforcement by examining the proposition from both the clients and the Customs perspective.

#### **1.5 Ethical Considerations**

Information has been obtained with the permission from the General Manager of Customs and are of a confidential nature. The researcher has been given permission to use such information for purposes of the research only. There is therefore a requirement that information contained in this document do not be made public. The research is accordingly obliged to adhere to this request.

#### **1.6 Limitations**

The Customs division is part of the South African Revenue service and falls more on the part of indirect taxation as opposed to other divisions within SARS. The research is therefore focused mainly on Customs and international trade issues.

## **1.7 Research Design**

The strategy that is chosen for the research design is aimed at attaining greater depth into the research problem thus enabling the researcher to analyse the problem and provide a comprehensive solution.

### **1.7.1 A Case Study**

As the study is qualitative rather than quantitative in nature the approach to the dissertation is one of a case study of a risk based trade compliance model. The first section of the dissertation will be the case study itself comprising of a strategic analysis. In conducting a strategic analysis a review will be done on existing research and customs administrations that are currently utilising the risk base approach to trade compliance. The researcher will then use these models as a benchmark for determining the effectiveness of such an approach into the South African Customs administration.

### **1.7.2 Data Collection and analysis**

The study will be qualitative in nature. The research will draw on the writings of social scientists. Secondary data will be obtained from the South African Revenue Services, historical material, various journals, and Internet searches.

### **1.7.3 Evaluation Of strategic options**

Three types of performance criteria will be used to determine an appropriate strategy viz:

- Suitability – whether the chosen strategy addresses the non compliance and trade facilitation gap of customs and excise.
- Acceptability – is concerned with whether the expected performance outcomes if the strategy is implemented fulfils the aim it is intended for.
- Feasibility-is whether the strategy can be made to work practically

#### **1.7.4 Nature and form of Results**

The dissertation will be presented in written format in a book form. The study will comprise of the fundamentals given in the research design. The study will documents the effectiveness of a risk based trade compliance model in achieving trade facilitation and compliance and an appropriate procedure that can pose as a way forward.

#### **1.8 Structure of The study**

The structure of the study is presented in five chapters as follows:

##### ***Chapter 1***

The introductory chapter will provide an overall background of the study

##### ***Chapter 2***

This chapter will centre around the theoretical elements comprising of strategic models that are required to analyse the SARS risk management process.

##### ***Chapter 3***

This chapter will present the current scenario within which the SARS Customs division is functioning in, at the same time identifies the gap by making use of a strategic model.

##### ***Chapter 4***

This chapter will focus on the present risk management process, making use of the strategic analytical tools discussed in chapter two to review international best practises.

## ***Chapter 5***

This chapter will outline a strategy to close the gap and details the recommendation and conclusion based on the findings of the study.

### **1.9 Summary**

Globalisation has changed the way business is conducted, this has also given rise to the large number of consignments shifting from a “warehousing” to a just in time economy. The future of Customs and if not the country will depend on how effectively we adopt to these changes.

Customs is the manager of the supply chain, in this instance we need to decide the consignments we are going to inspect and those that we are going to release without intervention. The risk based model proves to be a strategy to accomplish efficient release of cargo and high level of compliance with Customs legislation.

## **CHAPTER 2- THEORETICAL MODEL OF STRATEGY**

### **2.1 Introduction**

This chapter presents a theoretical framework for the formulation of a strategy within the public sector. Market dynamics have created challenges for the public sector. With the emergence of the global economy, new technology and increased societal demands to provide basic essential services with the limited resources makes it necessary for organizations especially public sector organizations to formulate effective and sustainable strategies. This chapter outlines the various strategic tools that can be used to assess the state of the business and develop a systematic planned approach to strategy implementation. The chapter concludes with a model that will form the focus for analysis and discussion in chapter four.

### **2.2 What Is A Strategy?**

*Strategy is the great work of the organization. In situations of life or death, it is the Tao of survival or extinction. Its study cannot be neglected. – Sun Tzu, The Art of War.*

In their book “Strategic Management”, Thompson and Strickland (2003) define strategic management as a game plan management uses to position themselves in the market, conduct operations, placing customer centrisism amongst its priorities to compete successfully and achieve organizational objectives.

According to Glueck and Jauch (1984), a strategy is a unified comprehensive and integrated plan that relates the strategic advantages of the firm to the challenges of the environment and that is designed to ensue the basic objectives of the enterprise are achieved through proper execution by the organization.



Grant, (1998) states that strategy is about “winning”, guiding management decisions to attain superior performance through established competitive advantages, he further states that it is a vehicle for effective communication and coordination within an organization. Indicating that a strategy is a link between the organization and its business environment. Lynch ( 2003), in his book “ Corporate Strategy’ states that corporate strategy is concerned with the organisations basic direction for the future , its purpose, its ambition, its resources and how it interacts with the world in which it operates.

The past twenty years has lead business to the era of the Knowledge Age. The quest to respond effectively and efficiently to changes in the competitive business environment has created the need to bench mark against best practises, be in touch with your core competencies and outsource to gain efficiencies within the organisation. Porter (1996) in his efforts to define strategy states that “positioning, once the heart of strategy is rejected as it is too static for today’s dynamic markets and changing technology”. Current globalization trend and the ability to imitate market positions gives substance to Porter’s statement as competitive advantage is temporary.

Strategy is therefore not a process of attaining operational efficiency as this by far only creates temporary gains to the detriment of sustained profitability.

The concept of strategy can be summed up to include a definite focus on the company’s objectives, there is an aim for competitive advantage and a need to understand its internal and external business environment. In this environment satisfying the customer forms a central theme of the business philosophy. This in affect enables the organisation to make pro-active choices and implement its plan to achieve its objectives.

### **2.3 Strategy In The Public Service**

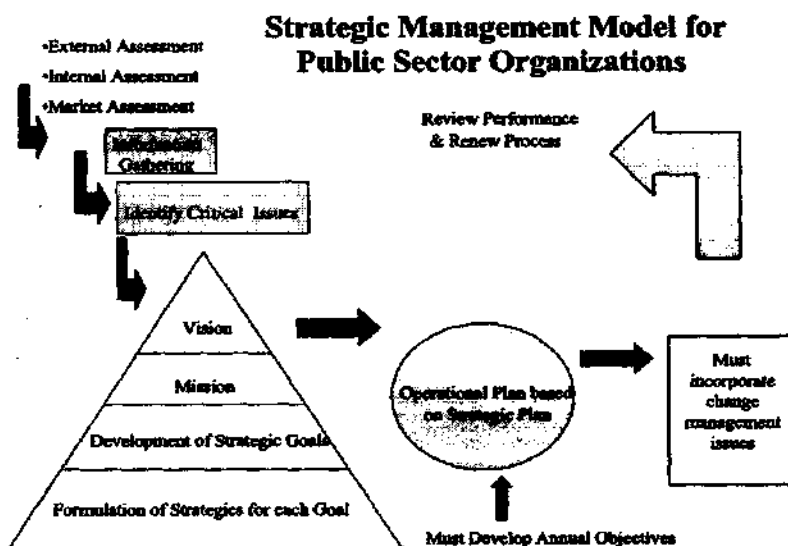
Heightened public awareness in the areas of socio-economic policies, the need for the ruling party to deliver with the scarce resources at hand makes it imperative for the change in the way the public service was conventionally managed. The public sector understandable constrained by

fiscal and bureaucratic processes have a considerable impact on private businesses that are competing in the global economy and demand improved efficiencies in service delivery to stay ahead. The need for a new approach necessary for the public sector to understand the environment to achieve performance and service quality is required.

The challenges in any strategic management processes be it a public or private sector is to ascertain, what changes are required, how are the changes to be implemented and managed and to provide a path that will guide the organisation in achieving long term sustainability.

In Figure 2.1, Bryson 2001 outlines the main tools required for the understanding, implementing, delivering and managing services and change.

Figure 2.1 Strategic Management Model for Public Sector Organisations



Source: Bryson, John M. Strategic Planning for Public and Non-profit Organizations. San Francisco: Jossey-Bass Publishers, 1988.

The above model illustrates the components for success and the capabilities of the organisation in its strategic management planning. The first step in this process includes information gathering.

A thorough knowledge of the internal and external business environment is required, analysing the trends in the market place and the opportunities that exist. The “market” in the public sector will refer to the relevant stakeholders. The organisations ability to react to these challenges is embedded in its vision and mission statement describing the company’s long term goals, how technology will impact on its future and what position they should adopt in terms of addressing the stakeholders needs. The mission statement should typically depicts what the present company does and the present business scope is, moreover its present capabilities and customer focus will mould and determine the ability of the organization to meet its long term vision (Thompson and Strickland, 2003).

## **2.4 Stakeholder Importance**

The responsiveness of the public service in particular the South African Revenue Services (SARS), to the interest of the society as a whole are paramount for successful performance and delivery. Figure 2.2 indicates the key stakeholders within the SARS Customs environment.

Figure 2.2 Stakeholder Chart

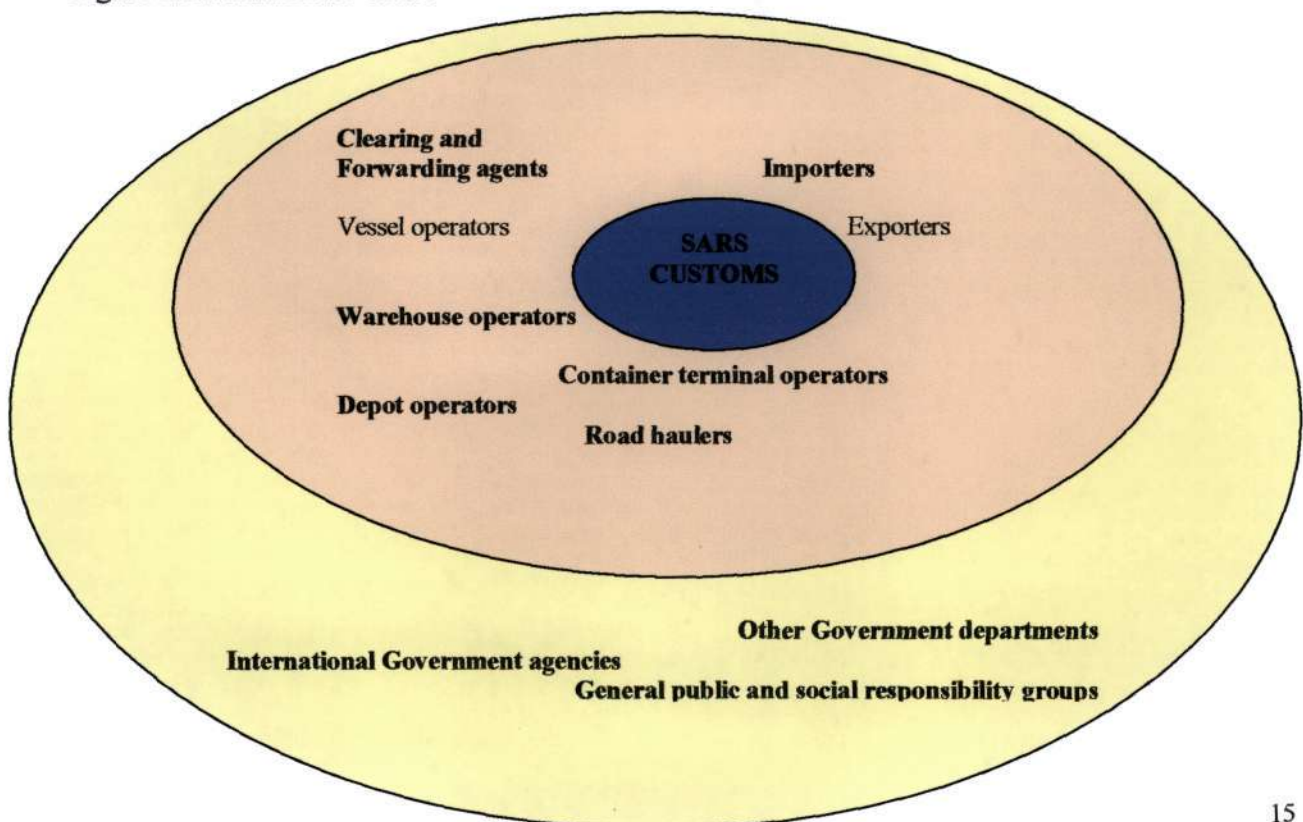


Figure 2.2 indicates several stakeholders however the clearing and forwarding, importers, exporters, container and terminal operators as well as the warehouse operators are by far the most important of our clients.

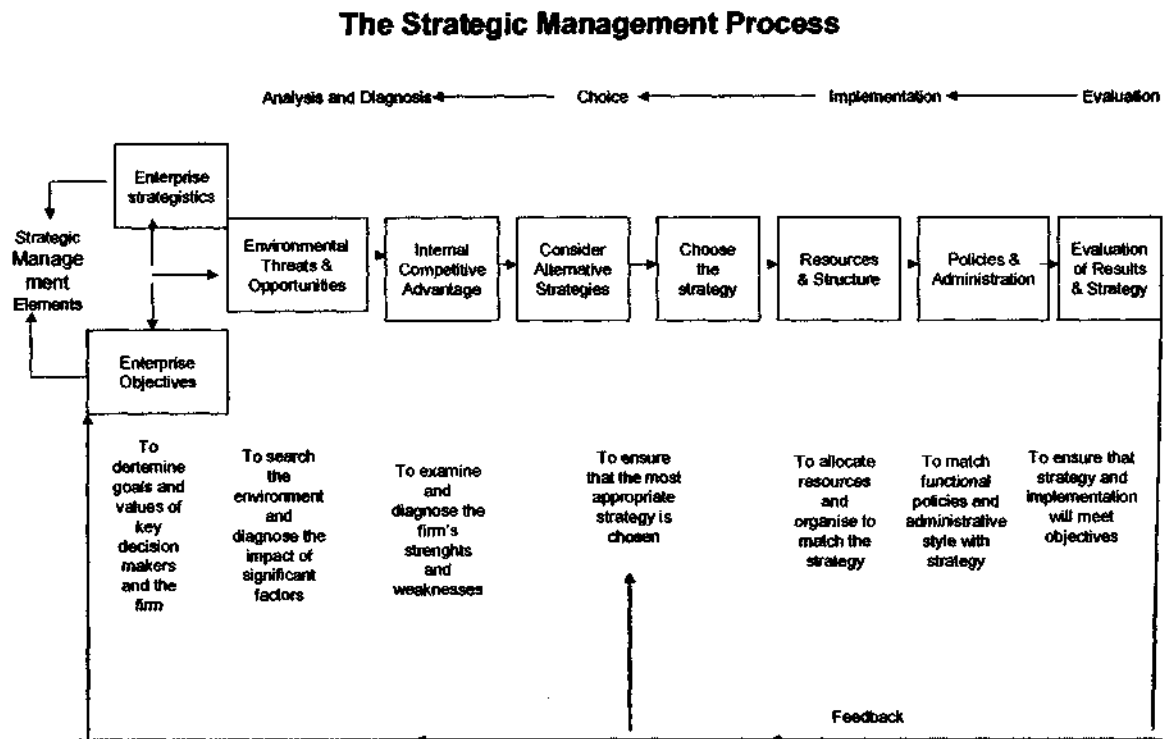
The SARS approach to pro actively improve stakeholder relationship and performance in service delivery has lead it to extensive modernization in areas of import and export processing such as electronic data interchange (EDI) which allows for efficient and effective release of cargo and electronic submission of manifest to advise customs in advance of the intention to import goods into the country. These efficiencies have enabled major manufacturers to further enhance their efficiencies by adopting Just in Time principles to minimize stock holding and reduce the amount of capital outlay within the industry.

## **2.5 The Strategic Management Process**

A well formulated strategy must take into account the process through which it will be implemented and its through implementation that strategies are formulated and revised. Mintzberg and Walters (1985) compared the strategic management process of intended strategies (strategies that originate from the planning process) with realized strategies (what the organization actually did - the crafting process) and found that in the planned strategy intentions are concise and directly translated into actions. The emergent strategy decisions arise through bargaining, chance and positive feedback.

Grant (2001) recognizes that skills, dedication, involvement and creativity are vital for success however he advocates that without proper analysis, decision making is more likely to be disorganized providing limited capability for evaluating and comparing alternatives. The approach therefore that the research will follow is a more rational, analytical method to strategy formulation rather than that advocated by Mintzberg. Glueck and Jauch (1984) in figure 2.3 set out a model that will form the basis for our evaluation of the strategic management process.

Figure 2.3 The Strategic Management Process



Source: Business Policy and Strategic Management, Glueck and Jauch, pg 6

The primary phases of the model will typically include analysis and diagnosis of the environmental factors, opportunities peculiar to the organization. Lynch (2003), states that corporate strategy should provide value to stake holders involved in the organization therefore its mission and objectives have to be carefully analyzed to determine whether there is the necessary strategic fit with the environment and the company resources.

The choice phase will include assessing and evaluating alternative solutions to provide the best strategic decision. Johnson & Scholes (2002) indicate that the choice that will be made will be that which will give the company the comparative advantage and provide direction for the future of the company. He further states that the options will be selected based on the extent to which they meet the test of suitability, acceptability and feasibility.

The implementation stage will include looking at a proper structure, policy plans and the management of organizational change to realize the intended strategy.

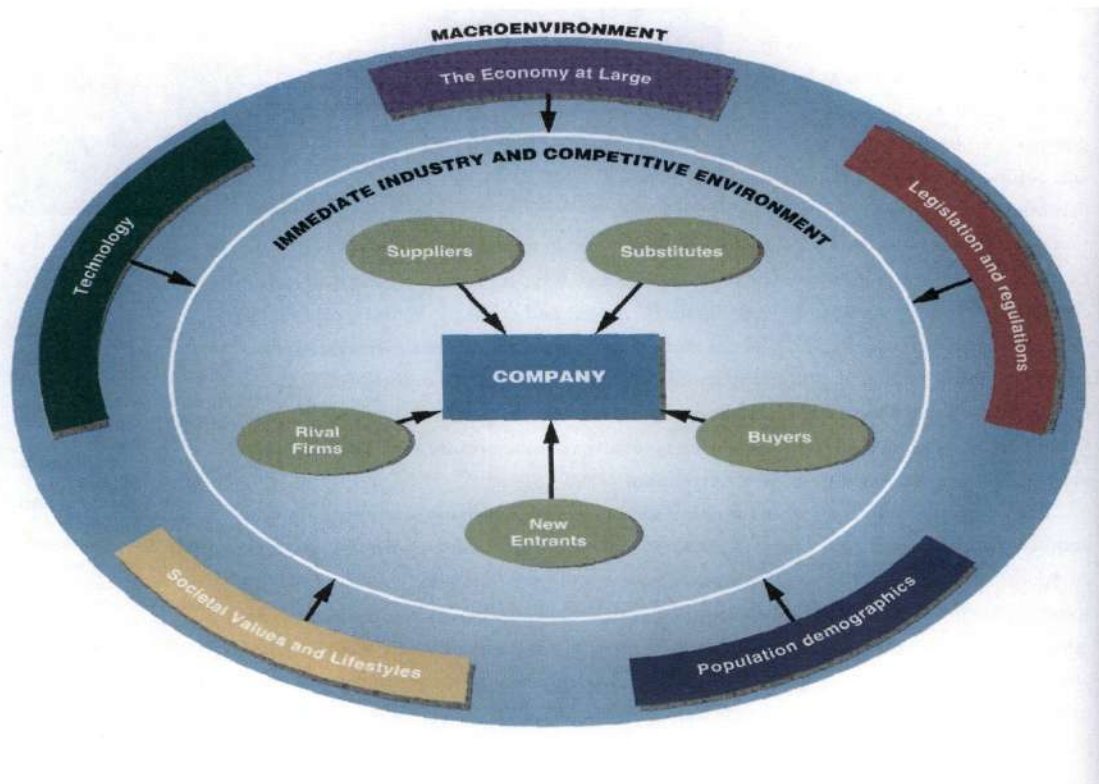
Due to globalization and the dynamic business environment, evaluation of the strategy is crucial to ensure that through feedback that is necessary to monitor the progress that is being made to achieve the company's objectives and make any changes should the need arise to keep the organization moving in the right direction.

## **2.6 Environmental Analysis**

Organizations function in the macro environment which consists of factors such as the economy at large, people's values, government policies and technological factors. The organizations also function in the immediate industry, this means that the firm should provide value to its customers, build strategic relationships with its supplies and ensure that it has a sustainable advantage to compete in the market place (Thompson and Strickland, 2003).

Grant (2001) distinguishes between vital and merely important environmental factors which are essential for effective strategic analysis as depicted in figure 2.4. He argues that although the macro environment plays a role the impact it has is relevant to the industry the firm functions in. The understanding of the company's internal and external environment is essential for developing strategic alternatives to provide a sustainable competitive advantage.

Figure 2.4 A Company's Macro Environment



Source: Strategic Management Concepts and Cases, 13<sup>th</sup> Edition, Pg 74

### **2.6.1 The Importance of Studying The Environment**

The environment is an essential element in developing a successful corporate strategy. It provides an insight into the nature of competition within the industry as well as the opportunities and threats that are inherent in the organization. These opportunities and threats may arise from the policy and regulations promulgated by government, changes in the cultures of the organization or the society and technological advancements that is being made. Porter like many other writers in the field of management and business show that strategic alliances with members in the supply chain are indispensable to achieve innovation, high quality standards and competitive prices, this all in the aid of creating value that will enable consumers to distinguish the organizations products from that of its competitors.

Lynch (2003), argues that there are three difficulties in determining the connection between the organizations corporate strategy and its environment.

- The prescriptive strategist believe that the environment can reasonable be interpreted in the market place while emergent strategist believe that the environment is to chaotic and unstable to provide any purpose in analyzing the environment.
- Uncertainty exists even in the chosen option as strategies have to be continually adopted in the turbulent environment that industries function in.
- There is a wide range of influences that impact the environment and providing a checklist is simply not prudent. A successful analysis should include understanding what the key success factors should be, and directing the environmental analysis towards these factors.

Whether the view is prescriptive or emergent, the reality is that the environment is subjective and poses a huge risk if not managed properly. Senior managers therefore need the ability to foresee as well as to react to environmental issues that may arise.

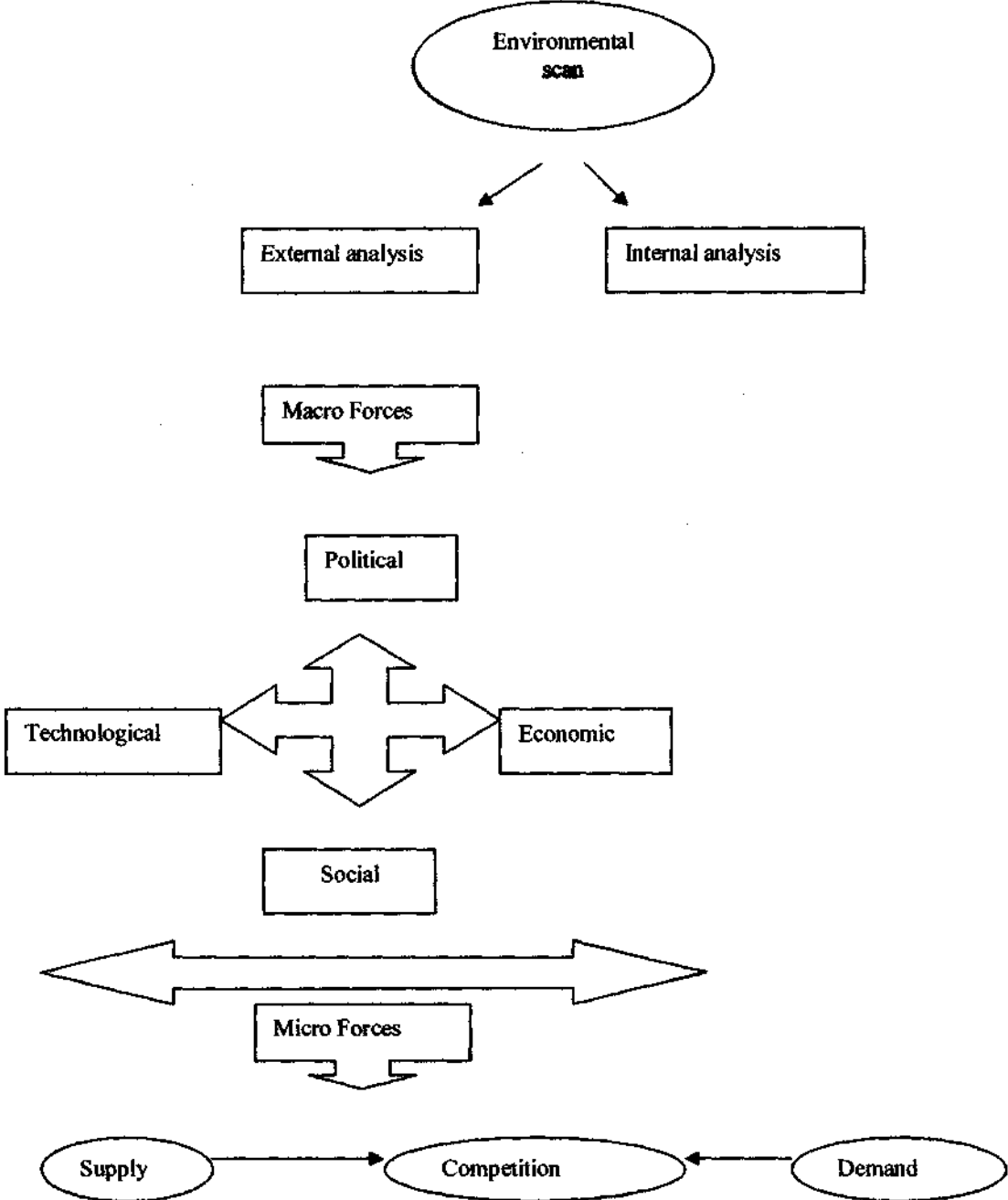
### **2.6.2 Analysing the Environment**

There are no simple rules governing the organization therefore each organization needs to formulate it own manner in which it will analyze it organization. Although other techniques exist two techniques that will be discussed is the ‘PEST’ analysis, which stands for the political, economic, social and technological aspects of the environment however the PEST analysis at times maybe expanded to include the legal and environmental analysis, giving us the acronym ‘PESTEL’ (Lynch, 2003).

The PEST analysis is seen to be more a forecast of historical information while some strategist argue that strategy is concerned with the future however the best evidence about the future can be ascertained form the past. Figure 2.5 indicates how the PEST forces fits into the overall environment.



Figure 2.5 PEST Forces



Scenario based analysis, according to Lynch (2003), is a possible model for future environmental analysis, where strategic implications can be investigated. Scenario based analyses takes the current situation and extends it to the future, it is not a model that predicts the future. It starts with taking several situations considering alternative starting points. The aim is to obtain a set of possibilities or scenarios that can be compared to determine its strategic significance.

Lynch (2003) describes the process as follows:

- Start from a radical view point.
- Develop a “qualitative description” of how events will unfold.
- Explore the result by building a few scenarios of the possible outcome.
- Introduce some environmental factor that could be obtained from the PEST analysis to explore possible reactions of the intended scenario.
- Test the scenario in terms of the suitability, acceptability and feasibility it has to the strategic objective, taking into account that it should lead to new strategic choices and involve a creative approach to adding value for the stakeholders and the consumers alike.

## **2.7 Industry Analysis**

An industry analysis concentrates on the forces that influence the organization. The aim is to establish a firm dominance in the market place that out matches all rivalry. Professor Michael Porter played an instrumental role in providing a structure for analyzing the competitive environment, which has wide range of implications for both the private and the public sector.

Competitor analysis has an essential role in strategic planning (internet 2).

- To help management understand the competitive advantage and disadvantage of its competitors.
- To understand the competitors past, present and future strategies.

- To develop an informed basis for future strategy development.
- Aid in establishing what the future returns are from investment and possible reactions that competitors will make in response to your intended actions within the market.

### **2.7.1 Key Success Factors In the Industry**

The key success factors (KSF) are those skills, resources, competitive capabilities and attributes that are essential for an organization to provide value to its stakeholders and consumers. In many large organizations success is measured by the level of profitability while in sum Public Services, success may be wider and include factors such as:

- Service delivery
- Protection of the society

According to Lynch (2003), KSF are common in major organizations competing within the same industry and do not differentiate one company from another. A useful starting point in analyzing the environment is to ascertain the factors that will play an integral role in achieving success within the organization.

Thompson and Strickland (2003), identify three questions that will assist to identify KFS:

- What decision criteria consumers use to choose between brands? What product attribute are crucial?
- What resources and competitive capabilities does a seller need to be competitively successful?
- What does it take for seller to achieve sustainable competitive advantage?

SARS playing a strategic role in the supply chain has to ultimately provide rapid and effective services, reduce administrative barriers to entry and be stimulus for foreign direct investment. SARS also has to ensure that its cost of collection is less than 1% of its cost of revenue collected through duties and taxes. This all has to be done while competing with other Public service

departments such as the department of Health and Transport for a bigger slice of the resources from Treasury. The more important key success factors in the industry will be discussed below.

### **Technology**

The ability to use improved technology to provide effective and efficient flow of communication between stakeholders and the organization, SARS has made use of the accredited client system that allows for electronic release of goods for certain categories of traders, this provides for effective facilitation of trade.

### **Marketing**

Extensive client and trader awareness in areas of trade agreements, benefits of closing the tax gap and an overall higher compliance rate can substantially improve cost of collection of revenue.

### **Skills and Capabilities**

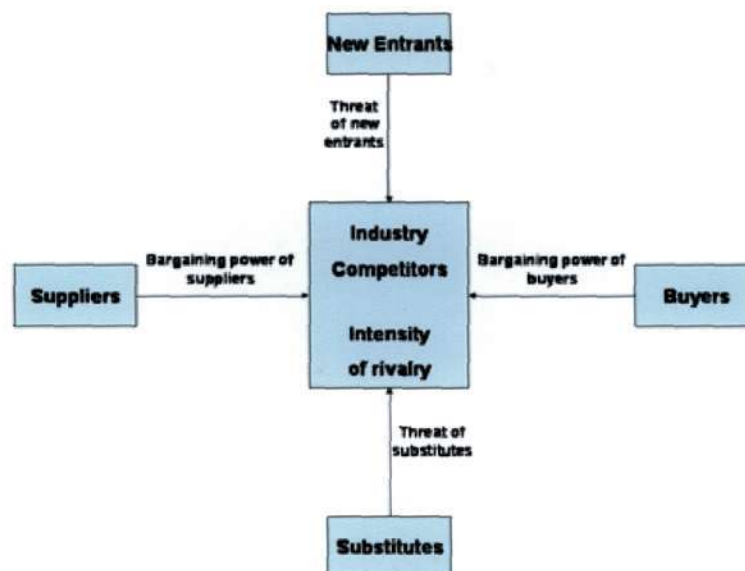
The public sector in particular SARS has embarked on a private public partnership in areas such as implementation of devices such as scanners for non intrusive inspection of goods. This not only has increased the capability of the organization but has resulted in international skills sharing from foreign customs administration and private enterprises. The area of customs is leased studied in the South African university, a proactive approach by SARS to establish a training school will enable core skills to developed, increasing specialization and creating a source for potential future resources.

Stephen Covey in his seminar in Sandton City, during March 2003, stated that we have created gaps in our organization more so as we have not been able to effectively move from the production age to the knowledge age. He further stated that we see machinery which can be clearly imitated as an investment rather than labour which is complex an unique as a cost, when It is one of our core capabilities that can be used to achieve a competitive advantage.

## 2.8 Analysis of the Competitive Environment

In industry organizations produce and market goods that have close similarities or similar uses. Some industries are more profitable than others, this in turn attracts organizations who wish to exploit the market opportunities in this area. The key to successfully maintaining leadership or a substantial market share is to understand the competitive structure of the Industry. There are several aspects of an organization that determine the intensity of competition within the industry. Porter's five forces model reproduced in figure 2.6 provides an effective model to understand competition within the industry.

Figure 2.6 Porters Five Forces Model



Source: Free Press, Techniques for Analysing Industries and Competitors, Michael E Porter, 1980

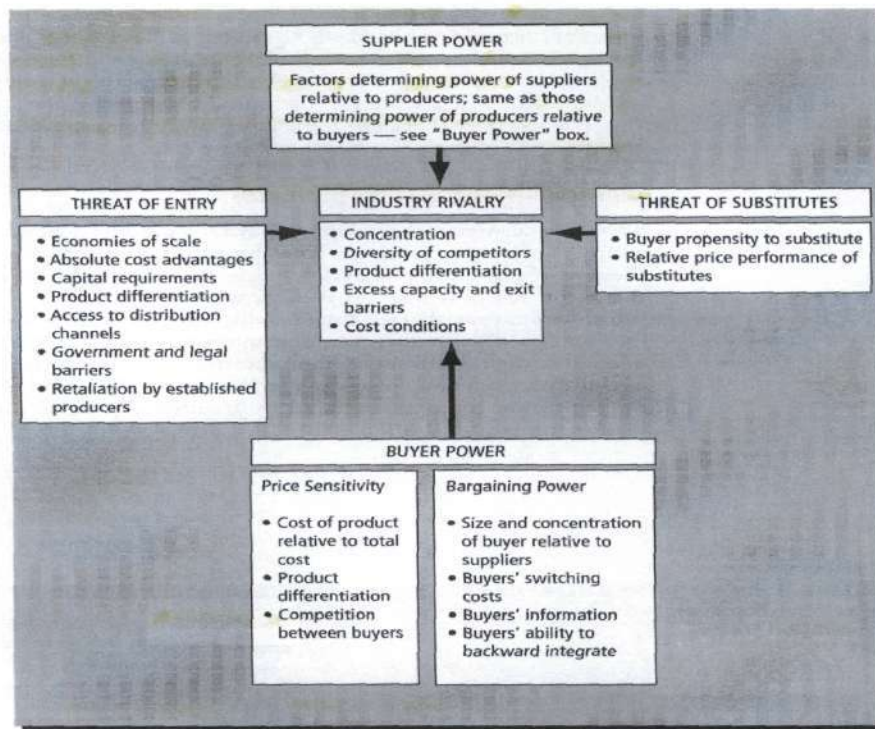
Porter explains that there are five forces that determine industry attractiveness and long-run industry profitability. These five "competitive forces" are

- 👇 The threat of entry of new competitors (new entrants)

- ✚ The threat of substitutes
- ✚ The bargaining power of buyers
- ✚ The bargaining power of suppliers
- ✚ The degree of rivalry between existing competitors

Grant (2001) further provides us with figure 2.7 that enables us to understand the strength of each of the competitive forces.

Figure 2.7 The Structural determinants of competition and profitability within the Porters framework

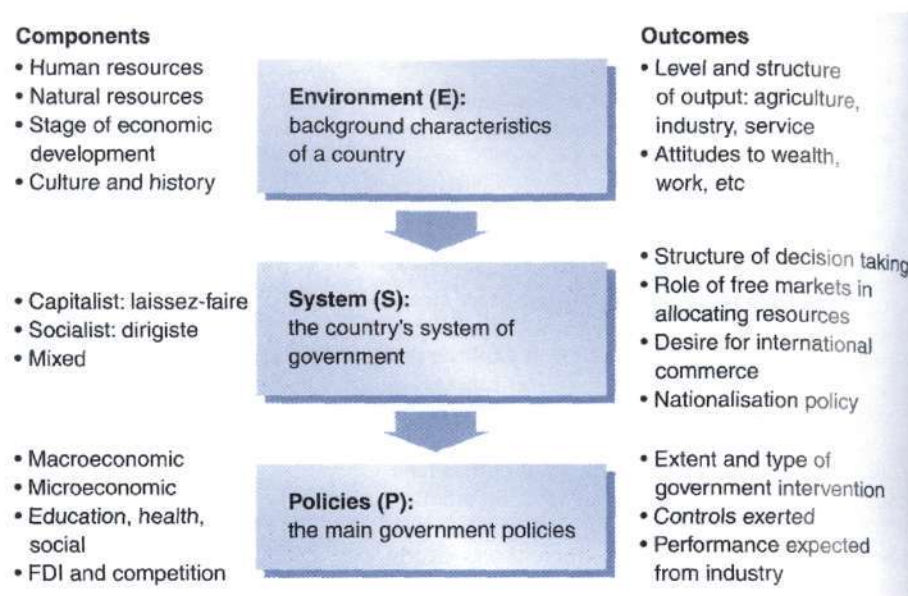


Source: Grant 2001, Contemporary Strategic Analysis, Pg58

## 2.9 Driving Forces

Industry and competitive conditions within an industry change due to the fact that there are factors and forces that are in place creating the pressure and incentive to change. Decisions made within the public sector are inextricably linked to private sector strategies. Government by its actions can either stimulate or regress the national economy. Lynch (2003), identifies three areas that influence strategy, the environment, the systems and the policies as indicated in figure 2.8.

Figure 2.8 Role of Government



Source: Adopted from Koopman, k and Montias, JM (1971), on the description and comparison of economic systems" university of California Press, Berekely.CA

South Africa's move towards democracy in 1994 and in it's inevitable entrance into the global market, lead to a change in the environment, its functions and its systems creating with a greater need for the freedom of movement of resources. A more proactive government stance was needed to stimulate the economy and encourage foreign direct investment. South Africa embarked on policies such as the Reconstruction and Development Plan and then the Growth Equity and Redistribution policy to achieve global competitiveness.

If we are to look deeper into the driving forces that changed the public sector functions, especially SARS, factors listed below played an instrumental role.

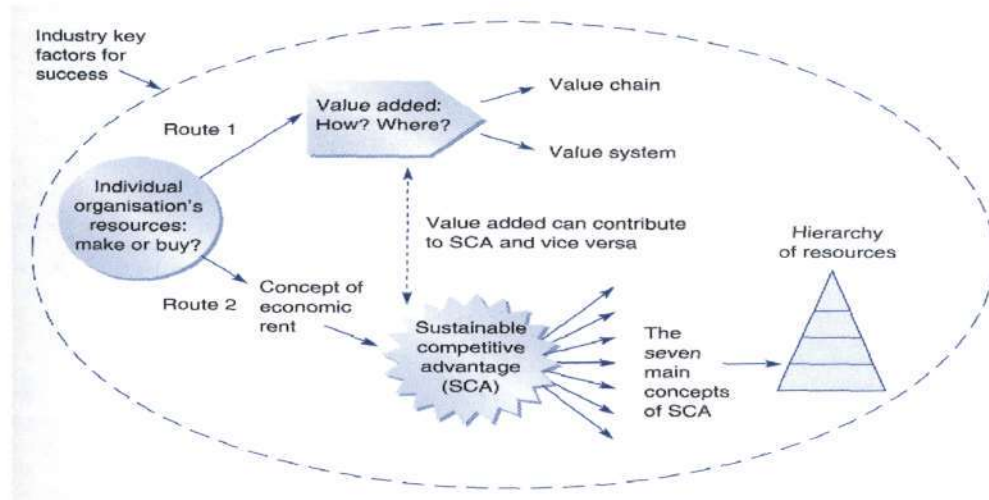
- Increased globalisation has created the need for improved service delivery. South Africa being one of the developing countries have to compete with the likes of Singapore and Malaysia amongst others. Reduced entry barriers and opening of markets in countries that were previously autocratic in leadership has undoubtedly been a magnet for investment.
- Internet and E-commerce, has lead to business to business communication. The need to improve communication flow has brought with it opportunities as well as threats. SARS by the implementation of the electronic data interchange system has been able to use this technology to facilitate trade, therefore aligning its self with Just in Time principles that are practised in large corporations. This in turn has also opened the organisations to more sophisticated levels of fraud and other disclosure requirements.
- Societal concerns, attitudes and lifestyle, has created growing concern regarding 'green' issues such as nuclear waste passing through South African harbours and terrorism threats have spawned a greater need for improved enforcement capabilities within the country while still ensuring facilitation.

### **2.10 Internal Analysis**

The organisations resources are the corner stone of strategy development. The organisation generates value by means of paying salaries to employees, dividends to its shareholders, essential services to the society and revenue to the fiscus. The organisation also uses the resources to differentiate itself from other organisations to deliver a sustainable competitive advantage. It therefore stands to reason that the organisation is only as successful as the capabilities of its resources. Figure 2.9 below indicates that resource analysis has to proceed along two areas, the value added and competitive advantage continuum.



Figure 2.9 Analysing Resources



Source: Richard Lynch, Corporate Strategy, 2003, 3<sup>rd</sup> edition, page 201

The value added route indicates how supplies are transformed into finished goods or services, which are then utilised by the market (Lynch, 2003). The competitive advantage route indicates how these combinations of resources deliver sustainable competitive advantage. This enables us to establish a framework to explore and analyse the strategic capabilities of the organisation.

### 2.11 Resource Based Analysis

Grant (2001) re-affirms that a company's vision and purpose is the starting point for the formulation of strategy. He further confirms that in a volatile environment a market focused strategy will not develop the desired result therefore the company's resources and capabilities might be a much more consistent basis to define its identity. Generally the firm's resources and capabilities provide a more stable foundation for long term strategy in light of the volatile external environment.

The resource view emphasises that by exploiting the differences amongst firms an organisation can achieve superior performance. Organisations should seek thorough knowledge of their resources

and capabilities to gain a sustainable competitive advantage. Factors that Pearce and Robinson (2001) as well as Grant (2001) outline as a guide when using resources based approach include:

- Select a strategy that exploits a company's principle resources.
- Break the competencies into specific competencies rather than having a broad category of competencies.
- Exploit the organisations resources effectively and efficiently.
- Utilise a functional approach.
- Build the future resource base of the company.
- Look at the resources holistically and not as isolated assets or capabilities.
- Use the value chain approach to determine capability as a source of potential advantage.

While a resource based view provides a good foundation for analysing the internal resources it should be used in context of the firm's competitive environment. The SWOT analysis will be examined next and should assist in complementing the resource based approach in conducting an effective internal analysis.

## **2.12 SWOT Analysis**

When conducting strategy planning for an organisation it is useful to take into account your own business activities as well as that of your competitors. A SWOT (strength, weakness, opportunity and threat) analysis is one such tool that can assist you achieve this. A SWOT analysis is based on the premises that strategy formulation efforts are aimed at attaining a good strategic fit between it internal capabilities and it external competitive market. The real value of the SWOT analysis lies in the ability that the strength, weaknesses, opportunity and threats can be effectively utilised to provide management decision making capabilities. Figure 2.10 gives a representation of a typical SWOT matrix.

Figure 2.10 SWOT Matrix

	<b>Strengths</b>	<b>Weaknesses</b>
<b>Opportunities</b>	S-O strategies	W-O strategies
<b>Threats</b>	S-T strategies	W-T strategies

Source: Internet 7

**S-O Strategies:** pursue opportunities that are good fit to the company's strengths.

**W-O Strategies:** over come weaknesses to pursue opportunities.

**S-T Strategies:** identify ways the firm can use its strengths to reduce its vulnerability to external threats.

**W-T Strategies:** Establishes a defensive plan to prevent the firms weaknesses from making it highly vulnerable to external threats.

Thompson and Strickland (2003), indicate factors that can be considered as strengths.

- A skill or important expertise
- Valuable physical or human asset
- Valuable organization asset.
- Valuable intangible asset such as brand name.
- Competitive capability
- Alliances and corporative ventures

While the above factors suggest important strengths, any deficiencies in any of the above factors can lead to an internal weakness. While the market opportunity is essential for the future growth

of the organisation, organisations must ensure that the opportunities that are selected have a good strategic fit with the resources and competencies of the organisation.

The threats an organisation faces may resemble itself in the form of new technology, lower cost or new regulations. These threats may be small or they could be devastating to the existence of the organisation. The responsibility therefore lies in the hands of the leaders of the organisation to evaluate the threats that exists in the external environment and put plans in place so as to overcome these threats. Thompson and Strickland (2003), emphasis that tailoring a strategy that best suits a company situation entail:

- Pursuing market opportunities that will suit the company's resource capabilities.
- Taking action to defend against external threats to the organisations business.

Grant (2002) argues that while the SWOT analysis is a framework for distinguishing between the internal strengths and weakness, and the external environments opportunity and threat it is handicapped in that the SWOT analysis provides an arbitrary classification of the external and internal factors. The strategy of an organisation has to therefore be consistent with its goal, values, resources, capabilities and the external environment, providing a good strategic fit.

### **2.13 Value Chain Analysis**

Every organisation consists of a set of activities undertaken which include designing, producing, marketing and delivery of a product or service. The cost involved in producing this product or service has an overall implication on the competitiveness of the organisation. Task analysis is therefore useful in ascertaining the company's cost of producing a product or service relative to its rival. One of the main analytical tool for the strategic cost analysis is the value chain. Thompson and Strickland (2003), state that a value chain, "shows a linked set of activities and functions it performs internally" as depicted in figure 2.11.

Figure 2.11 The Value Chain



Source: Thompson and Strickland, 2003, *Strategic Management Concepts and Cases*, 13<sup>th</sup> Edition, Pg 74

Creating value over the cost of performing the activity is the overall objective of the organisation. Value chains of rival organisations often differ for various reasons. This may include the degree of vertical integration, it is understandable that a company that produces its own parts incurs substantially higher cost than that of a company that buys the parts that it needs. Likewise the cost of a company using a low cost leadership strategy will differ from an organisation perusing a high value differentiation strategy.

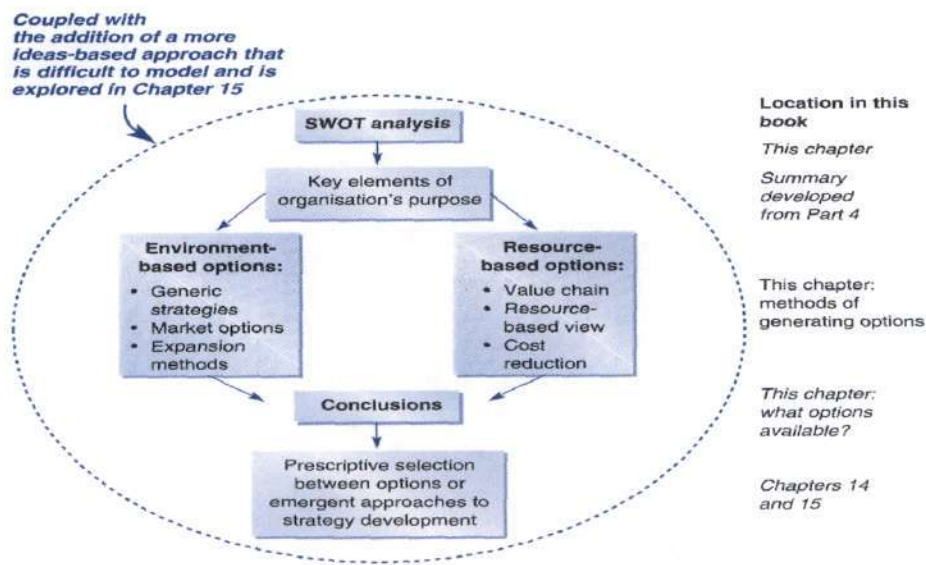
In analysing the value chain we need to distinguish between primary activities such as the production process itself and support activities such as research and development process, that together give meaning and existence to the organisation.

### **2.14 Developing Strategic Options**

Professor Andrews (1987) stated that the link between the company's mission and objectives with the strategic options are crucial to the development of an individual strategy and the ability to identify competitive advantage. The option development process begins exploring the competitive environment by looking at generic, market options and expansions strategies. The

focus then shifts to the company's own resources and looks at the resource base view together with the cost cutting options. Figure 2.12 adopted from Lynch 2003, indicates a typical strategic development options model.

Figure 2.12 Developing Strategic Options



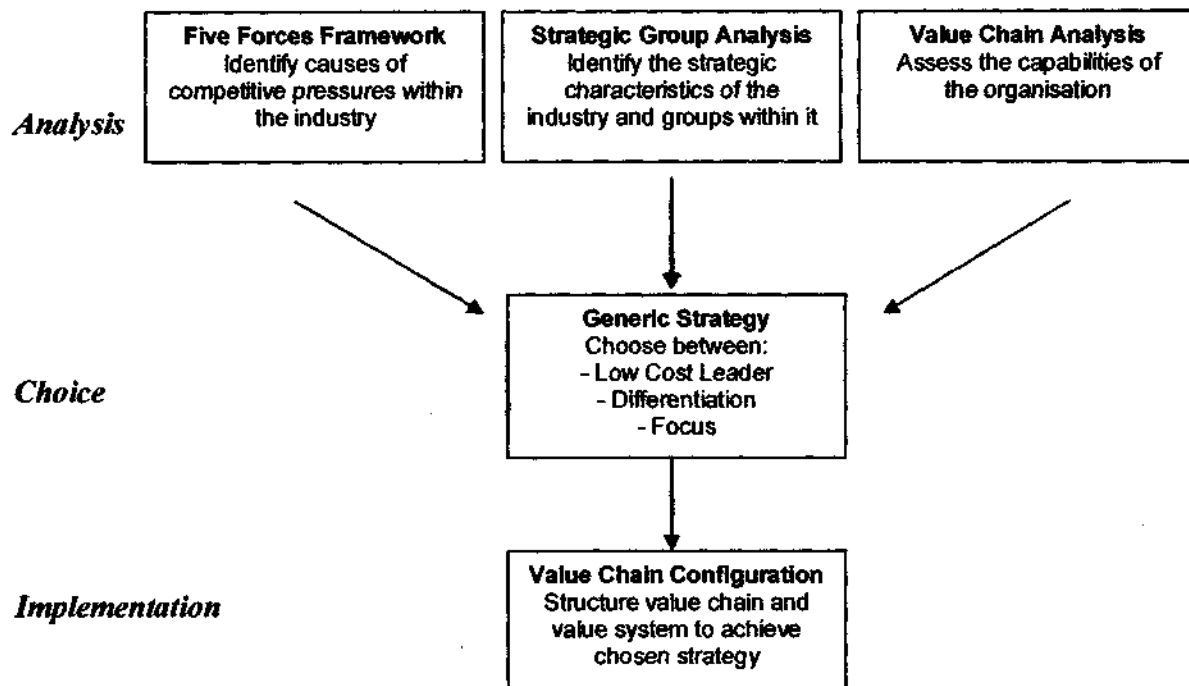
Source: Richard Lynch, Corporate Strategy, 2003, 3<sup>rd</sup> edition, page 461

### 2.14.1 Porters Positioning Approach

Porter can be regarded as one of the founding father of the positioning approach which was realised mainly due to the need to achieve sustainable competitive advantage. This was an outside in approach to strategy with the company choosing a strategy that best fits the opportunities and challenges of the external environment. A procedure of strategic decision making one that is of a prescriptive nature. The approach is based on the structure, conduct and

performance paradigm and when analysed further include the following steps as depicted in figure 2.13 (Internet 3):

Figure 2.13 An Outline of the Positioning Approach



Source: Johnson & Scholes, Exploring Corporate Strategy, 2002, 6<sup>th</sup> edition, CH 4.

- Analyse the industry and its attractiveness (using the five competitive forces and the strategic group analysis).
- Choose one of the three generic strategies (cost leadership, differentiation and focus) ensuring that the organisations is positioned in such a manner that it utilises one strategic option.
- Use the value chain to form an operational chain that distinguishes between primary and support activities.

While Porter started the evolutionary discussion that changed the direction of strategic decision making, by using his five forces model and focusing on the position of a company within the industry as a basis for extra ordinary profits, several writers have emphasised that the approach is

seen to be static. Focusing on a firm's capabilities and core competences prior to the consideration of external firm variables such as industry composition seems more plausible.

### 2.14.2 Generic Competitive strategies

The core of a company's competitive strategy is to deliver added value to consumers by making use of internal initiatives. This may also include offensive and defensive move to counter act the actions of competitors, re allocation of resources that pose the greatest strategic advantage and the development of new markets to attain long term competitiveness

In figure 2.14 Thompson and Strickland (2003), set out five generic strategies that stand out.

Figure 2.14 Generic Strategies

		Competitive Advantage	
		Low Cost	Differentiation
Competitive Scope	Broad	Low Cost Leader	Differentiation
	Narrow	Low cost focus	Differentiation focus

Source: Adapted from M E Porter, Competitive Advantage, Free Press, 1985



- A low cost strategy- appeal to the overall market by being a low cost provider.
- A broad differentiation strategy-differentiating the company's product to appeal to a wider range of buyers.
- A best cost provider strategy- giving the consumers added value when purchasing the product.
- A focused strategy based on low cost- focusing there attention on a certain segment of the market and out competing rivals by means of low cost.
- Focused strategy based on differentiation- concentrating on a certain segment of the market and out competing rivals by means of offering special attributes that are unique to the organisation.

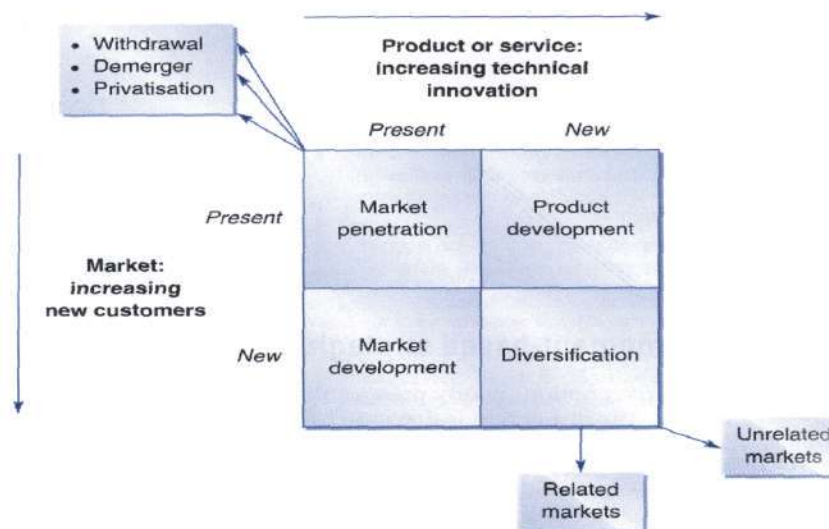
While Professor Michael Porter, of the Harvard school of business initially utilised the generic strategies based on the environmental option to determine possible strategies, modern day strategist believe it to be too historical and prefer the resourced based view to the development of strategic options. The resource base option is valuable when market opportunities are limited and resources are scarce.

### **2.14.3 The Market Option Matrix**

The market option matrix presents the market choices and the product opportunities available to the organisations. The market option matrix takes into account a wider strategic perspective and considers options such as launching new products and moving into new markets as well as possibility of withdrawing from existing markets and moving towards un related markets. Figure

2.15 illustrates through the Ansoff Model the strategic choices that can be made by an organisation.

Figure 2.15 Ansoff Model



Source: Richard Lynch, Ansoff Model, 2003, 3<sup>rd</sup> Edition, Pg 479

The model presents four sets of broad options which include:

- **Market penetration in the existing market-** this strategic option aims to attract customers from directly competing products by penetrating the existing market. Retaining existing customers forms the central point for maintaining sustainable competitive advantage as direct competition invites retaliation from competitors. Increasing market share should include investment in product quality building brand equity as this will most certainly help achieve long terms goals over and above a pricing strategy that is centred on aggressive price cutting.
- **Market development using existing products-** this option focuses on attracting new customers for its existing product range. This may include seeking new segments of the market, looking for exposure to extended geographical range and new uses for the product that will eventually bring in new customers (Lynch 2003).

- **Product development for existing market-** This strategy aims to substantially improve on and introduce a new product to the market. Lynch (2003), states that the following reasons could provide a justification for new product strategy:
  - ◆ To utilise excess production capacity
  - ◆ To counter competitive entry
  - ◆ To exploit new technology
  - ◆ To maintain company image as a innovator
  - ◆ To protect overall market share
- **Diversification strategy-**when a company diversifies it moves out of its current products and markets. This move carries with it a risk of moving into the unknown. The level of risk the company is willing to take depends on whether it should move into the related or un related market.

Moving into a related market will mean that the company's value chain has some kind of connection with the market it is going into and can be distinguished as follows.

- ◆ When the company is involved with the outputs of the activity such a distribution, this is known as *forward integration*.
- ◆ When the organisation becomes involved into supplying the inputs to the value chain such as raw materials, this is known as *backward integration*.
- ◆ When the organisation moves directly into areas related to its existing activities, this is known as *horizontal integration*.

The aim of this strategy is to create synergies so that more effective control is achieved from having control of the value chain.

The move into unrelated markets is one that is even more risky, mainly due to the fact that detailed knowledge of the key success factors is limited. The rationale for such an option

could merely be a speculative venture. Buy and develop an existing industry and then sell it off at a profit or to become a holding company that can diversify its risk.

#### **2.14.4 The Expansion Matrix Option**

Regardless of the organisations motivation to expand outside its markets the strategies it uses to compete will be driven by the organisations internal and external expansion opportunities and its geographical spread of activities. Organisations had to move outside there home country markets to achieve and maintain there market share. The potential for market growth varies significantly from country to country, emerging markets have a higher potential for growth than economies that are mature. Thompson and Strickland (2003), state that one of the most important dilemma's in competing in foreign markets is whether to customise the company's offerings in each country or whether to offer a more standardised product world wide.

Figure 2.16 Expansion Strategies

		Company	
		Inside	Outside
Geographical location	Home country	<ul style="list-style-type: none"> <li>• Internal development</li> </ul>	<ul style="list-style-type: none"> <li>• Merger</li> <li>• Acquisition</li> <li>• Joint venture</li> <li>• Alliance</li> <li>• Franchise</li> </ul>
	International	<ul style="list-style-type: none"> <li>• Exporting</li> <li>• Overseas office</li> <li>• Overseas manufacture</li> <li>• Multinational operation</li> <li>• Global operation</li> </ul>	<ul style="list-style-type: none"> <li>• Merger</li> <li>• Acquisition</li> <li>• Joint venture</li> <li>• Alliance</li> <li>• Franchise</li> <li>• Turnkey</li> <li>• Licensing</li> </ul>

Source: Richard Lynch, 2003, Corporate Strategy, 3<sup>rd</sup> Edition, Pg 483

Figure 2.16 indicates possible expansion strategies that can be used which include:

- ◆ Acquisitions-the organisation uses this approach to develop by acquiring another organisation. The relevance of such an option is to possibly build brand equity, acquire some core competencies and special technology.
- ◆ Mergers- A merger is similar to an acquisition, however this sort of option if followed mainly due to the fact that neither of the company has the resources to acquire the other company on its own.
- ◆ Joint venture and alliance-this is a formation of a company whose shares are jointly owned by two parent companies. An alliance is an agreement by through Mutual Corporation to develop each other.
- ◆ Franchise-is a right in the form of a licensing agreement in which the licensee has to produce a good or service, they make take the form of a brand name or a pre-formed package of activity (Lynch 2003).

#### **2.14.5 The Resource and Competence Based Approach**

The resource based approach sees organisations with superior systems and structures as being competitive as a result of having markedly lower costs, or offer markedly higher quality or product performance (Teece, Pisano and Shuen, 1997). This approach focuses on the rents (return earned by the resources over and above that required to bring it into production), accruing to the scarce factors of production rather than the profits of the product market positioning.

Recent empirical literature has suggested that a firm's resource is vital for its success. Cool And Schendel (1988), in there study of the pharmaceutical industry revealed a significant difference in the degree of performance of organisations competing within the same strategic group.

A comparison of the resource based approach and the competitive forces approach revealed the following by Teece et al. (1997). The competitive forced approach typical entry into a specific industry followed the following process.

- ↳ Pick an industry based on its attractiveness.
- ↳ Choose a strategy based on speculation regarding competitors.
- ↳ Obtain or acquire the relevant resources to compete in the market

This competitive forces process rationally chooses the best alternative from a list of well defined investment choices. The resource based strategy is strongly opposed to this type of model, the resource based model is one that concentrates on the individuality of the organisation as the business development process is seen as a complex process as organisations lack the ability to develop key competencies quickly, resources are not easily tradable e.g. Know-how and reputation. Given the fact that organisations resources are heterogeneous, the entry decision proposed by the resource base is as follows.

- ↳ Identify your organisations unique resources.
- ↳ Decide in which markets these resources can earn the highest rent.
- ↳ Decide whether the rents from those assets can be best utilised by integrating into related markets, selling intermediate output into related market or selling the assets themselves to a firm in the related market.

The following factors indicate when the use of the resource base model is valuable (Internet 3):

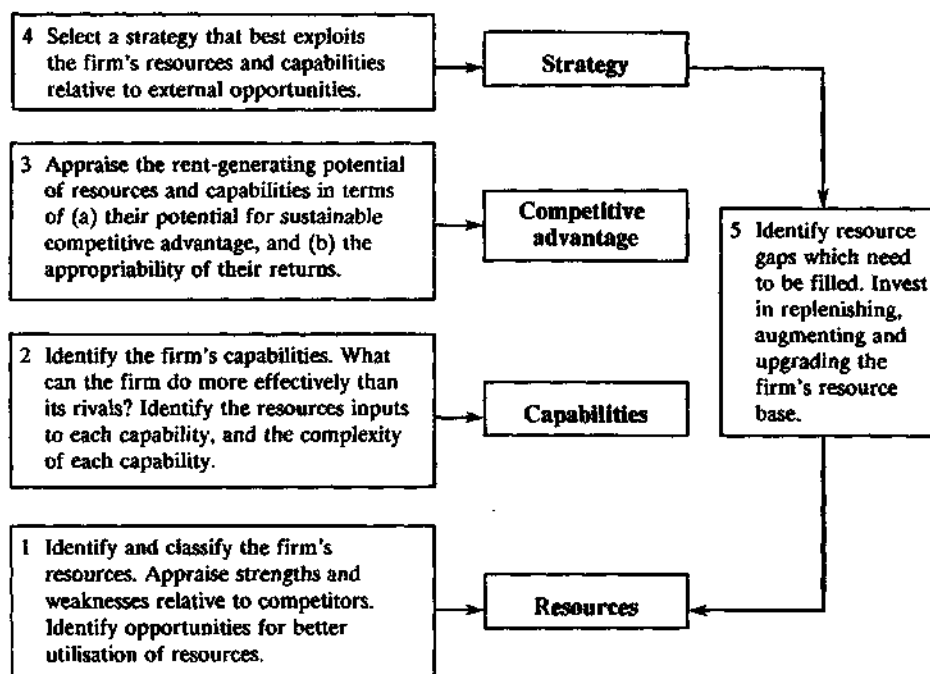
- ↳ In cases of acquisition and divestment.
- ↳ Entering joint ventures and other partnership agreements.
- ↳ Considering make versus by alternatives.
- ↳ Entering new markets.
- ↳ Taking on new strategies.

If control over scarce resources is the source for economic profits then issues such as skills acquisition, management of knowledge and know-how and learning become fundamental strategic issues.

### 2.15 Identifying Resource Gaps

Strategy is not only about deploying its resources and capabilities but also about building its resources in achieve competitive advantage in the future. A gap analysis is a conventional yet useful way to go about evaluating a company's strength, capabilities and weaknesses in developing a strategy that most effectively deploys its resources against its key success factors within the industry. Figure 2.17 provides a framework for analysing resources and capabilities.

Figure 2.17 Framework for analysing resources and capabilities



Source: Grant, RM, Contemporary strategic analysis, 2001, 3<sup>rd</sup> Ed (2001) pg 138.

The resource gap approach takes a somewhat statistic view to resource analysis. Professor Michael Porter contends that continuous improvement, innovation and upgrades are a key to successful competitive advantage. The strategic fit of the organisations resources is vital to ensure that current and future opportunities are effectively exploited. This strategic fit may form a strong basis for the organisation's ability to diversify into other related fields of business.

### **2.16 Core Competencies**

Core competencies can be derived from the combination of an organisations skills and technology to provide added value to its customers. A core competency is an internal activity that an organisation performs better than competitors. An organisations core competency may include skills and expertise in producing a product, speed, flexibility to adapt to different needs of the customer and ability to be innovative amongst others.

According to Thompson and Strickland (2003), "a company's core competency resides in its people and intellectual capital rather than its assets and balance sheet". A core competency does not automatically give you a competitive edge unless it becomes a distinctive competency that sets the organisation apart from its rivals.

According to Thompson and Strickland (2003), for a resource to comply as a basis for sustained competitive advantage the following factors need o be considered.

- Is the resource distinctive i.e. hard to copy?
- The life span of the resource.
- Is the resource competitively superior?
- Can the resources be out matched by different resource and capabilities of rivals?



### **2.17 Resource based strategy option: Cost Reduction**

Competition has intensified over the last decade especially with low wage production countries and introduction of advanced technology. This inadvertently means that in order to survive in the business arena organisations need to cut cost drastically. The following provides a useful guide for cost cutting strategy (Lynch, 2003).

- Cost savings in the designing of the product.
- Building supplier relationship to achieve best price and quality.
- Through achieving economies of scale and scope.
- Improving its experience curve in the production process.
- Increasing capacity utilisation by ensuring production is as close to capacity as possible.
- First mover advantage, by establishing the organisation as a low cost provider the image and brand can be maintained more economically than new comers as a presence is maintained in the market.

While cost cutting strategy is a useful means to attain greater turnover it does have several short comings. Overly aggressive price cutting leads to a price war that finally ends up in reduced profits. Cost advantage is normally short lived until competitors catch up therefore the value of the organisation cost advantage is the ability of the company to sustain this advantage over extended period of time.

Finally cost reduction strategy may distort the image of the company as well as creating limited flexibility in offering added value to the customers.

## **2.18 Combined Approach**

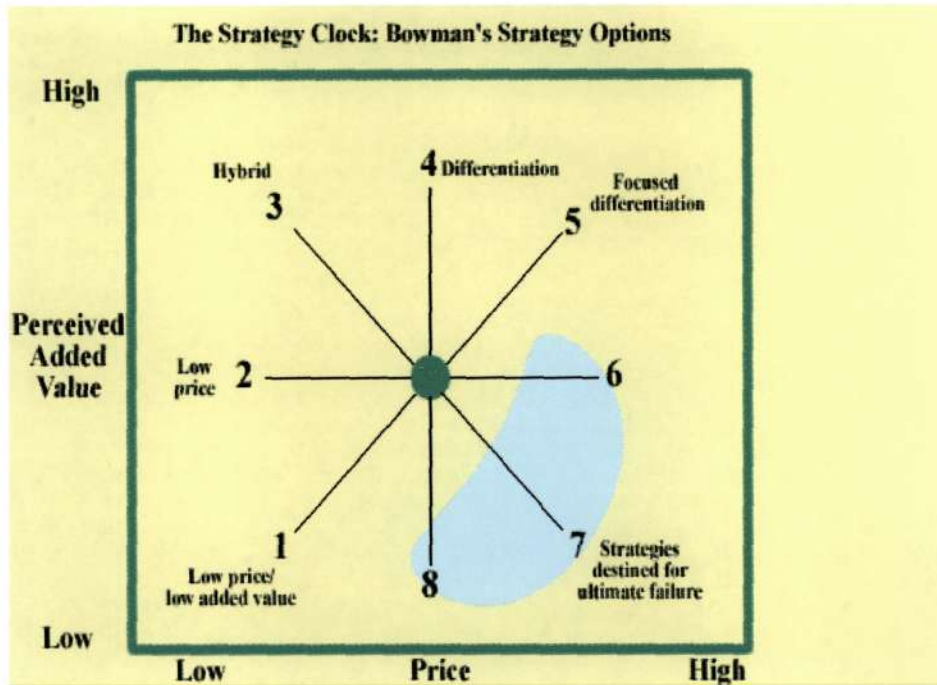
A search for sustainable competitive advantage comes from firm's internal capabilities as well as from understanding the environment and being innovative to meet market demands. Professor Michael Porter has in affect changed his original stance, emphasising the need for a resource based as well as a positioning approach to strategy development process.

In his article "what is Strategy?" (Porter ,1985), defines positioning from a supply side as a set of activities based on cost value or both he further emphasis that positioning does not depend on the differences in the demand side but can be based on the following classification below:

- Needs based positioning-serving the needs of a consumer base with a tailored set of activities.
- Variety based positioning-produce a sub set of an industry's product that attracts the customers some of the time.
- Access based positioning-by segmenting the accessibility of customers in different ways; a different set of activities can be used to reach them.

Porter is in affect arguing that sustainable competitive advantage comes from a firms capabilities as well as the ability the company has to position its self better than his competitors. Johnson and Scholes also outline a combined approach in their strategic clock where they argue that the key variables that are seen by the consumer are perceived quality and price. Figure 2.18 outlines the five possible strategic routes that are likely to succeed and three that are likely to fail.

Figure 2.18 The Strategy Clock



Source: Based on the work of Cliff Bowman, *Competitive and Corporate Strategy*, Irwin 1996.

### 2.19 The Long-term Objective as the Best Strategic Option

Managers have realised that seldom does short term profit maximisation bring sustainable growth and profitability. The decision is for the manager is therefore

- Should large dividend payments through cost saving, cutting back on investment and research and retrenchment be the order of the day or
- Should they commit the organisation to developing its resources and investing portion of their profits to attain long term rewards.

The answer seems to be quiet unanimous amongst strategists, to achieve long term prosperity is the best option. In this regard seven common objectives form the foundation of a successful strategic option this includes:

- Profitability
- Competitive position
- Employee development
- Employee relations
- Technological leadership
- Public responsibility
- Productivity

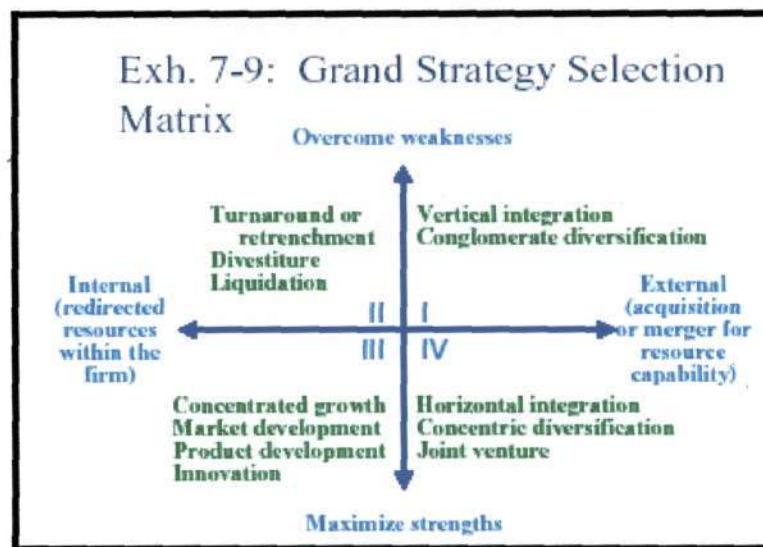
Sometimes referred to as master or business strategies, grand strategies refer to the broad options available to organisations in pursuing their long term objectives. Grand strategies include:

1. Concentrated Growth - A focus on a particular product / market combination. (i.e. selling existing products to existing markets).
2. Market Development - Selling existing products to new markets. Can include national / international expansion, or cross selling to new market segments.
3. Product Development - Developing new products for existing markets.
4. Innovation - A focus on product, process and management innovation.
5. Horizontal Integration - The acquisition of a company at the same stage of the value chain.
6. Vertical Integration - The acquisition of a company either further down the supply chain to wholesalers and retailers (forward integration), or further up the supply chain to suppliers (backward integration).
7. Joint Venture - A co-operative arrangement between a number of competitors who, as individual companies, lack the necessary competencies or resources to compete successfully.
8. Concentric Diversification - The acquisition or internal development of a business outside of, but in some way related to a company's existing scope of operations.

9. Conglomerate Diversification - The acquisition or internal development of a business outside of, and in no way related to a company's existing scope of operations.
10. Retrenchment / Turnaround - Temporary measures taken to "weather the storm", typically accomplished through cost or asset reduction.
11. Divestiture - The sale of a business or significant part of the business as a going concern.
12. Liquidation - The sale of a business's assets, not as a going concern.

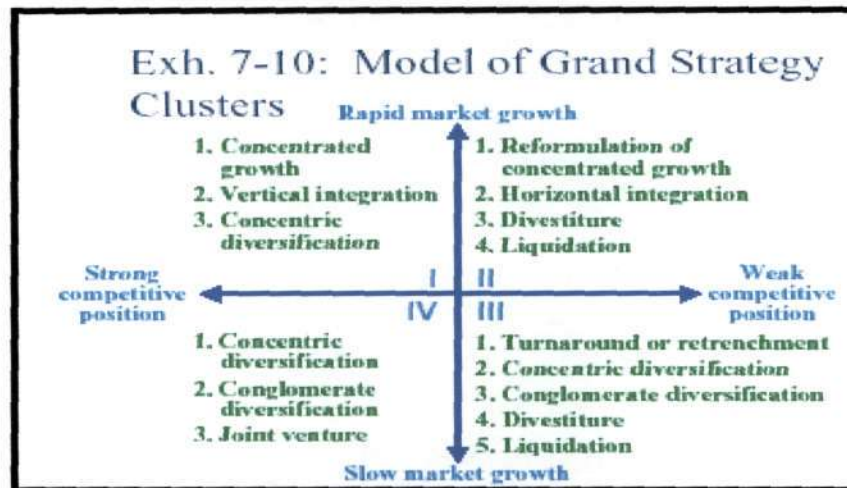
Anyone of these grand strategies forms the basis for achieving long terms objectives. Figures 2.19 and 2.20 provide useful tools to assist the organisation evaluate and provide a means of making a better choice among the grand strategic alternatives.

Figure 2.19 The Grand Strategy Selection Matrix



Source: Internet 8

Figure 2.20 Model of Grand Strategy Clusters



Source: Internet 8

## 2.20 Strategy Evaluation

Lynch (2003), bases strategy evaluation on six criteria's i.e.

- Suitability this criteria assesses whether the strategy addresses the circumstances in which the organisation is operating within.
- Acceptability deals with the expected performance outcomes if the strategy was implemented and the extent to which these outcomes match the expectations of its stakeholders.
- Feasibility is concerned with whether this strategy that is chosen can actually be made to work in practise. Lynch states that an option may lack feasibility in three ways i.e.
  - ❖ Due to the lack of culture. Skill and resources that is internal to the organisation.
  - ❖ The external organisation and the nature of competition within the industry.

- ❖ Lack of commitment from managers and staff alike.
- Business Risk that is taken must be acceptable to the organisation. The three factors that important when choosing the strategy include:
  - ❖ To make an explicit assessment of the risk.
  - ❖ Have a contingency plan to ensure that the loss is minimised.
  - ❖ Decide whether the level of risk is acceptable to the organisation.
- Attractiveness to stakeholders of the strategic option chosen is a vital issue. Stakeholders interests and perception may not always be the same. Therefore it is essential to prioritise the stakeholders interest
- The mission and values of the organisation is an indication of the value that the organisation will like to add to it stakeholders. An essential test of strategy is to establish whether the chosen option will be consistent in delivering this value that is the reason for the existence of the organisation.

The use of empirical evidence utilised by firms previously can prove also as a basis of making selections from the strategic options available. Lynch (2003), states that understanding a particular market and the competitive circumstances forms one of the basis for strategy selection. Arthur D little (1970) developed a matrix which matches the strengths and weaknesses within the organisation with life cycle of phase of the industry. Figure 2.21 indicates on one axis the stage of maturity of an industry from a young through to a declining market while on the other axis indicates the competitive position of the organisation within the market.

Figure 2.21 Evaluation Using the Life Cycle Portfolio Matrix

<i>Maturity</i>	<i>Embryonic</i>	<i>Growing</i>	<i>Mature</i>	<i>Ageing</i>
<i>Competitive position</i>				
<i>Clear leader</i>	<b>Hold position</b> Attempt to improve market penetration  <i>Invest slightly faster than market dictates</i>	<b>Hold position</b> Defend market share  <i>Invest to sustain growth rate (and pre-empt potential competitors)</i>	<b>Hold position</b> Grow with industry  <i>Reinvest as necessary</i>	<b>Hold position</b>  <i>Reinvest as necessary</i>
<i>Strong</i>	<b>Attempt to improve market penetration</b>  <i>Invest as fast as market dictates</i>	<b>Attempt to improve market penetration</b>  <i>Invest to increase growth rate (and improve position)</i>	<b>Hold position</b> Grow with industry  <i>Reinvest as necessary</i>	<b>Hold position</b> <i>Reinvest as necessary or reinvest minimum</i>
<i>Favourable</i>	<b>Attempt to improve position selectively</b>  Penetrate market generally or selectively  <i>Invest selectively</i>	<b>Attempt to improve position</b>  Penetrate market selectively  <i>Invest selectively to improve position</i>	<b>Maintain position</b>  Find niche and attempt to protect it  <i>Make minimum and/or selective reinvestment</i>	<b>Harvest, withdraw in phases, or abandon</b>  <i>Reinvest minimum necessary or disinvest</i>
<i>Defensible</i>	<b>Attempt to improve position selectively</b>  <i>Invest (very) selectively</i>	<b>Find niche and protect it</b>  <i>Invest selectively</i>	<b>Find niche or withdraw in phases</b>  <i>Reinvest minimum necessary or disinvest</i>	<b>Withdraw in phases or abandon</b>  <i>Disinvest or divest</i>
<i>Weak</i>	<b>Improve position or withdraw</b>  <i>Invest or divest</i>	<b>Turn around or abandon</b>  <i>Invest or disinvest</i>	<b>Turn around or withdraw in phases</b>  <i>Invest selectively or disinvest</i>	<b>Abandon position</b>  <i>Divest</i>

Source: Reproduced from Arthur D Little, 1996. Lynch 2003, Pg 527

The life cycle portfolio matrix was developed in order to aid with the selection that can be made. If a company was in a mature market and had a strong competitive position within the market then a possible strategy it could adopt would be to:

- Sought cost leadership
- Renewed its focus strategy
- Differentiate itself from its competitors.



While this provides a useful basis for strategic selection Lynch (2003) states that technological changes and marketing initiatives can complicate the selection phase.

## **2.21 Strategy Implementation and Execution**

*“Frederick Hertzberg said, if you want people to be motivated to do a good job, then give them a good job to do”.*

In implementing strategy a major factor for the manager is to establish how the organisations resources are to be allocated. The manager needs to maintain a balance between the budget as well as the manpower and technology required to effectively and efficiently execute the strategic plan. Thompson and Strickland (2003) confirms that forceful re-allocation of operating funds and moving people to new organisational units signal a determined commitment to strategic change and is needed to stimulate the implementation process and gives it credibility.

According to Day (1984), to turn strategy into basic implementation plans requires four elements.

1. Identification of the strategic objectives.
2. Formulation of the specific plan by taking the objectives and turning them into tasks and deadlines.
3. Resource allocation and budgeting.
4. Monitoring and controlling the procedure to ensure the objectives are being met and that only the agreed resources are being spent and the budgets are adhered to.

## **2.22 Creating Strategy Supportive Policy and Procedure**

The strategy implementation and execution process can either make or break a strategic option chosen. Managers therefore have to be inventive in devising policy and practises that ensure effective strategy implementation. A change in any work environment creates some degree of stress and uncertainty. The need to establish those jobs that need to be executed rigidly and those that can have a bit of flexibility needs to be clearly defined and communicated.

Thompson and Strickland (2003), agree that proper operating procedures aid the task of implementing strategy in the following ways.

1. New and revised procedures provide a sense of stability as it regulates how strategy needs to be implemented. It further adds a degree of dependability into how certain tasks needs to be executed.
2. Policy and procedure help to align behaviour and actions of individuals and groups towards the intended path to achieve the company's objective.
3. Standardised policies and procedures help maintain consistency in how a particular activity needs to be executed, especially in organisations whose operating activities are broadly scattered along different areas.
4. Policy implementers can utilise the policy changing process as a powerful tool for changing culture to provide strategic fit with the new strategy.

## **2.23 Types of Implementation Program**

The level and degree of implementation programmes depends largely on the challenges an organisation faces. The two essential causes of variations in the implementation programmes include.

- The degree of uncertainty in the environment.
- The magnitude of the strategic change required.

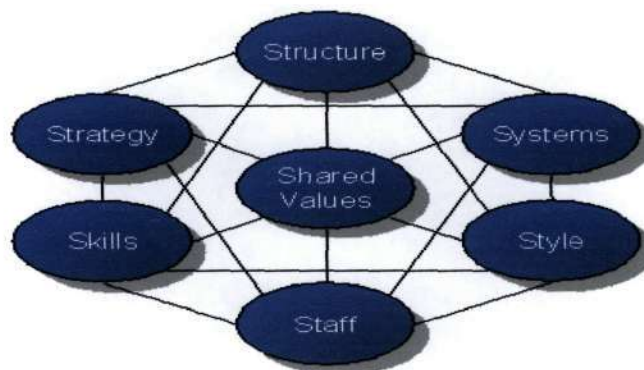
In responding to these causes in the variations of implementation, the organisation can adopt the following programmes (Lynch, 2003).

1. Comprehensive implementation program is utilised when a major change in the strategic direction of the organisation is required.
2. Incremental implementation program may be used when there are conditions of uncertainty such as changes in market conditions.
3. Selective implementation maybe used when the other two methods may lead to substantial resistance or when it is not necessary to make a substantial change in all business areas.

### **2.24 Change Management**

Change management is a key driving force for innovation and creativity. McKinsey's Seven "S" model can be used to ascertain why changes take place and if effectively managed can mean major success within the organization. Strategy and structure are synonymous with each other, no company can effectively implement a strategy that is not properly linked to its structure (Glueck and Jauch, 1984).

Figure 2.22 McKinsey's Seven "S" Framework



Source: Internet 9

Each of the seven “S” Framework represented in figure 2.22 is elaborated on further.

### **Strategy**

The integrated vision and direction of the company, as well as the manner in which it derives, articulates, communicates and implements that vision and direction.

### **Structure**

The policies and procedures which govern the way in which the organisation acts within itself and within its environment

### **Systems**

The decision making systems within the organisation can range from management intuition, to structured computer systems to complex expert systems and artificial intelligence. It includes

- Computer Systems,
- Operational Systems,
- HR Systems

### **Style**

Style refers to the employees shared and common way of thinking and behaving - unwritten norms of behaviour and thought:

- Leadership Style
- Organizational Culture

### **Skills**

Skills refer to the fact that employees have the skills needed to carry out the company's strategy.

### **Staff**

Staff means that the company has hired able people, trained them well and assigned them to the right jobs. Selection, training, reward and recognition, retention, motivation and assignment to appropriate work are all key issues. All the elements within the above model are crucial for the coordination and success of an organisation.

### **2.25 Cultural consideration To Successful Strategy Implementation**

In implementing and executing the strategic plan management needs to give due regard to cultural issues that may arise. A proper plan is required to address the cultural issues necessary for changes to take place effectively. Where the fit between culture and strategy is strong, there will be less need for management to depend on policies and procedures to enforce the desired cultural behaviour.

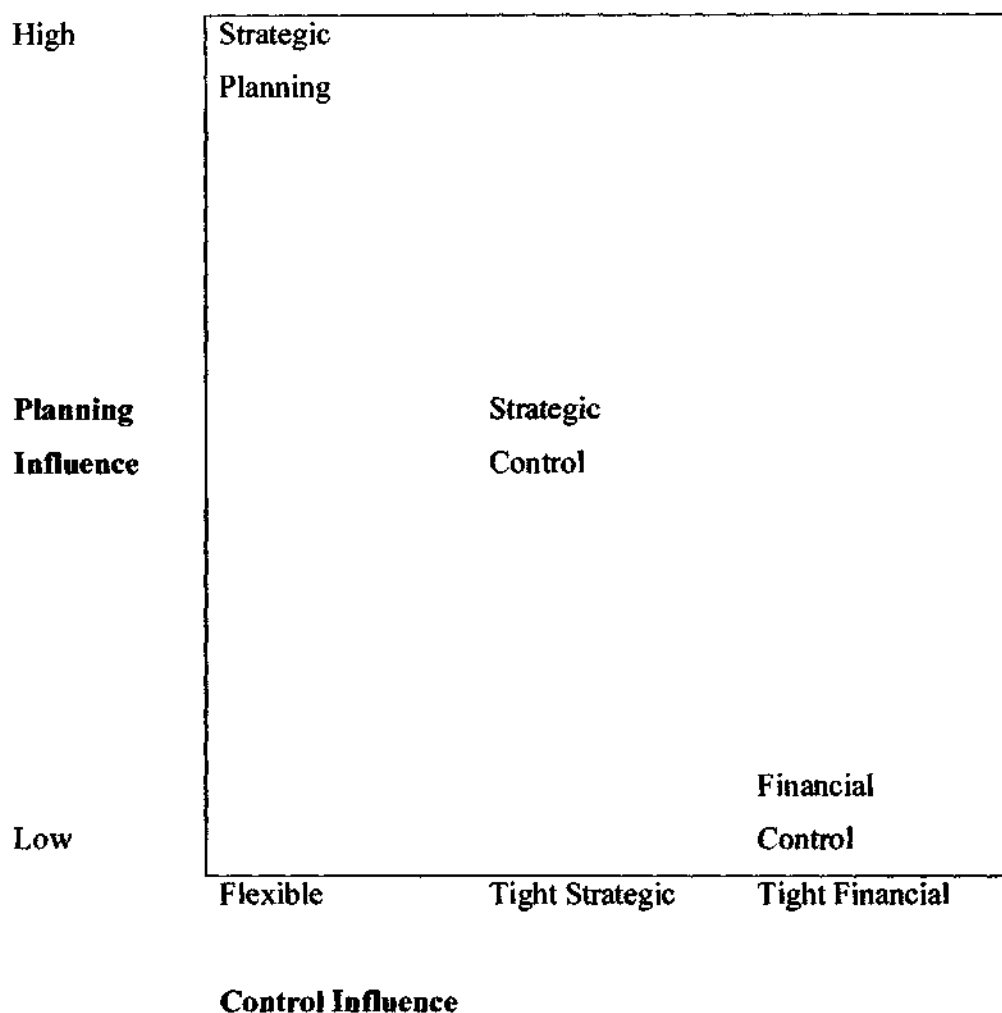
There is however a need to align the corporate culture with the strategic intent of an organisation. This may include revising the policies and procedures in ways that drive cultural change by altering incentive compensation to reward desired cultural behaviours, recruiting and selecting new employees who have desired cultural values and communicating to employees the basis for cultural change and its benefits thereof (Thompson and Strickland, 2003).

Building a spirit of a high performance workforce requires a results orientated culture and uses people management techniques that inspire workers to do their best (Schneider, 1994). A high performance work force is all one in which employees are treated with respect and dignity, they are trained and encouraged to use their own initiative and creativity in executing their tasks. Clear accountabilities are established and the use of full range of reward and punishment performance systems is used.

### **2.26 Strategic Management Style**

Goold and Campbell identified three corporate management styles, financial control, strategic control and strategic planning as depicted in figure 2.23.

Figure 2.23 Management Styles



Source: Johnson And Scholes (2002) Exploring Corporate Strategy

The principle differences between the management styles included the level at which strategies were formulated. The strategic planning style included head office playing a vital role in formulating and coordinating strategies while the financial control style emphasised corporate head offices emphasis on financial management. A third style includes a combination of both styles, this is known as strategic control.

In the strategic management style emphasis was on establishing long term competitive advantage that were reflected in performance goals such as market share, innovation and quality leadership. According to Grant (1998), the major weakness of the strategic planning process includes.

- Lack of autonomy which results in the lack of initiatives and ownership.
- Lack of responsiveness to new circumstances and opportunities.
- Lack of diversity as a result of the unitary view imposed by the corporate.

Strategic planning is appropriate for the smaller business that do not spread across a wide range of products and industries, where long term strategy goals are more important than short term profits.

In the financial control style, corporate head quarters have limited involvement in business strategy formulation. Primary control is exercised through short term budgetary control. Objectives are short term and easily quantifiable, provide an added incentive for managers to improve efficiency and expand business profits. Grant (1998), states that this type of management style has three benefits;

- Encourages top management capabilities among business level managers due to flexibility given to them to determine business unit strategy.
- Emphasis is on profit enabling the managers to use more effective strategies to gain results.
- As major decisions are taken at business unit levels corporate level managers can focus on corporate issues.

Grant (1998) further elaborates that despite managing by numbers these styles have two weaknesses.

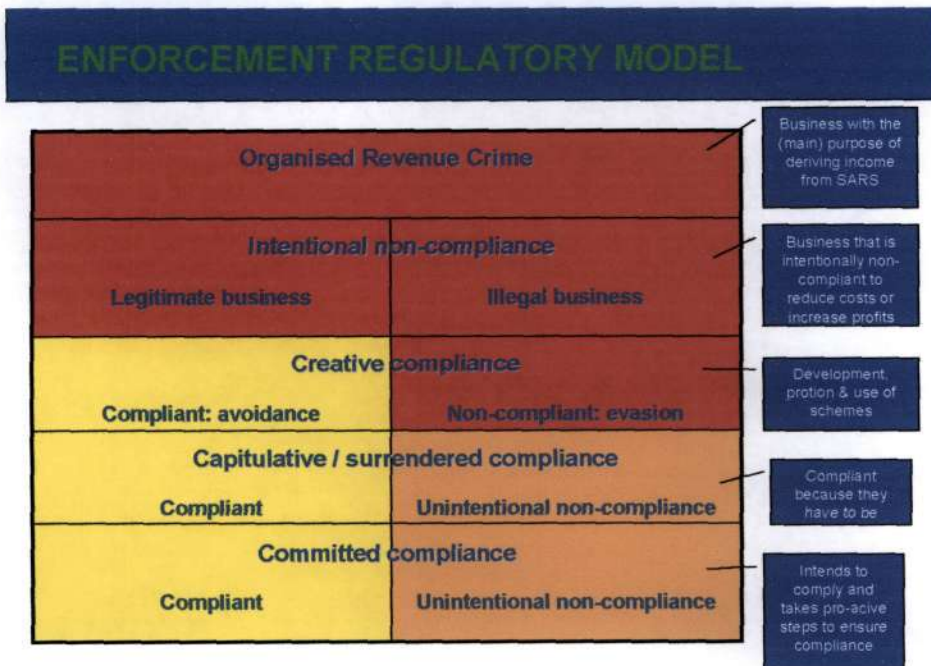
- Managers may sacrifice long term strategies that may result in profits in the future over short term profits.
- Achieving coordination between business units may become difficult as they compete for limited resources.

The financial control style is suited for an organisation that are characterised by broad business diversity, with investment projects that are short to medium.

### 2.27 Framework for the Case Analysis

South African's culture of compliance is strongly influenced by there past history. People of different race groups tended to have a natural reluctance to follow government policies and procedures which they felt where discriminatory. Paying of taxes and complying with customs rules and regulations fell within this ambit. The culture of compliance is further influenced by the current macro-economic and social political conditions. Figure 2.24, however, indicates that the client's behaviour can range from being deliberate or in some instances unintentional due to the lack of knowledge.

Figure 2.24 SARS Enforcement Regulatory Model



Source: SARS Business Intelligence, internet site



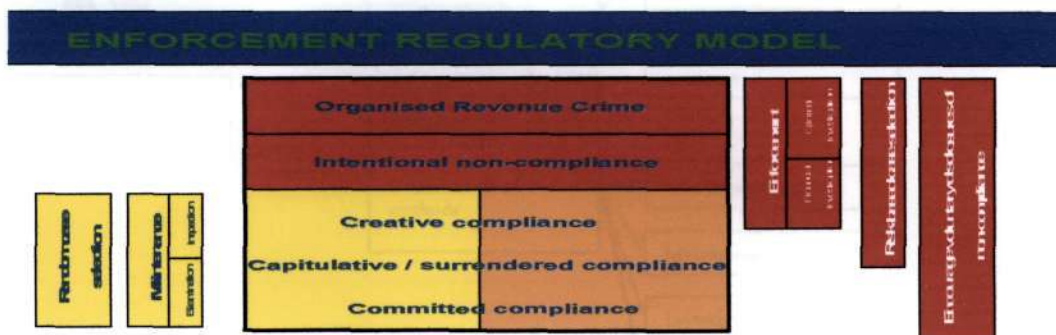
SARS behaviour on the other hand is dictated by its mandate to optimize revenue collection and protect the citizens of the country from illicit imports and exports. This behaviour is further influenced by the resources available to meet these objectives. Strong internal strengths such as skilled staff and financial backing from treasury to modernize SARS have enabled its Customs department to meet the challenges of globalization and trade liberalization. The task is however complicated when confronted by the governments economic policies which requires additional funding for the delivery of essential services such as housing and health, which places added strain on the administration to collect more funds to subsidize state spending.

SARS response in fulfilling its mandate is therefore determined by the behaviour of its clients. This behaviour more often than not creates a tax gap or a leakage within our fiscus. The actions SARS may take to close this tax gaps include:

- ✿ High visibility- throughout the region and the country which provides as a deterrent to non compliance or voluntary disclosure of non compliance.
- ✿ Random risk based actions to detect wilful non-compliers based on selected criteria's.
- ✿ Maintenance checks which would entail physical examinations or post audit inspections.
- ✿ Combinations of methods including compliance checks, maintenance audits, investigative audits, criminal and financial investigations.

Figure 2.25 gives a graphical presentation of the actions taken by SARS in performing its mandate.

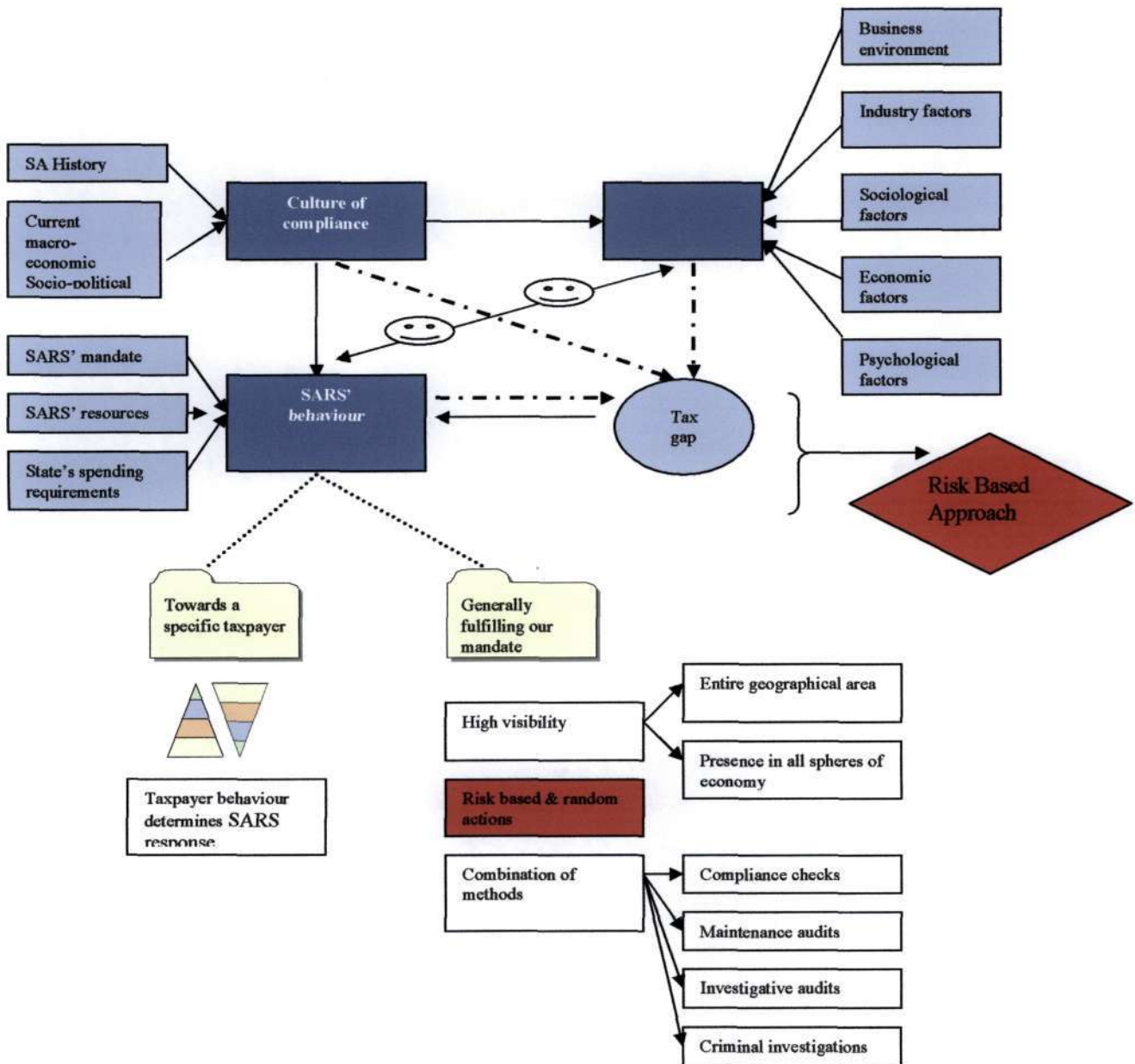
Figure 2.25 SARS Response to Tax Payer behaviour



Source: SARS Business Intelligence, internet site

The model in figure 2.26 will form the basis for the analysis of the case study. The model focuses both on internal as well as external factors that contribute to forming the tax gap. This therefore has created a need to close this tax gap through an effective risk management process.

Figure 2.26 Framework for the Case Analysis



## **2.28 Summary**

Strategy is about organisational change, a firm's action is strategic when its can maintain its competitive edge. In affect not all decisions are strategic some decisions are made in order to maintain the current state of affairs. Many writers like Porter advocated initially that strategy was the ability of the organisation to position itself within an industry so that appropriate choices could be made. Other writers such as Grant advocated a resource view to attaining competitive advantage. Strategy is however about knowing your internal and external environment that serves as a platform to achieve sustainable competitive advantage.

The chapter gave a rational approach to strategic decision making, emphasising the use of strategic tools as a key to analysing the business environment in achieving an organisations vision. The chapter further indicated that long term objectives and grand strategies can serve as useful strategies that if implemented correctly and monitored can provide sustainable competitive advantage.

Whether strategy is rational and deliberate or emergent through trial and error, understanding the culture and management style that is necessary to implement the strategy is the back bone for success.

## **Chapter 3- Analysis of Case Study Evidence**

### **3.1 Introduction**

The South African Revenue Services (SARS) is focused towards optimal revenue collections and the facilitation of legitimate trade. To this end the organization engages in a variety of activities and employs different skills across numerous branch offices and ports of entry within South Africa. The South African Revenue Services Act, No 34 of 1997 provided for administrative autonomy of the entity and provided the mandate for the performance of the following tasks (SARS annual report, 2003):

- ✚ Collect all revenue that are due.
- ✚ Ensure maximum compliance with legislation.
- ✚ Provide a customs service that will maximize revenue collections, protect our borders as well as facilitate trade.

Customs administrations play a strategic role in the growth of international trade and the development of the global market place. The efficiency and effectiveness of a customs administration can significantly influence the economic competitiveness of a country. The Kyoto Convention came into force with the aim of simplifying and harmonizing customs procedures in order to facilitate and encourage international trade. Amongst the items discussed in the convention the modernization of customs by using automated systems and the use of pre-arrival notifications of interventions became the focus of discussion. Customs administrations around the world have adopted this philosophy as it is seen as a driver for attracting foreign direct investment and enhancing the movement of goods within the supply chain.

This chapter provides an analysis of the case study and explores the internal and external activities of SARS.

### **3.2 Background**

South Africa is 1 221 040 square kilometres in area with a population of 43.2 million (World Bank and Banque Mondiale, 2001). The country's Gross domestic product in 2002 was \$104.2 billion, the import share of the gross domestic product was 26.6% in 2002. The growth rate of goods and services on the import side was an average of 8.1% while exports grew by 4.1% (World Bank, IMF 2002). This effectively means that South Africa is becoming one of the world's most sophisticated and promising emerging markets in the world. The unique combination of highly developed first world economy infrastructure and a huge emergent market economy has given rise to a strong entrepreneurial and dynamic investment environment with many global competitive advantages and opportunities. In order to improve the competitiveness of the importers, exporters and its stakeholders customs has aimed to establish a barrier free clearance environment. Customs agencies around the world together with the organizations they interact with face a number of challenges from globalization, including explosions in import and export volume, pressures for intensified trade facilitation, and protection of vital health, safety and security interests. The future prosperity of the global trade community depends upon the successful facilitation and enforcement of import and export trade data systems and risk management protocols by government customs authorities. A barrier free clearance procedure is not aimed at ignoring the need for abandoning its duties of anti-smuggling and prevention of fraud but rather to change our enforcement strategy from containment to risk management to target high risk groups.

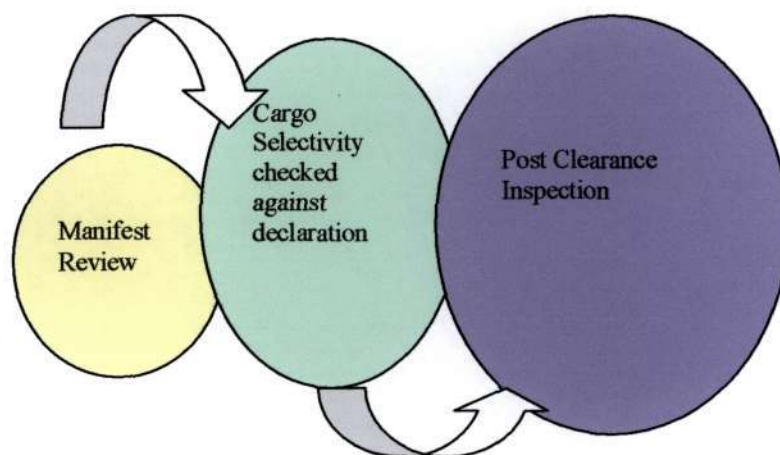
The South African Customs is in the process of completing the import and export automation system. The system allows clearing and forwarding agencies as well as shipping lines to utilize computer and communication systems to electronically link up with customs by transmitting messages via electronic data interchange (EDI). This system allows customs to process declarations made automatically instead of manually so as to expedite cargo clearances, in this way facilitating the release of paperless clearance of cargo. The current system allows for EDI clearances within four hours of submission to customs while manually entries can take anything up to twenty four to forty eight hours. In this respect the organization launched a re-engineering and transformation project, under the project name "Siyakha" (We Are Building). This

transformation included re structuring of customs into teams concentrating on trade facilitation, anti-smuggling and post clearance inspections. This case study will be focused primarily on the activities concentrated on customs trade facilitation and enforcement.

While South Africa's economy is growing to be stronger it also creating a "haystack" that is enormous that contains a combination of legitimate traders and those who indulge in the activities of money laundering, narcotics trafficking and fraud. To differentiate between these combinations the South African Customs has undertaken a modernization program. The risk management re-engineering playing the pivotal role to intervene by exception, allowing for most of the compliant customers and passengers to clear customs smoothly.

The South African customs currently have three major risk management areas for cargo clearances. This is depicted in the figures 3.1.

Figure 3.1 The Three Major Risk Management Areas



- ✦ Manifest Review- this is the initial stage where pre-arrival information is submitted to customs. The anti-smuggling and compliance teams use this information to target specific consignments.
- ✦ The cargo selectivity stage- in this stage the actual intention of the trader is compared against his supporting documents.
- ✦ Post clearance inspection stage- is where the client is subjected to post audit verification of consignments against documentary proof submitted and company records held.

SARS has further implemented an electronic risk management system, known as the integrated Risk Analysis Solution (ICRAS). This system is primarily used at the cargo selectivity and checking stage. ICRAS uses a risk analyzer based on the information and intelligence fed into the system to categorize consignments between high, medium, and low risk. Based on the decision from the risk analyzer customs officers may release, stop for physical examination or detain a consignment.

The case study provides an over view of the customs risk management process. Further chapters will indicate whether this mythology followed by the South African Customs aimed at maintaining a balance between trade facilitation and enforcement to the extent that it provides our country with the necessary strategic advantage required to attract investment and provide sustainable growth for the country as a whole.

### **3.3 SARS Business Strategy**

The SARS has to effectively choose a strategy bearing in mind the mandate it has to fulfil, the challenges it faces and the number and type of products it administers. The desired future of SARS is contained in its vision which aims to:

**Be an innovative Revenue and Customs Agency that enhances economic growth and social development, and supports our integration into the global economy in a way that it benefits all South Africans.**

The main Purpose of the organization is enshrined in the Mission Statement which indicates the activities the organization is engaging in. This mission Statement for the SARS is to:

**Optimize the revenue yield, facilitate trade and enlist new tax contributors by promoting awareness of the obligation to voluntarily comply with South African Tax and Customs laws, and provide a quality and responsive service to the public.**

In pursuing to be a pro active and innovative organization SARS is committed to provide excellent service to the public by pursuing values that help build relationships, continually improve business processes and conduct based on :

- **Mutual respect and trust**
- **Equity and fairness**
- **Integrity and honesty**
- **Transparency and openness**
- **Courtesy and commitment**

In accordance with the government sector the organization is also guided by Batho Pele (People First) principles.

The aim of SARS is to create a resilient organizational foundation, by encouraging morale obligation for people and organizations to pay their taxes and adhere to the SARS policies. SARS, however, faces immense challenges to improve revenue collections, narrow the tax gap and improve efficiency and effectiveness.

### **3.4 SARS Leadership**

There is a strong relationship between the life cycle stage of an organization and the nature of its leadership (Carter, 1999). South Africa's evolutionary history created a contrast of leadership.



The struggle for freedom and justice developed a culture of resilient leaders while at the same time oppression against the masses created a subservient leadership within the country.

The Commissioner for the South African Revenue Service, Doctor Pravin Gordhan was appointed into the post in November 1999, to transform the South African Customs and Revenue administration into a strategic government institution. His background as a freedom fighter a man of integrity exemplifies the leadership qualities that were hidden during the time of apartheid. Commissioner Gordhan has represented South Africa in many International undertakings, including several peacekeeping missions and is currently the Chairman of the World Customs Administration.

The Commissioner responded to the challenge to provide a sustainable and competitive environment by providing leadership that is required to generate new ideas and interdependence between the Revenue and Customs administration. He undertook SARS first transformation under the project called “Siyakha” (We Are Building) and with surgeon like precision implemented and moved the South African Revenue Service into a global administration to be “reckoned” with (Internet 5).

### **3.5 Analysis of the Environment**

The South African customs authority is influenced by the trade policies embarked on by the Department Of Trade And Industry and the Reserve Bank in so doing the monetary policies as well as the fiscal policies adopted by the country have a formidable impact on the strategies of customs. These policies adopted by government are based on improving the economic fundamentals of the country and as such these form the environment in which customs actually function in. It therefore is prudent to analyze the external environment of customs by making use of the PEST model.

### **3.5.1 Economic Environment**

The economy of a country is the total of the goods and services produced by the country. These goods are either consumed within the country or traded with other countries. The trade that takes place is influenced by economic policies of the country which consists of the monetary and fiscal policies. Monetary policies control the supply of money by means of interest rates while fiscal policies are adopted by the government aimed at changing the level of government expenditure through taxes. SARS thus is the administrative body responsible for administering fiscal policies and therefore the activities of SARS effectively influence the economy.

#### **3.5.1.1 Trends in Developing Countries Trade**

During 1989 and 1997, there was a rapid expansion of world trade even more significant was the expansion of trade in the developing countries. Table 3.1 indicates that between 1989 and 1997, the value of world merchandise exports increased at a compound annual rate of 7.6 per cent while the developing countries increased at an annual rate of 9.5 per cent. Developing countries imports also improved considerably at a rate of 10.4% (WTO, 1998). The total contribution of the total trade (merchandise exports plus imports) of all developing countries at the end of 1989, to the gross domestic product was 38.3 percent, this indicated the greater integration of the developing countries in the world economy.

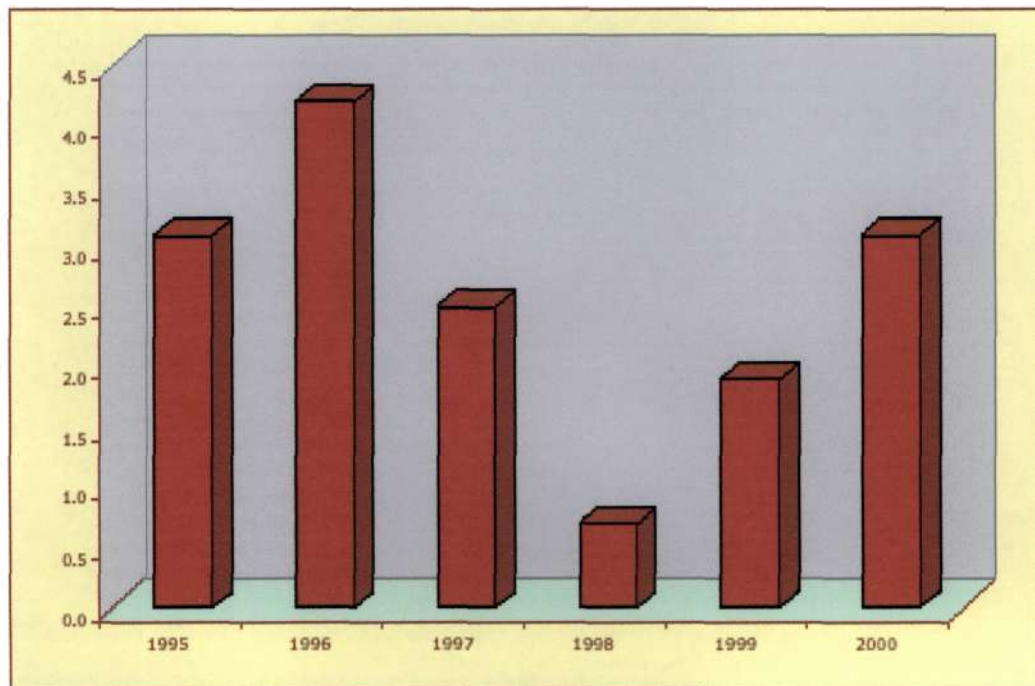
Table 3.1 Trends in World Merchandise Trade

	Exports		Imports		Exports Growth Rate	Imports Growth Rate
	1989	1997	1989	1997	1989-1997	1989-1997
42 Developing Countries	399368	865921	396712	994633	10.2%	12.2%
Developing countries Members of WTO	466320	962419	456939	1091432	9.5%	11.5%
Least developed Countries	14044	21507	21698	32751*	5.5%*	5.3%*
All Developing Countries	674924	1395585	658899	1451235	9.5%	10.4%
World Trade**	2237081	4023348	2341482	4185652	7.6%	7.5%

Source: WTO, 1998, Trade Policy and Market Access Issues for Developing Countries, Pg 10

South Africa is classified as an upper middle income developing country, with a GDP at the end of 2000, of R874 billion. Real GDP has grown considerably by 2.6% between 1995 and 2000 as reflected in figure 3.2.

Figure 3.2 Percentage Growth in Real GDP at Market Prices, 1995-2000.



Source: South Africa Reserve Bank - Quarterly Bulletin March 2001

Figure 3.2 indicates that South Africa is recovering from the slow down of the economy in 1998 and while the world economy improves through 2000, South Africa's participation in the global economy is becoming more prevalent.

In further analyzing the relationship of other developing countries within the Sub-Saharan Africa region of which South Africa is a part, table 3.2 indicates that there is a strong expansion between manufactured export and imports as compared to non-manufactured exports and imports. This is a significant change, as South Africa's economy was previously based on the primary sector, consisting of the agricultural and mining sectors as primary contributors to the economy.

Table 3.2 Developing Countries Trade (1989-1997) Manufacturers and Non Manufacturers  
(Annual growth rates in %)

	Manufactures exports	Non manufactures exports	Manufactures imports	Non manufactures imports
42 Developing countries	14.2%	5.5%	14.6%	9.8%
Latin America and the Caribbean	15.3%	6.7%	17.7%	10.4%
Asia and Pacific	12.6%	6.0%	12.4%	8.8%
Sub-Sahara Africa	15.2%	1.7%	7.0%	7.3%
Europe, Middle-East and North Africa	11.1%	6.9%	12.5%	9.1%
All Developing countries	14.2%	8.5%	14.0%	9.7%

Source: WTO, 1998; World Bank 1998.

This information is significant as change from a primary sector that ordinarily supplied the rest of the world with raw materials, South Africa now will require these raw materials to sustain its manufacturing sector. Moreover these raw materials will be obtained from countries that provide the best strategic cost advantage. This in turn means increased customs activities.

### **3.5.1.2 Trade Liberalization**

Most of the developing countries are part of the World Trade Organization (WTO), have made significant progress towards trade liberalization in the following areas:

- ✚ Applied tariffs have been removed
- ✚ Most countries have bound their tariffs to be in line with the Uruguay Round of Agreements.
- ✚ The use of non tariff barriers has decreased in most countries.
- ✚ The intervention of government in trade has declined.

One of the first attempts of South Africa to liberalize its trade was the introduction of export subsidies as an attempt to counter the anti-export bias of import protection. This was followed by aggressively supporting the exporters by means of the custom duty drawbacks and duty exemptions. The General Export Incentive Scheme was adopted to provide exporters incentives

based on the value added and local content, before it was removed in 1994 when South Africa signed the General Agreement on Tariff and Trade (GATT). Like many developing countries South Africa opted for import substitution industrialization and export orientated industrialization as strategy for economic growth. However it seemed that emphasis was more on import substitution focusing on capital intensive upstream activities and chemical industries like SASOL. This was done with the aid of tariff provisions as well as complex systems of customs duties and surcharge that allowed exemptions to be granted on a firm by firm basis rather than product specific tariffs.

The Modification of The Application of Tariff Policy (IDC, 1990) report was a major turning point for South African trade liberalization, which saw a shift from import substitution industrialization to export orientated industrialization. The Industrial Development Corporation advocated for a lower tariff structure while lowering the protection by replacing of complex formula duties with specific anti-dumping measures. All these measures were introduced with the aim of increasing exports.

South Africa's entrance into the WTO was a process that further liberalized the economy. The WTO played an important role in binding South Africa's tariff phase down schedule. South Africa's average weighted duties also decreased from 34 percent to 17 percent for consumption goods, 8 percent to 4 percent for intermediate goods and 11 percent to 5 percent for capital goods. The WTO and GATT binding for these categories being 26 percent, 4 percent and 15 percent respectively (Cassim, Onyango and Seventer, 2002). It was inherent that South Africa had opened up these sectors to foreign competition.

Apart from the imposition of the WTO and the GATT will, further liberalization was made possible by the EU-South Africa Trade Agreement, which came into force in January 2000 and the South African Development Countries (SADC) trade protocol which was concluded in August 1996. These trade agreements provided for the freeing up of 86 percent of the tariff lines for the SA-EU trade and 97 percent for the SADC trade (Cassim, Onyango and Seventer, 2002).

### **3.5.1.3 Trade Relations**

South Africa participates at both the regional and bilateral trade agreements. South Africa was a founding member of the GATT (1947) and is a member of the WTO. South Africa shows a strong commitment to the principles of these organizations especially as the Commissioner for SARS is the chairman for the World Customs Organization. The high level of competition for foreign direct investment has led to South Africa forming strong economic trading blocs to gain access to markets of foreign countries.

South Africa has actively secured bilateral agreement with the EU-South Africa trade agreement giving preferential duty rates to goods originating from South Africa and visa versa. South Africa further secured the African Growth and Opportunity Act (AGOA), which enables Sub Saharan countries to trade with America on a preferential basis. South Africa focus on an export orientated strategy is supported by its move towards participation with Mercusor via a free trade agreement with Brazil, and India. This will enable greater facilitation of trade between the South American and Eastern countries. Regionally South Africa has access to 14 Sub Saharan countries with a market access of one hundred and forty million, which is expected to grow at an annual rate of 3 percent (internet 4).

The European Union (EU) is responsible for more than half of South Africa's foreign trade. The European Union in a statement in May 2002 stated that South Africa has overtaken Algeria, Saudi Arabia, Malaysia and Singapore in overall trade with the EU. This was in light with a slowing global economy in 2001 which resulted in a 0.3 percent drop in EU imports from the rest of the world. South African exports to the EU grew by 11 per cent (internet 4). The EU remains South Africa's most important trading partner accounting for 40 percent of its imports and exports as well as 70 percent of its foreign direct investment (internet 4). South Africa also participates in the South African Customs Union, this agreement allows for member countries to remove all trade barriers amongst themselves and adopt a common set of external tariffs. The union currently consists of Botswana, Lesotho, Namibia, Swaziland and South Africa. South Africa entered into a free trade agreement with the SADC countries to address the trade

imbalances within the region. South Africa also undertook to reduce its tariff rate at a greater pace than that of the member countries.

In the East, Japan is far the largest trading partner with South Africa and the fourth largest overall trading partner (internet 4). According to the South African trade relations web site total bilateral trade amounted to thirty two billion in 2001 between these two countries an increase of 2 percent over the previous years while exports to Japan grew by 9.3 percent. The principles trade includes motor industry and electronic sectors, exports to Japan include raw materials while manufactured goods are being imported into the country. The table 3.3 indicates the trade between Japan and South Africa between 1992 and 2002.

Table 3.3 South Africa's Trade Data for Imports and Exports with Japan

Year	JAPAN Total Imports - R million constant 2000 prices	SA's share of JAPAN Total Imports	JAPAN Total Exports - R million constant 2000 prices	SA's share of JAPAN Total Exports
1992	1200585	0.571	1749487	0.507
1993	1291838	0.549	1936730	0.631
1994	1462577	0.568	2109653	0.56
1995	1696718	0.529	2238414	0.617
1996	1968630	0.569	2316791	0.532
1997	1894103	0.614	2353732	0.494
1998	1777234	0.645	2458026	0.522
1999	2052616	0.59	2765515	0.446
2000	2632022	0.639	3323735	0.447
2001	2843984	0.65	3287231	0.424
2002	3039169	0.703	3758338	0.439

Source: Internet 4

In North America the United States is the most important trading partner with South Africa providing both export promotion and inward investment mobilization. South Africa has a surplus

trade balance with the United States which reached R4.5 billion in 2001 (internet 4). The United States provides more value added products to South Africa while the exports to United States include raw materials. The adoption of the AGOA act by South Africa has however seen a considerable effort on the part to change to supplying manufactured products to the Americans especially in the product categories such as textile and clothing sector. Table 3.4 indicates the trade between South Africa and the United States between the periods 1992 to 2002.

Table 3.4 South Africa's Trade Data for Imports and Exports with the United States

Year	United States Total Imports - R million constant 2000 prices	SA's share of United States Total Imports	United States Total Exports - R million constant 2000 prices	SA's share of United States Total Exports
1992	2851203	0.308	2306826	0.548
1993	3226269	0.272	2484900	0.526
1994	3662434	0.276	2724059	0.496
1995	3893983	0.273	2953847	0.56
1996	4634840	0.272	3524361	0.546
1997	5026765	0.267	3850769	0.503
1998	5983714	0.289	4322238	0.517
1999	6986475	0.261	4568562	0.479
2000	8733623	0.293	5417336	0.41
2001	9606632	0.302	5939886	0.41
2002	10864330	0.284	6265783	0.00

Source: Internet 4

In Latin America Brazil is South Africa's largest trading partner, with bilateral trade reaching R5.3 billion in 2001 (internet 4). Trade between Mexico and South Africa has also grown to



R1.2 billion in 2001 (internet 4). Exports to both these countries range in a variety of products from coal and nickel to household furniture. Table 3.5 indicates the trade between South Africa and Brazil between the periods 1992 to 2002.

Table 3.5 South African Trade Data for Imports and Exports

Year	<b>Brazil's Total Imports - R million constant 2000 prices</b>	<b>SA's share of Brazil's Total Imports</b>	<b>Brazil's Total Exports - R million constant 2000 prices</b>	<b>SA's share of Brazil's Total Exports</b>
1992	<b>118737</b>	0.37	<b>184237</b>	0.45
1993	<b>148311</b>	0.45	<b>206133</b>	0.47
1994	<b>191285</b>	0.49	<b>231394</b>	0.49
1995	<b>271686</b>	0.51	<b>234926</b>	0.54
1996	<b>321085</b>	0.48	<b>269212</b>	0.55
1997	<b>363417</b>	0.47	<b>296309</b>	0.61
1998	<b>384176</b>	0.32	<b>324038</b>	0.45
1999	<b>340770</b>	0.30	<b>316608</b>	0.47
2000	<b>405936</b>	0.34	<b>382037</b>	0.54
2001	<b>474588</b>	0.47	<b>474335</b>	0.67
2002	<b>447222</b>	0.36	<b>545358</b>	0.78

Source: Internet 4

The statistics provided in the tables above aids in the analysis to understand the impact of trade relations with the various countries and the magnitude of the customs activities that will be required to monitor and implement these agreements and ensure that effective control is maintained so that the agreements can be utilized for the purposes it is intended for. Table 3.6, 3.7 and 3.8 indicates South Africa's top twenty trading partners.

Table 3.6 South Africa's Top Trading Partners

<b><u>SA Imports from:</u></b>	
<u>Country</u>	<u>Amount (R/m)</u>
1. Germany	24 881
2. USA	22 151
3. UK	16 106
4. Japan	14 839
5. Saudi Arabia	14 136
6. Iran	8 133
7. France	7 896
8. China	6 935
9. Italy	6 247
10. Australia	4 651
11. Switzerland	4 459
12. Taiwan	4 223
13. Netherlands	3 553
14. South Korea	3 527
15. Belgium	2 905
16. Sweden	2 903
17. Finland	2 568
18. Ireland	2 388
19. Spain	2 075
20. Malaysia	2 065

Source: SA Revenue Services Monthly abstract of Trade Statistics: Jan - Dec 2000

Table: 3.7 South Africa's Top Trading Partners

<b><u>SA Exports to:</u></b>	
<u>Country</u>	<u>Amount (R/m)</u>
1. USA	25 626
2. UK	18 949
3. Japan	16 867
4. Germany	16 448
5. Netherlands	7 033
6. Belgium	6 436
7. Italy	5 893
8. Mozambique	4 997
9. Zimbabwe	4 859
10. Zambia	4 562
11. South Korea	4 108
12. China	4 096
13. France	3 960
14. Taiwan	3 695
15. Switzerland	3 670
16. Australia	3 557
17. Israel	3 552
18. Spain	3 504
19. India	2 950
20. Hong Kong	2 385

Source: SA Revenue Services Monthly abstract of Trade Statistics: Jan - Dec 2000

Table 3.8 South Africa's Top Trading Partners

<b><u>Total Two-way Trade</u></b>	
<u>Country</u>	<u>Amount (R/m)</u>
1. USA	47 777
2. Germany	41 329
3. UK	35 055
4. Japan	31 706
5. Saudi Arabia	15 156
6. Italy	12 140
7. France	11 856
8. China	11 031
9. Netherlands	10 586
10. Belgium	9 341
11. Iran	8 633
12. Australia	8 208
13. Switzerland	8 129
14. Taiwan	7 918
15. South Korea	7 635
16. Zimbabwe	6 158
17. Spain	5 579
18. Mozambique	5 358
19. India	4 714
20. Hong Kong	4 334

Source: SA Revenue Services Monthly abstract of Trade Statistics: Jan - Dec 2000

### **3.5.2 Technology**

In a globalized environment technology becomes a key enabler in customs administration. SARS aims at introducing value adding technology that will supplement its processes to enhance revenue collection and meet the client's needs. According to the SARS annual report the technology division within SARS was transformed to meet the strategic goals of the customs administration by achieving the following:

#### **3.5.2.1 Infrastructure enhancement**

- ✚ SARS upgraded the processing power of its mainframe. This enabled greater system performance, productivity and turnaround times. The storage capacity of data was also enhanced.
- ✚ SARS upgraded its wide area network under the transformation project of Siyakha, this allowed optimal through put and performance. Satellite technology used at border posts where telecom lines were not available were upgraded to allow for minimum down time and greater communication performance.
- ✚ Software programs were upgraded to ensure greater security, the windows 2000 is being upgraded to windows XP for security purposes.
- ✚ The storage area network (SAN) was implemented for the consolidation of disk storage, centralized backups and positioned SARS appropriately in terms of the disaster recovery plans (DRP).

#### **3.5.2.2 Optimizing processing and business methods**

The following customs systems were developed and implemented during the 2003 period:

- ✚ The automated registration and accreditation system, allowed for the electronic submission of import declarations.

- ✦ The warehouse inventory management system, this included an electronic register that updated the stock that was placed in warehouses where duty was suspended for a period of time.
- ✦ Removal in bond and removal in transit systems were implemented to allow for automatic acquittal of goods moving between customs control areas and customs authorities in the African countries.

In 2002 the single registration process was approved and demonstrated. The focus of this process was to allow a client to have a single registration number across tax product types. This single view process is aimed at having generic customer details as well as product specific details that would provide a comprehensive profile of a client.

### **3.5.3 Social**

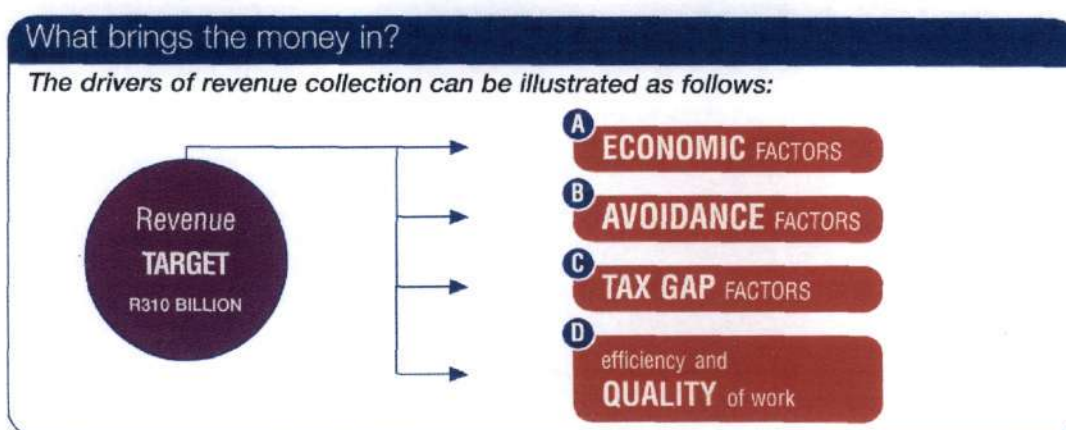
SARS as a revenue agency for government is tasked with collecting all revenues due in terms of legislation. The revenue raised is used to provide basic services such as health, welfare and maintaining security. According to the 2001 census unemployment was at twenty four percent, more than two thirds of the household do not have running water, three out of every ten houses do not have electricity and just under two thirds of the house hold live in formal dwellings. SARS plays a pivotal role in collecting the revenue to fund these challenges enabling the country and the economy.

#### **3.5.3.1 SARS Role in the Society**

SARS main task is to collect revenue in terms of legislation and provide a conducive environment for trade. Bulk of the moneys needed by Government is raised by SARS. This is done through the imposition of taxes and duties. These monies are then used to produce basic services such as education, health, welfare, maintaining law and order and national security. Also equally important is the Governments investment in the infrastructure of the country to ensure sustainable development e.g. roads, railways and telecommunication. South Africa faces

the over whelming challenge of poverty and sustainable development, if we cannot raise adequate funds these service deliveries will be compromised or alternatively require our country to borrow the funds from abroad. Figure 3.3 indicates the drivers of revenue that assist SARS in achieving its objectives.

Figure 3.3 Drivers of Revenue



Source: The SARS Way Booklet, 2003

- ✦ Economic factors are driven by the state of the economy and are beyond SARS control. This is the largest contributor to our income. In times of economic down turn more aggressive intervention activities are needed to generate additional revenues.
- ✦ Tax avoidance, there exists in any system legal loop holes, SARS identifies these loop holes and changes policies and legislation to close these gaps.
- ✦ The current tax gap, due to declarations been made that are intentionally aimed at clients illegally obtain a financial gain. According to the SARS way brochure, 2003 we have over 16.5 million clients that are economically active of which SARS only knows 7.3 million. Recent studies have indicated that SARS tax gap maybe as high as R30 billion of which customs constitute a gap of R1.5 billion (SARS way booklet, 2003).
- ✦ Efficiency and quality of work, effective and efficient performance with good internal controls can significantly contribute to the revenue collections for SARS. The 2004

estimated revenue target for SARS is R333.3 Billion of which customs needs to collect R85.6 billion (Customs Divisional score card, 2004).

### **3.5.3.2 SARS Transformation**

In 2000, SARS adopted a transformation strategy under the project name Siyakha, to fundamentally change the business process and policies. The need for transformation was as a result of the need to move from a highly bureaucratic inward focused organization to one that was a high performance organization. This transformation was aimed at improving the skills level as well as the skills mix and by providing enabling technology to deliver a high level of service to its clients. According to the SARS annual report the transformation was implemented in 3 different phases.

- ✚ Short term changes- this consisted of infrastructure and process improvements. The traditional isolated work environment was changed to a team orientated process where skills could be shared and enhanced.
- ✚ Short term to medium terms changes- this consisted of a new business architecture, policy changes and organizational design enhancement.
- ✚ Medium to long term changes- new automation and technology platform, continuous policy and process improvements.

During the periods of October 2001 and September 2002 customs offices were restructured focusing on the implementation of new management teams, new business processes such as anti-smuggling teams, post clearance inspection teams and risk profiling teams. The transformation was effectively followed up by awareness campaigns and aggressive communication drive to educate the staff and to minimize the resistance to change.

Change is on going and SARS will endeavour in the next three years to achieve the following changes:



- ✦ Implementation of the Large Business Office, to better manage the tax affairs of large corporate sectors in an integrated manner.
- ✦ Focus on trade facilitation and supply chain management with enhanced skills and technology.
- ✦ Improving service standards by implementation of e-SARS by migrating to an electronic transaction environment.
- ✦ Building business intelligence by improving risk profiling and providing a single view of a client across all tax and duty types.

### **3.5.3.3 Service**

“*SARS at Your Service*”, represents the philosophy adopted to describe the nature and quality of there engagement with clients. This serves to embed the strong service orientation in accordance with the principles of Batho Pele and the SARS values.

In line with international best practices SARS launched the service monitoring office (SMO) in October 2002, this office serves to facilitate the speedy resolution of complaints that could not be solved through normal operational channels.

Remedial steps that have been taken by the SMO include:

- ✦ Holding branch offices accountable for the speedy resolution of queries.
- ✦ Reprimanding office management and staff were required.
- ✦ Tracking the service delivery offices when required.
- ✦ Process improvement where the underlying problem relates to the administration system.

### **3.5.3.4 The SARS Culture**

SARS is an organization of approximately 14 000 employees of which 2715 are spread across customs activities. Table 3.9 provides a demographic break down of the staff within customs.

Table 3.9 Customs Demographics

<b>Customs Demographics</b>								
<b>Region</b>	<b>African</b>		<b>Coloured</b>		<b>Asian</b>		<b>White</b>	
	Total	%	Total	%	Total	%	Total	%
Head Office	62	31.7	12	6	18	9	103	52.8
Gauteng	398	66.7	40	6.7	38	6.37	313	52.8
Eastern Cape	41	30.4	15	11.1	6	4.4	73	54
Western Cape	57	20.4	77	28	11	3.9	134	48.2
Free State	106	76	12	8.6	3	2.2	18	12.9
KwaZulu Natal	179	48	24	6.4	76	20	97	25.8
Mpumalanga	220	82	6	0.02	2	0.01	40	14.9
Northern Cape	32	26	46	17.7	2	0.02	41	34
Limpopo	200	88	2	0.08	2	0.08	24	11
North West	133	92	7	0.05	1	0.01	4	0.03
<b>TOTAL</b>	<b>1428</b>	<b>0.53</b>	<b>241</b>	<b>0.09</b>	<b>159</b>	<b>0.06</b>	<b>847</b>	<b>0.32</b>

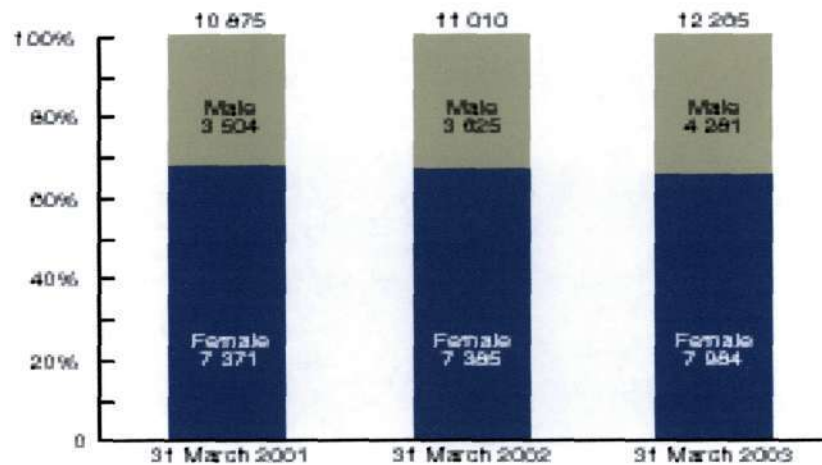
Source: Information obtained from SARS Human Resources Department, 2004

SARS has made great strides towards achieving employment equity with ethnic black constituting the largest percentage of the customs work force. To this effect recruitment process advanced equity criteria and specific organizational interventions are implemented to attract, train and retrain the valuable employees from previously disadvantaged backgrounds. The implementation of the Siyakha transformation program has contributed to the organization improving gender and race representation at all levels of the organization.

SARS gender profile indicated in the figure 3.4 illustrates its determination for the advancement of females at all levels of the organization. SARS has been able to adequately meet the gender requirements of 36 percent indicated in the Employment Equity Commission Report of 2002.

Although there was a drop from 68 per cent in 2001 to 65 percent 2003, females still constitute the majority of the total staff compliment of SARS.

Figure 3.4 Gender Workplace Profile



Source: SARS Annual Report, 2003

Since March 2002, females represented in managerial ranks increased from 30 per cent to 32 per cent, from 35 to 37 per cent in professional ranks and from 53 to 57 percent in elementary ranks.

SARS has also placed an increasing emphasis on recruitment of disabled people, the total compliment of disabled people within SARS as at March 2003, included 0.8% of the workforce. Most of the staff was employed in clerical positions.

Over the past years SARS has increased the number of graduates and tertiary level appointments. This was vital in implementing and consistently applying complex legislation as well as embedding the sophisticated approach of risk profiling. Significant appointments occurred within the customs and enforcement areas with the increased challenge of trade facilitation and enforcement being the order of the day. Table 3.10 indicates the education profile of the existing workforce.

Table 3.10 Educational Profile of Existing Workforce

Master's degree	0,07%
Tertiary education	26,59%
Senior certificate	49,79%
Junior certificate	1,65%
Less than junior certificate	0,94%
Not indicated	20,85%

Source: SARS Annual Report, 2003

The SARS culture aims at every staff becoming a leader in customs, this means that SARS has adopted the following behaviour role within the organization:

- ✚ Own the problem own the solution, take the initiative of solving problems in your area of work.
- ✚ Achieve business understanding that breeds expertise and actively supports delivery on our higher purpose.
- ✚ Be a team player.
- ✚ Constantly upgrade our skills.
- ✚ Take responsibility to hold the highest level of professional integrity.
- ✚ Practice active listening and constructive feedback.
- ✚ Judiciously apply the law.
- ✚ Role model the SARS value
- ✚ Lead with passion and humility
- ✚ Be sensitive to diversity and tolerate differences
- ✚ Explore opportunities for innovation and actively drive transformation.

### **3.5.3.5 Administration of Prohibited and Restricted Goods**

While customs overriding objective is the collection of Revenue its also plays a vital part in the protection of the South African economy. Various seizures were made at different ports of entry

which included cocaine, ecstasy and counterfeit goods that had a total value of R 11 673 550. Table 3.11 lists the various seizures that were made at the customs district offices around the country.

**Table 3.11 Total Seizures Made By South African Customs, 2003**

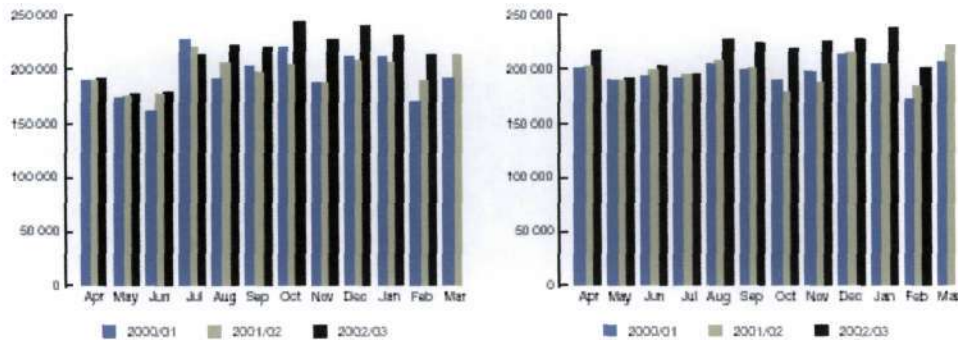
Office	Date	Product	Quantity	Value
Johannesburg International Airport	2002-04-01	Narcotics – cocaine	20 g	R7 000
Maseru Bridge	2002-04-01	Cannabis (dagga)	15 kg	R15 000
Maseru Bridge	2002-04-12	Cannabis (dagga)	5 kg	R5 000
Johannesburg International Airport	2002-04-24	Cannabis (dagga)	48,6 kg	R49 600
All national airports in SA	2002-04-24	Electronics – counterfeit	1 708 CD/VCD/DVDs	R100 000
Maseru Bridge	2002-05-08	Cannabis (dagga)	7,6 kg	R7 600
Mdatsane-East London	2002-05-14	Narcotics – ecstasy	4 044 tablets	R65 000
Maseru Bridge	2002-05-17	Cannabis (dagga)	71,05 kg	R71 050
Cape Town International Airport	2002-05-23	Narcotics – cocaine	0,5 kg	R225 000
Caledonspoor	2002-07-05	Cannabis (dagga)	942 kg	R942 000
Durban International Airport	2002-07-16	Narcotics – ecstasy	17,8kg	R6 000 000
Maseru Bridge	2002-07-20	Cannabis (dagga)	10 kg	R10 000
Johannesburg International Airport	2002-07-26	Cannabis (dagga)	20 kg	R20 000
Johannesburg International Airport	2002-08-07	Cannabis (dagga) – compressed	15 kg	R15 000
Durban International Airport	2002-09-13	Watches	± 2 500 pieces	
Johannesburg International Airport	2002-11-08	Narcotics – cocaine	5,2 kg	R2 200 000
Johannesburg International Airport	2002-12-09	Narcotics – cocaine	1 kg	R450 000
Beit Bridge	2002-12-18	Narcotics – dagga	2,3 kg	R2 300

Source: SARS Annual Report, 2003, pg 36.

### **3.5.3.6 Trade in Endangered Species**

The South African Customs service also has the responsibility together with the South African Police to enforce the Convention on International Trade In Endangered Species of Wild Fauna And Flora (CITES). While enforcing the CITES agreement is quiet difficult especially in light of the booming tourism industry as indicated by figure 3.5, SARS has joined forces to co-operate with national authorities and parties to the convention, Interpol and World Customs Organization to combat this illegal trade. Customs created the anti-smuggling teams which enables it to be uniquely positioned at various ports to counter this problem.

Figure 3.5 Administration of Travellers/Passengers



Source: Provided courtesy of the Department of Home Affairs for the SARS annual report, 2003, pg 35.

### **3.5.4 Political and legal**

The political and legal environment entails all the legislation and agreements that influence trade. These laws form the basis upon which customs activities are conducted and are necessary to ensure predictability and consistency.

#### **3.5.4.1 Legislation and Litigation**

The achievement of the SARS mandate to provide optimum revenue while ensuring enforcement is at its highest level requires legislation that is effective and practical, coupled with a robust litigation division. In this respect the SARS Law and Administration department provides a critical competencies in assisting SARS draft legislation in respect to the customs Act as well as representing SARS in litigation appeals, enhancing trade corporation with other customs administration. This all aids in providing business with consistency on the application of the law through providing rulings and general guidelines.

The Customs and Excise Act 91, of 1964 regulates the activities of the customs administration within South Africa. The act further requires SARS to administer the following acts that govern the country.

- ✚ The Public Administration and Justice Act.
- ✚ The Criminal prosecutions ACT
- ✚ The Counterfeit act
- ✚ Department of Trade and Industry Act

The dispute resolution process was initiated to contain the incidence of litigation and offer a speedy resolution process. Tables 3.6 and 3.7 indicate the results of extensive consultation and deliberation

Figure 3.6 Litigation

	2002/03	2001/02
Appeals won	18	12
Appeals lost	10	2
Cases withdrawn	21	41
Cases postponed	18	31
Cases conceded	18	10
Cases settled	37	34
Referred back	0	6
Awaiting judgement	2	6
Cases on hand at 31/03/03	113	121

Source: SARS Annual Report, 2003

Figure 3.7 High, Constitutional And Supreme Court

	2002/03 Non- Customs	2002/03 Customs	2002/03 Total	2001/02	% Change
Cases currently pending	8	248	256	140	83
Cases pending before Constitutional Court	0	0	0	0	
Cases pending before the Supreme Court Of Appeal	9	4	13	20	(35)
Cases settled	0	8	8	15	(47)
Cases successfully defended	13	25	38	38	0
Cases lost	4	7	11	13	15
<b>TOTAL</b>	<b>34</b>	<b>292</b>	<b>326</b>	<b>226</b>	<b>44</b>

Source: SARS Annual Report, 2003

#### **3.5.4.2 International Relations**

SARS is especially fortunate in the fact that several donor interventions in support of the Government's social-economic goals were extended to the Customs. In particular reference has to be made to the assistance received from the Swedish tax administration to develop and utilize there risk profiling "SARAP" module. The project is a vocal point of SARS transformation of business processes and has prompted similar transformation in customs risk management. Further assistance from the Danish embassy (DANIDA) assisted SARS with the ICRAS risk profiling business solution for customs based on the same principles of SARAP.

#### **3.6 Industry Environment**

SARS plays a strategic role in promoting investment and trade within the country. Its ability to provide a sustainable competitive environment to its clients is determined by its ability to facilitate trade while still maintaining the integrity of its supply chain.



### **3.6.1 Customs and the International Supply Chain**

Supply chain management can be broadly defined to be the effectiveness and efficiency in coordinating the efforts of procurements, manufacture, marketing and distribution. Each of the four activities could be spread across continents. As these activities cross borders they become subject to customs intervention. South Africa's trade policy move away from import substitution to one of export orientation and the further liberalization of trade and the use of technology to facilitate cargo clearances have stimulated its involvement in the globalization process.

Costs for business in the supply chain can be divided into three categories:

- ✚ Direct costs, this involves the payment of duty and value added tax.
- ✚ The cost of complying with any import and export restrictions, such as compulsory document requirements.
- ✚ The opportunity costs involved in not taking part in any of the concessions or the inappropriate use of customs regimes that may lead to future liabilities.

Managing the supply chain is a key factor to success as goods move across countries. Going into the different markets may depend on the scope and structure of the duty rate and agreements that are available in countries. China's entrance into the WTO will involve significant reduction in tariff duties for South African exports to China and increase the scope of the market size. Awareness and application of the customs policies is crucial to efficient movement of goods.

There are various facilities available within South Africa if used appropriately can provide organizations with a sustained cost advantage, these include:

- ✚ Customs warehouse facilities- allow goods to be stored without payment of duty and vat until released for final home consumption.
- ✚ In warding processing relief –allows duty and vat to be waived provided the goods are used in a manufacturing process after which it is exported.

- ✦ Temporary relief of duty-duty is suspended for a period of time hereafter it has to be exported. This is critical as it enables companies to use specialized machinery on projects etc without incurring additional costs.
- ✦ Outward processing relief allows for goods that were originally exported to be imported free of duty and restrictions.
- ✦ Removal in transit and in bond-goods may move across district offices within South Africa or through the country without paying duties and vat.

In affect customs laws can either be deal breakers or deal makers, understanding the role of customs within the supply chain as more than just the physical handling of goods is pivotal if the organization needs to attain a strategic cost advantage.

SARS introduced the accredited client program to achieve compliance within the supply chain. The focus of the accredited client program was to facilitate the business of legitimate clients while focusing their efforts on non compliant clients. A prerequisite of the system is that clients have established records with customs and the following in place (SARS Annual Report, 2003):

- ✦ Developed accounting system
- ✦ Developed internal control system
- ✦ Computerized system

SARS also conducts inspections at client's premises to ensure conformance to the accreditation requirements, table 3.12 indicates clients participating in the program.

Table 3.12 Profile of Clients Participating in the Accredited Client Program

Type	Number
Importers	318
Exporters	71
Agents	188
Removers in bond	11
Warehouses	7
<b>TOTAL</b>	<b>695</b>

Source: SARS Annual Report, 2003

Customs consideration is the focal point in the management of the international supply chain. Laws being constantly changed and becoming more complex as barriers to trade crumble means that the correct application of the rules will result in real advantages.

### **3.6.2 Cargo Security within the Supply Chain**

Following the September 11, SARS held a Consultative Workshop On Cargo Security, with objectives of:

- ✦ Informing Government and business on recent developments surrounding the areas of international supply chain security.
- ✦ Explain SARS approach in regard to the WCO resolution on supply chain security, with specific emphasis on the US Container security initiative.
- ✦ To arose stakeholder awareness and commitment towards a combined approach on security.
- ✦ To propose a follow up plan

The General Manager of Customs, Mr. Vuso Shablala alluded to the fact that the essence of the supply chain security rested upon the following (Cargo security report, 2002):

- ✦ Advanced reporting of export consignment information, to enable identification and targeting of high risk consignments.
- ✦ Risk management capability, to allow pre screening of containers before they leave South Africa.
- ✦ Using technology to pre-screen high risk consignments, by the deployment of X-ray and gamma ray scanning devices, to minimize delays, tampering and spoilage should containers have to be physically inspected.
- ✦ Developing and using smart and tamper proof containers, to ensure that the goods are secured throughout the life cycle of its journey.

The workshop was aimed at the freight forwarders, ocean carriers, export councils, shippers, container depot operators, rail operators, Department of Trade and Industry, SA Port Authority, Transnet Logistics, SA Maritime Association and the SA Chamber of Business.

SARS approach towards the WCO resolution was summarized as follows:

- ✚ Analysis of the customs operating environment, this will consist of an internal analysis of SARS physical and operational security environment.
- ✚ Sector based consultation with supply chain stakeholders, to ensure a combined approach to supply chain security.
- ✚ Determination of appropriate solutions, using appropriate technology and procedures to support the of the Cargo Security initiative.
- ✚ Consultation with neighbouring Customs Administrations.

The Port Of Durban together with a joint partnership with the Ports Authority has established a partnership in the acquisition of a container scanner. This scanner is manned by Customs personnel. South African Customs recently entered into a joint working partnership with the US Customs Department to inspect all containers destined to the US, to ensure that advanced information is submitted to the US customs for profiling and the integrity of the containers is maintained within the supply chain.

South Africa has reacted pro actively to the container security program even though it did not feature as the top twenty strategic ports which export the highest volume of direct containers to the US. In so doing South Africa has enhanced its role as a fundamental stakeholder within Africa and enhanced the countries competitive advantage.

### **3.6.3 The Impact of Globalization**

Most countries that are in the developing stages have not been able to reap the benefits from globalization because of several weaknesses. According to Nayyar (1997), the developing countries form an integral part of globalization in the twentieth century. They accounted for 66 percent of the total exports from developing countries in 1992, an increase of 30% from between 1970 to 1980. The developing countries have since been severely impacted by the financial crisis, debt and economic slow down, which further diluted their success in integrating into the world economy.

Firms in advanced countries have however extended their outreach programs through trade and production activities to territories around the world, however globalization was further intensified by factors such as advancement in technology and liberalization of trade that swept through the world. Economic globalization is a very uneven process, as trade and investment is focused in few countries (Martin Khor, 2000). While for example a country with a low income may account for a small portion of the world trade, changes in demand or export price and import duties may have major economic and social effects on that country.

The initial view that trade liberalization is necessary and has positive effects for the development of a country is being challenged. The (UNDP) United Nations Development Report (1999), states that the top fifth of the world's people in the richest countries enjoy 82 percent of the expanding export trade and 68 percent of foreign direct investment while the bottom fifth only accounts for 1 percent. This has reinforced the trends of economic stagnation and low human development. According to UNDP economic integration has divided the developing and transitional countries into those who are benefiting from global opportunities and those that are not.

Dani Roderick (1999) argues that developing countries must participate in the world economy on their own, not on terms dictated by the global markets and multilateral institutions. While Roderick's statement is bold, one must consider that developing countries can control how fast they liberalize their imports but cannot by itself determine how fast their exports can grow. Thus

trade liberalization can cause imports to surge without a corresponding increase in exports, this affectively can cause widening trade deficits, deterioration in the balance of payments and the extension of external debts, which can constrain growth prospects and lead to a recession.

Khor (2000), emphasis that trade liberalization should be a gradual process. He further states that what is important is the timing; sequence and scope of liberalization must be accompanied by the strengthening of the local enterprises, infrastructure, technology and human resources as well as build the export capacity of the country. Developing countries should also have the flexibility to make strategic choices in finance and trade investment policies where they can decide on the scope and the rate of liberalization.

Table 3.13 indicates the comparison of globalization for the different emerging market regions between the periods 1994 and 1998.

**Table 3.13 Comparison of Regional Globalization, 1994-1998 (as a percentage of GDP)**

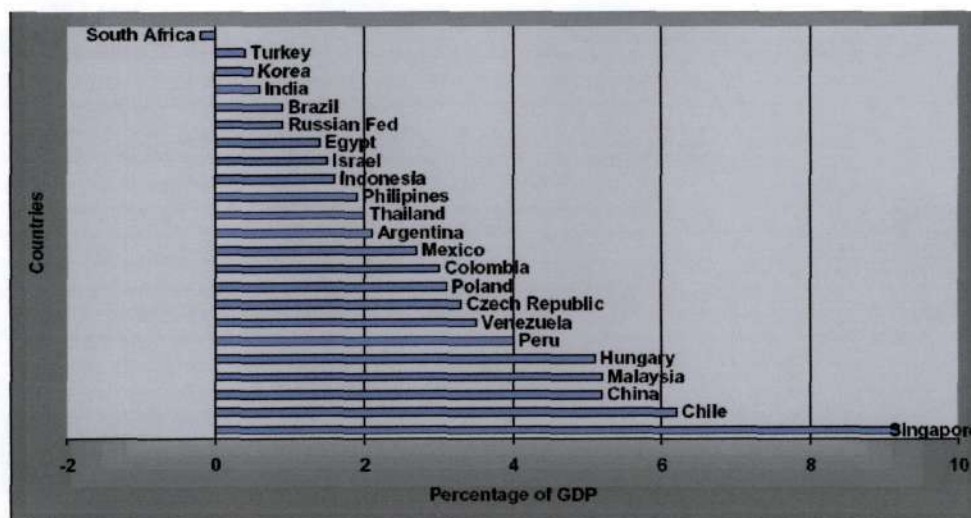
<b>Region</b>	<b>Trade</b>	<b>Net FDI Inflows</b>	<b>Net portfolio Inflows</b>
All emerging markets <sup>1)</sup>	82.6	2.8	1.8
Asia	129.7	3.3	2.3
Latin America	37.9	3.2	1.7
Eastern Europe	74.0	3.1	1.5
Other <sup>2)</sup>	57.4	1.1	1.0
South Africa	49.0	-0.2	2.8

Sources: World Bank, 2000b

The comparisons are based on the levels of international trade, net foreign direct investment and net pot folio inflows. Table 3.13 clear indicates that international trade has been a catalyst for globalization. The Asians less rigid economic and local policies have been a major driver for investment into the country while South Africa's isolation has had a significant affect on its trade with the rest of the world.

While Figure 3.8 indicates South Africa to be a moderate globalizer, this picture however is due to change. South Africa is becoming a major player in the African continent, being the main driver behind South African renaissance in the form of the New Partnership for African Development (NEPAD). Further intentions of the country to enter into MERCOSUR agreement with Latin American countries, China and India to establish a free trade agreement will improve its interaction in the global economy.

Figure 3.8 Aggregate Levels Of Globalization and Economic Growth. 1994-1998



Source: Loots, E. 2001

### 3.7 The Role of Customs In Light Of Globalization

The evolution into the innovation and technological information world is prompted Stephen Covey, a motivational speaker to call the knowledge age. The application of Information technology has transformed the global world. Production facilities are spread over continents, to ensure greater efficiency and maximum market penetration. Customs as a facilitator is a critical link that can ensure trade achieve the benefits that flow from a knowledge era.

Business needs customs to be responsive to their needs efficient and effective processing of their shipments and predicable set of rules and regulations. This may mean attaining just in time deliveries so that no longer will companies have to tie there capital in holding stock and deliver goods to the markets before competitors launch there products.

While trade facilitation is priority, customs must be mindful of its traditional role as guardian of the community and its economy. Globalization has complicated this role for Customs around the world due to increased volumes and greater need for facilitation and service delivery. Figure 3.9 indicates the increase in customs operation activities during the 2001 to 2003.

Figure 3.9 Operational Statistics in respect of imports and exports, 2001-2003.

Total value of imports and exports		April 2002 – March 2003		April 2001 – March 2002	
Imports	Exports	Imports	Exports	Imports	Exports
R273 174 400 000	R309 699 400 000	R212 652 100 000	R265 241 700 000		
Total number of transactions		April 2002 – March 2003		April 2001 – March 2002	
Imports	Exports	Imports	Exports	Imports	Exports
1 300 402	1 446 271	1 426 607	1 255 236		
Total value of SADC imports and exports		April 2002 – March 2003		April 2001 – March 2002	
Imports	Exports	Imports	Exports	Imports	Exports
R1 066 106 687	R6 763 602 647	R81 673 810	R163 904 310		
Total value of European Union imports and exports in rands		April 2002 – March 2003		April 2001 – March 2002	
Imports	Exports	Imports	Exports	Imports	Exports
R30 964 365 620	R33 133 776 006	R2 501 936 921	R10 456 251 632		

Source: SARS Annual Report, 2003

In the new global economy, with cyber crimes, fraud, transnational crimes are but a few challenges that face a customs administration. To bridge these gaps South African customs needs to build partnerships with agencies and business partners. Moreover in order to maintain a high

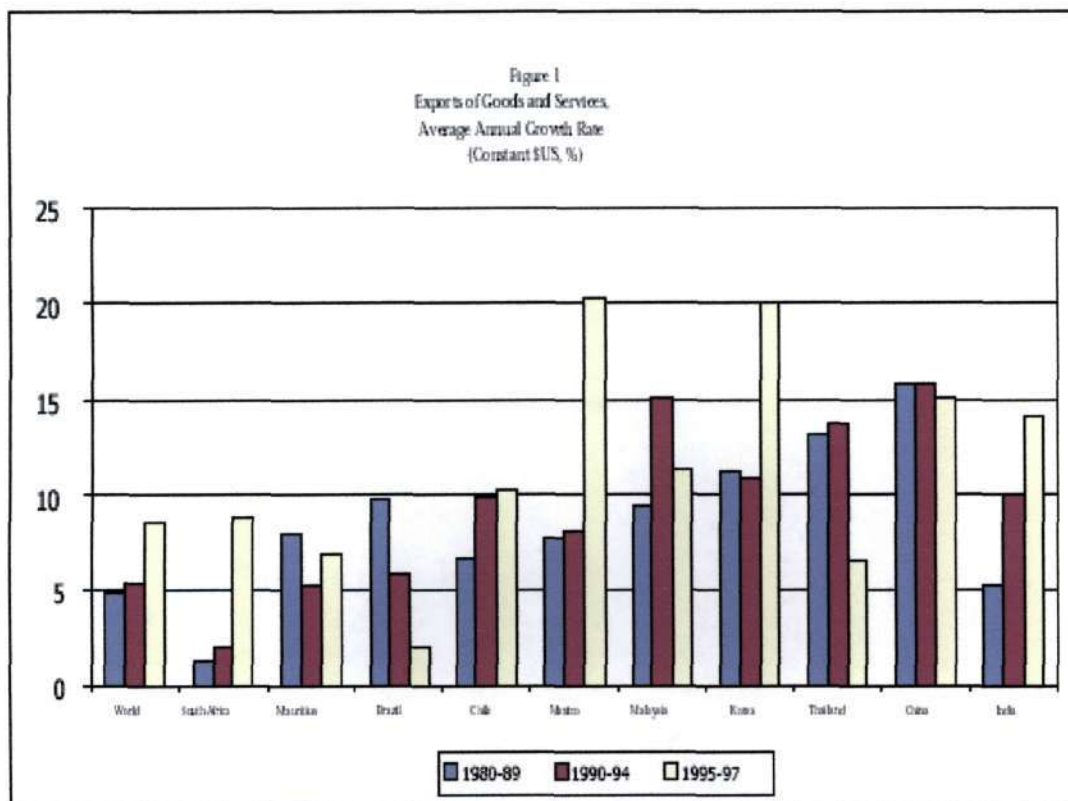


degree of compliance and trade facilitation customs systems and procedures need to be simplified, harmonized and improved to attain the right balance.

### **3.8 Competitors Analysis**

Figures 3.10 and 3.11 indicates that South Africa's export and investment performance improved substantially especially after the post apartheid 1994 and the adoption of more liberal economic policies. Although much improved, South Africa's export growth and foreign direct investment still lag behind those countries that have dynamic emerging economies such as Chile, Mexico, Malaysia, Korea, China, Thailand and India.

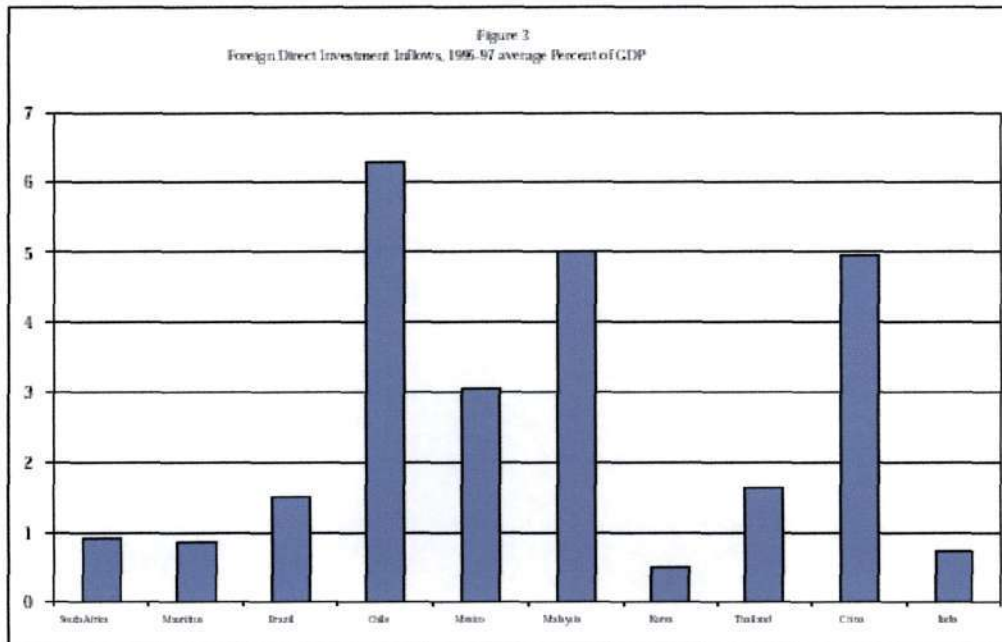
Figure 3.10 Export of Goods and Services



Source: South Africa's International Competitiveness, Stephen S.Gloub, 2000, Pg 5

096908

Figure 3.11 Foreign Direct Investment Inflows, 1995-97 average percentage of GDP



Source: South Africa's International Competitiveness, Stephen S. Gloub, 2000, Pg 7

Krugman (1994) goes as far as to claim that international competitiveness is a dangerous obsession when applied to countries as opposed to companies. He states that competitiveness can be defined as a favourable business climate measured by structural and macro economic policies, education and labour market rigidities. Gloub (2000), however, defines competitiveness in terms of international cost and price competitiveness, which is measured by comparison of the price competitiveness or cost across countries in a common currency i.e. the real exchange rate.

### **3.8.1 The Exchange Rate Impact on Competitiveness**

The exchange rate is one of the most important variables that affect international trade initiatives. A common question asked by policy makers is: How realistic is the exchange rate? This involves looking at what the equilibrium exchange rate should be to sustain exports and to what degree the exchange rate is over valued or under valued.

The real exchange rate refers to the actual exchange rate after adjusting for differences in prices and costs of production between South Africa and its main trading partners, and serves as a yard stick for determining import and export behaviour. Table 3.14 indicates countries included in the calculation of South Africa's real exchange rate.

Table 3.14 Countries Included in the Real Exchange rate calculation Of South Africa

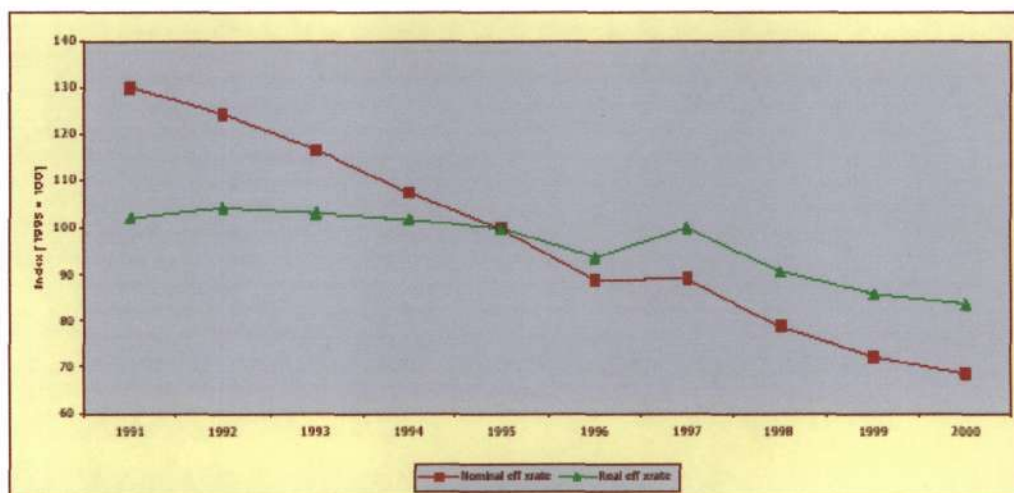
<b>Developed</b>	<b>Developing</b>
Australia	<b>Asia</b>
Canada	China
Denmark	Hong Kong
France	India
Germany	Indonesia
Ireland	Malaysia
Italy	Singapore
Japan	South Korea
Netherlands	Taiwan
Norway	Thailand
Spain	
Switzerland	<b>Africa</b>
United Kingdom	Ghana
United States	Kenya
	Madagascar
	Malawi
	Mauritius
	Mozambique
	Nigeria
	Tanzania
	Zambia
	Zimbabwe
	<b>Americas</b>
	Argentina
	Brazil
	Mexico
	<b>Europe, Middle East</b>
	Iran
	Israel
	Saudi Arabia
	Turkey

Source: South Africa's International Competitiveness, Stephen S. Gloub, 2000, Pg 21

South Africa's nominal devaluation of its currency has not been as drastic as it has been made out to be. The nominal exchange rate does not account for the inflation differentials between South Africa and its major trading partners. For this purposes the South African Reserve Bank (SARB)

uses the real effective exchange rate. Figure 3.12 indicates the trends in the nominal and effective exchange rate.

Figure 3.12 Nominal and real effective exchange rates (1995=100)



Source: South African Reserve Bank Quarterly Bulletin

Investors base their decisions on the level of stability, in this regard the exchange rate is an important factor. During the periods 1996 and 2001, foreign investors reported a substantial loss as a result of the Rand's 22 percent and 37 percent plunge respectively against the dollar. This effectively meant that a foreign investors 40% profit margin would have shrunk to 3 percent, a currency decline is therefore a disincentive to investors. This, however, did leave South Africa would some positive outcomes:

- ✚ South African exports are 37% cheaper in dollar terms and therefore more competitive.
- ✚ South Africa's labour is relative cheap in dollar terms versus other emerging markets which will assist exports.

### **3.8.2 Growth and Competitiveness of South African Exports**

Due to the volatile external international environment balance of payments was previously managed with the objective of compensating for the financial inflows by producing trade surplus in order to generate foreign currency and repay external debt. During 2000, both import and export volumes increased substantially with the overall trade balance as indicated in the table 3.15, a surplus of 3.7 percent of GDP. The 8.2% indicated the improved performance of the export sector, with agriculture being the major contributor. Vehicle manufacturers themselves have benefited due to the increase in global demand for catalytic converters during the latter part of 2000. The increase of imports by 7.4% indicated a stronger growth in the South African market.

Table 3.15 Balance of Payment, Rm, constant 1995 prices

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Trade balance	23,366	21,753	20,100	10,482	4,776	5,873	6,368	7,917	20,243	23,025
Exports	101,700	104,276	109,324	114,061	125,867	137,514	145,097	148,262	150,145	162,500
Imports	78,334	82,523	89,224	103,579	121,091	131,641	138,729	140,345	129,902	139,475
<b>Percentage growth</b>										
Exports		2.5	4.8	4.3	10.4	9.3	5.5	2.2	1.3	8.2
Imports		5.3	8.1	16.1	16.9	8.7	5.4	1.2	-7.4	7.4
<b>As a percentage of GDP</b>										
Trade balance	4.5	4.3	3.9	2.0	0.9	1.0	1.1	1.3	3.4	3.7
Exports	19.6	20.5	21.2	21.5	23.0	24.1	24.8	25.2	25.0	26.3
Imports	15.1	16.2	17.3	19.5	22.1	23.1	23.7	23.8	21.6	22.5

Source: South African Reserve Bank Quarterly Bulletin

Table 3.16 also indicates South Africa's gradual move away from the primary dominated sector to that of a manufactured export driven sector.

Table 3.16 Composition of the Export Basket

Category	1990	1993	1996	1999
Gold	33.7	31.2	23.5	16.3
Primary products	24.5	25.4	21.5	20.4
Material-intensive products	6.1	5.7	7.1	7.9
Manufactured products	9.2	14.4	19.9	23.6

Source: IDC, 2000

A highlight of South Africa's international trade was given impetus due to the re-orientation from an inward to an outward looking economy with emphasis on export growth. Table 3.17 indicates the world trade grew by 5.7 percent while SACU's total exports declined by 1.5 percent this was due to the exports of minerals which declined by 9.9 percent while South Africa's food products and commercial services outperformed global trade by 4 percent and 9% respectively ( The state of policy in South Africa, 2002).

Table 3.17 World Export by Broad Product Group, US\$ billion

	SACU 1994	SACU 1998	SACU % CHANGE	WORLD TRADE 1991	WORLD TRADE 1998	WORLD % CHANGE
Total merchandise	18 852	17 559	-1.5	4 245 357	5 369 681	5.7
Agriculture and food	2 118	2 407	4.1	393 439	443 784	2.6
Minerals	6 052	3 939	-9.9	445 808	518 500	4.9
Manufactures	10 682	11 212	1.2	3 405 110	4 407 397	6.1
Commercial services	3 556	5 109	3.2	1 085 916	1 374 052	5.9

Source: Merchandise –UnComTrade, Statistics Canada World Trade Analyser

### **3.9 Internal Analysis**

In order for an organisation to attain sustainable competitive advantage, it needs to analyse its external environment as well as its internal capabilities and resources to provide a strategy that best fits the organisation. The SWOT analysis is a useful analytical tool to establish whether the company's present strategy is working and the opportunities and threats that could affect its future success.

#### **3.9.1 Strengths**

Strengths are skills, valuable assets, expertise or habits that are developed by an organisation that enables it to attain enhanced competitiveness.

##### **3.9.1.1 Revenue Performance**

The SARS has constantly played a strategic role in managing South Africa's fiscal policies. During the periods from 1995 to 2003/4 tax periods, SARS has offered large tax relief to the consumers. During the 2003/4 period SARS contributed a total of R13.2 billion in tax relief. Table 3.18 indicates a summary of the tax relief granted to individuals.

Table 3.18 Tax relief granted to individuals

Year	R'000
1998/99	3 700 000
1999/00	4 850 000
2000/01	9 900 000
2001/02	8 308 000
2002/03	15 000 000
2003/04	13 250 000
<b>TOTAL</b>	<b>55 808 000</b>

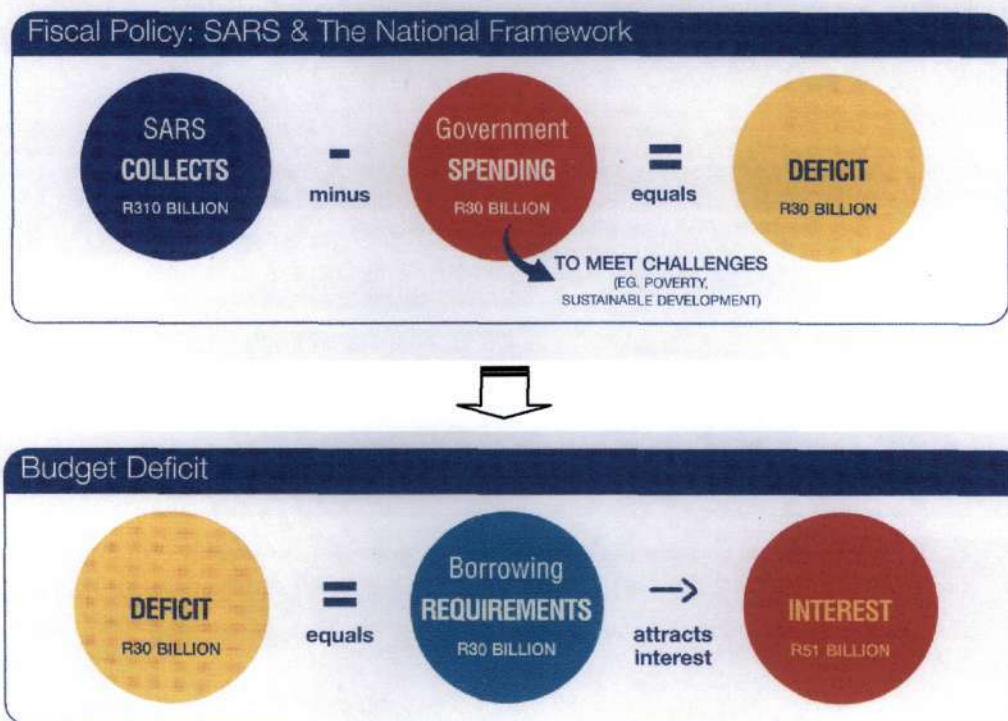
Source: SARS Annual Report, 2003

Table 3.18 indicates that SARS has consistently exceeded its revenue performance. This has been mainly due to real economic growth, evidenced by increased international trade and corporate earnings and a more focused enforcement approach. Further to this through transformation efforts, efficiency gains have been realized. SARS exceeded the revenue target for the 2003/4 period by R13.7 billion and the revised estimate by R2.1 billion. This exceeded the previous year's figures by 11.8 percent.

The improved revenue collection has enabled the government to increase spending on vital public service goods and services, as well as reduce government debt. This has indirectly boosted investor confidence.

For the year that ended 31 March 2004, government needed R 340 billion to pay for the basic services to South Africa. Figure 3.13 indicates that R310 billion is expected to come from tax collections and the rest from public borrowings.

Figure 3.13 Budget Deficit Implications



Source: SARS Way brochure, 2003, Pg 4



While meeting and exceeding the target is vital, SARS has to ensure that the collections are also consistent throughout the year. Figure 3.13 indicates that any short fall means that South Africa has to incur immense borrowing cost in the form of interest payments that can total in the region of R51 Billion (SARS Way Brochure, 2003), consequently leaving the South Africans worse off.

SARS increasing integration into the global economy has indicated marked changes in its indirect tax types especially in the following:

#### Fuel Levy

An amount of R15.334 billion was received in respect of fuel levy during 2003, which was R168 million greater than the printed estimate. The difference is due to the slightly higher than anticipated fuel sales. Figure 3.19 indicates a marked improvement in the sale of fuel from 2002 onwards. This could be interpreted to mean greater economic activity within the country together with the implementation of payment of fuel levy at source provided for improved efficiency in the collections by SARS.

Table 3.19 Growth in fuel sales

Year	Increase
1998/99	0,0%
1999/00	0,7%
2000/01	(2,2%)
2001/02	1,8%
2002/03	2,9%

Source: SARS Annual Report, 2003

### Excise Duty





Excise duty collections amounted to R 11,473 billion, which exceeded the printed estimate by R406 million. This was attributable to gains in the consumption of spirits, cigarettes and ad valorem duties.

#### **3.9.1.2 Service Monitoring Office (SMO)**

In line with international best practices and as part of SARS commitment to customer services the SMO was launched in October 2002. In establishing this office SARS resort to the speedy resolution of complaints which could not be resolved in the normal operations channel. SARS also sends a clear message that in collecting revenue it will ensure that administrative actions are lawful, reasonable and administratively fair as guaranteed by the constitution.

Although the SMO does not report to the parliament it functions independently from local branch offices and reports directly to the Commissioner. This enables the Commissioner to gain first hand knowledge regarding problem areas from an independent source and to take the necessary steps to pursue resolutions.

While the SMO received 7246 complaints, the success should be measured not on the number of complaints received but the number resolved. This included following types of remedial action:

-  Holding branch office accountable for speedy resolution.
-  Reprimanding branch offices management and staff were warranted.
-  Tracking the service delivery of the offices and the issues raised.
-  Process improvement where the underlying problem relates to the administration system.

### **3.9.1.3 Customs Quality Management System (QMS)**

The Customs QMS has been rolled out to ensure consistent application of rules and regulations relating to the Customs and Excise Act 91, of 1964. The QMS system rolled out is envisaged to develop a culture of standardized processing in customs centred around the country with the aim of attaining the ISO 9000 accreditation for policy and processes.

### **3.9.2 Weaknesses**

A weakness is a resource or a skill that the organisation lacks or performs poorly (Thompson and Strickland, 2003). South Africa is entering the global world after years of isolation, this has inadvertently created major skills miss match together with the debts inherited from the previous regime have reduced South Africa's competitiveness among the likes of other developing countries such as Malaysia and India.

#### **3.9.2.1 SARS Worsening Debt Situation**

While SARS is focusing its attention to the worsening debt situation, however has not done enough. SARS debt as a percentage of total revenue is 19.8 percent. When compared to other countries, they reveal ratio's of 8 percent for the Organization for Economic Development and Corporation, Canada 5.3 percent, Ireland 4.01 percent. Australia 5.3 percent and New Zealand 3.7 percent. Table 3.20 illustrates the outstanding debts at 2003 year end.

Table 3.20 SARS Outstanding Debt

Debt type	Amount R billion
Individuals	10,1
Companies	12,7
PAYE	12,1
VAT	21,1
<b>TOTAL</b>	<b>56,0</b>
<i>Less: Unallocated receipts</i>	2,3
<i>Less: Objections and appeals</i>	13,0
<i>Less: Estates and liquidations</i>	5,5
<i>Less: Provisions for write-offs</i>	3,2
<b>TOTAL AFTER ADJUSTMENTS</b>	<b>32,0</b>
Total tax revenue	282,2
<b>Debt before adjustments as a % of total tax revenue</b>	<b>19,8%</b>

Source: SARS Annual Report

A further age analysis of debt shown in table 3.21 indicates a substantial increase in the outstanding debt between 2002 and 2003 tax year of between 42.9 percent. This significantly affects SARS ability to optimize collections.

Table 3.21 Age Analysis of Outstanding Debt

	Debt at R billion		% change	
	2002/03	2001/02	2002/03	2001/02
Interest	7,3	5,1	43,1%	27,5%
1 – 8 months	10,4	9,9	5,1%	57,1%
> 8 months	38,3	24,2	58,3%	26,8%
<b>TOTAL</b>	<b>56,0</b>	<b>39,2</b>	<b>42,9%</b>	<b>33,3%</b>

Source: SARS Annual Report, 2003

### **3.9.2.2 The Lack of an Effective Risk Analysis System**

While SARS has made great strides in the establishment of industry focus enforcement campaigns, this has in some instances worked against SARS and the interest of the clients. SARS has currently adopted a risk management system that is still in its infancy, strategic intelligence is still not available to provide input into the system.

A number of physical inspections, raids and post audits are carried out based on subjective criteria established by local branch offices. There is a lack of uniformity and consistency in its operations. The impact is quite significant as negative publicity relating to company's that publicly trade their shares on the stock exchange could severely impact company's equity position.

### **3.9.2.3 Auditor General Qualification Report**

The auditor general could not satisfy himself as to the validity and accuracy of the policy, procedures and revenue and therefore could not express a clean audit opinion for the following reasons (SARS Annual Report, 2003):

- ✚ Excise duty and fuel levies-the control functions performed by SARS to verify the accuracy of excise duties and fuel levy was mainly documentary proof while the inspections performed were inadequate or not performed at all. This could lead to severe revenue leakages if not managed well.
- ✚ Penalties and interest on customs- a concern raised by the Auditor General was that SARS was not complying with section 39(3) of the VAT Act in respect of charging interest and penalties on late payment of amounts deferred by clients.
- ✚ Sureties- Guarantees and bonds are issued by financial institutions in favour of SARS for customs and excise duty payable. The values of the bonds in some instances are prescribed while in other instances it is managed based on operational needs or historic

policies of SARS. This poses a severe risk as bonds may not be substantial or inadequate to address the risk should a client default.

- ✚ Limited reliance were placed on the internal audit section of SARS for external audit purposes as working papers, audit reports and supporting documents were incomplete.

#### **3.9.2.4 Weakness in Internal Control**

The Auditor general in his report to the Commissioner indicated that various internal control measures were lacking, amongst them included:

- ✚ Registers- deficiency regarding the completeness and accuracy of registers in respect of various customs and excise duties were found.
- ✚ Receipts were unprocessed or not allocated to the relevant account- all amounts were not allocated into the client from whom payment has been received. Further to this several provisional amounts remained unallocated to the customs duty account. Although these funds were used up by treasury the amounts were still recorded as a suspense amount.

#### **3.9.2.5 SARS Culture**

While substantial improvements have been made, the staffs of SARS still have a poor work ethic that is characteristic of the government sector. Table 3.22 reveal that internal fraud still persists within the organization, with twenty eight officials from SARS being dismissed for fraud or bribery and poor attendance that compromise efficiencies accounted for fourteen dismissals.

Table 3.22 Dismissal for the March 2002/03 financial year

Action	Number of dismissals
Dismissal: Fraud/bribery	28
Dismissal: Attendance	14
Other	21
Total	63

Source: SARS annual report, 2003 Pg 49

### **3.9.3 Opportunities**

Businesses around the world realize the benefit of E-commerce and EDI opportunities, in order to maximize their business potential, remain competitive and ensure continued growth. There is little doubt that e-commerce will dominate all sectors of the market. Customs has realized this and is headed towards the E-commerce arena, making a determined effort to meet the new-age expectations and participate successfully in a dynamic market place.

Customs in enabling E-commerce/EDI must be able to integrate and streamline their entire operations to provide a key process in the supply chain. Customs formed relationships with various trading partners to ensure the exchange of information and expertise was in line with industry standards. In essence customs E-commerce strategy aims to achieve the following:

- ✚ Attract, retain and cultivate relationships with clearing agents.
- ✚ Aim for a paperless environment.
- ✚ Provide a catalyst for the automation of current manual processes.
- ✚ Reduce capturing effort and eradicate capturing errors.
- ✚ Provide accurate management and statistical information to enhance decision making.
- ✚ Automate corporate processes to deliver the right information to customers quickly and cost effectively.
- ✚ Introduce electronic risk profiling to reduce fraud.

Customs has made significant efforts to transform its traditional manually driven operations, by the implementation of the following systems that will provide greater flexibility in delivering a high quality service to its clients in the future.

- ✚ Cape Phase 2 was piloted at Johannesburg and is to be rolled out around the country. This system allows for the electronic processing of bills of entry, resulting in improved turnaround times.

- ✚ Electronic declarations- SARS has moved closer to a paperless environment through the electronic data interchange system. This system acts as a tool to interface between the Cape Phase 2 system and the electronic systems of the clients.
- ✚ Manifests receipts and acquittals- the electronic submission of manifest (advance notice of goods arrival), allows for effective risk assessment capability. It is envisaged that this system will later “talk” to systems of the (NPA) National Port Authority (COSMOS), depot operators and shipping lines. This will effectively mean electronic release of goods, with minimum human intervention.
- ✚ The Warehouse Management Inventory system- the previously manual balances and checks done by customs inspectors at clients warehouses in respect of bonded goods, is being replaced by an electronic system. This system allows for the virtual acquittal of goods within the warehouse. This enhances duty collection by SARS and increases capacity of the staff to perform more intensive audits on other aspects of client’s transactions.
- ✚ Transit system- goods in transit are effectively destined for other neighbouring countries passing through South Africa. The transit system allows for the automatic acquittal of transit entries. This reduces the potential threat of diversion of goods into South Africa for home consumption.
- ✚ Duty at source system (DAS) - This system is aimed at simplifying the administration of the main excisable industries, namely, oil, tobacco and spirits. The principle of the DAS systems allows SARS to assess excisable duties at point of manufacture. Together with South Africa’s involvement in NEPAD, regional corporations have been strengthened as BLNS countries have agreed to the co-implementation of DAS. This effectively will reduce revenue leakages as a result of round tripping of excise goods.
- ✚ The single customs declaration – is a further effort towards building consistency and predictability within the African continent. SARS has entered into agreements within a number of participating African States to utilize one single import and export declaration across territories. This further enhances trade facilitation and strategic exchange of information.

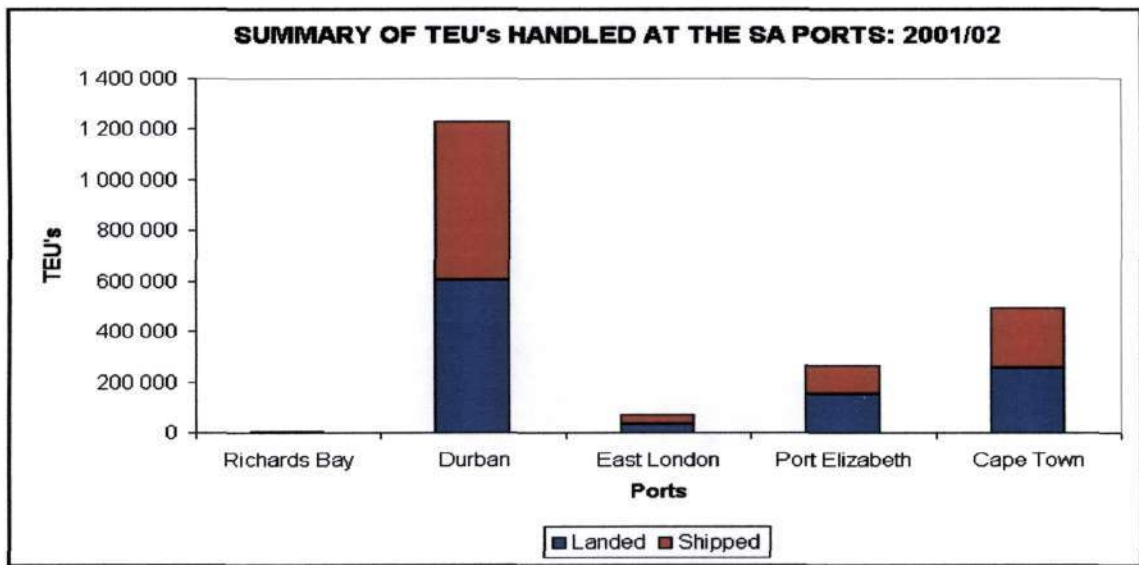


Customs has already started realizing the benefits from a paperless customs environment. The achievements so far and in the future can only serve to positively hasten the elimination of red tape, to transform customs from a regulator to a facilitator of trade within South Africa.

### **3.9.4 Threats**

The movement of freight primarily takes place between Johannesburg and Durban and a series of midsized corridors. Future flows are expected to continue along the same trends however the volumes are expected to increase substantially. Figure 3.14 indicates the number of twenty foot equivalent units (TEU) handled by the ports.

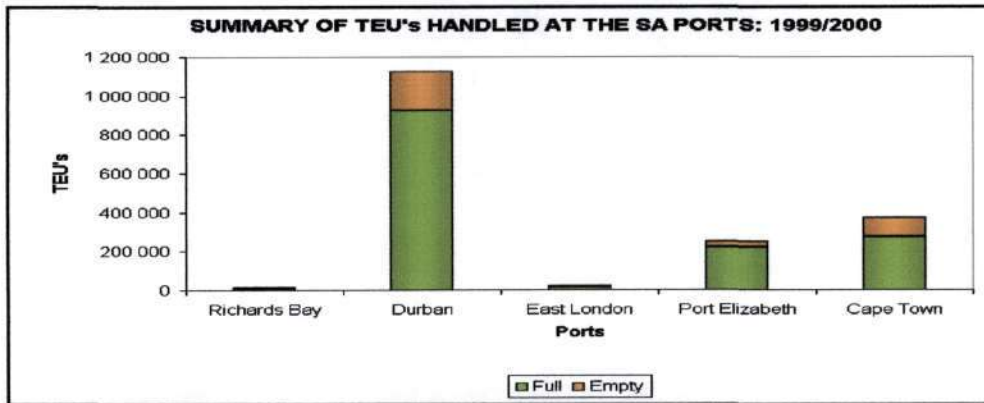
Figure 3.14 TEU'S HANDLED PER PORT – 2001 / 2002



Source: Information Received from the National Port Authority

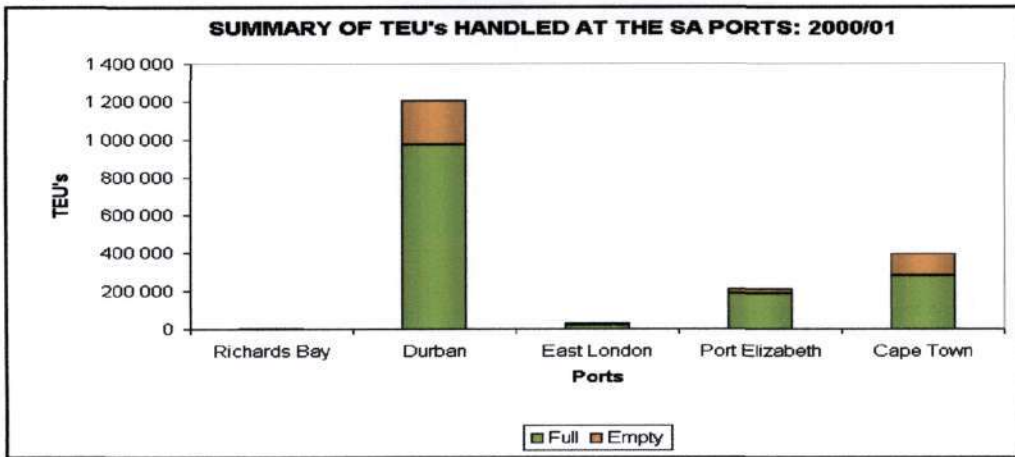
Further liberalization and the conclusion of bilateral trade agreements saw an upswing in trade between South Africa. A country that was primarily driven by import substitution was now focused on export orientated policies. This is evident in the increase in volumes flowing through the ports, as characterized in figures 3.15, 3.16 and 3.17.

Figure 3.15 TEU'S HANDLED PER PORT – 1999 / 2000



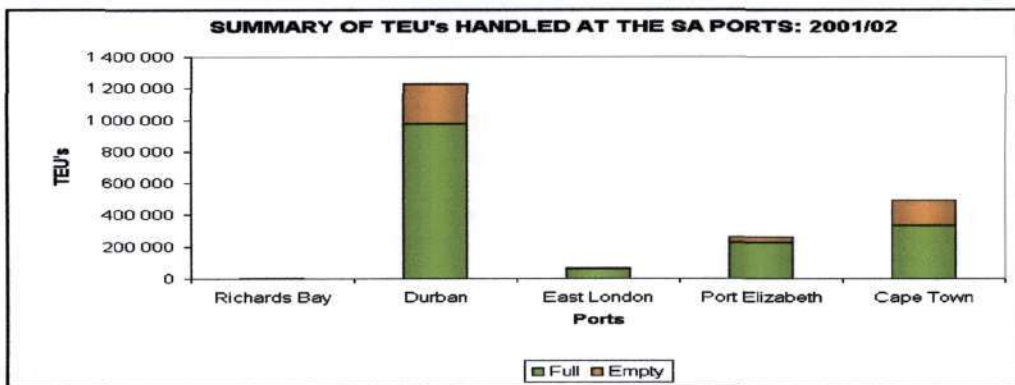
Source: Information Received from the National Port Authority

Figure 3.16 TEU'S HANDLED PER PORT – 2000 / 2001



Source: Information Received from the National Port Authority

Figure 3.17 TEU'S HANDLED PER PORT – 2001 / 2002



Source: Information Received from the National Port Authority

The increased volumes lead to an increase in the number of transactions processed by customs during the periods 1999 to 2000, as indicated by table 3.23.

Table 3.23 Total Number of Transactions Processed between 2001-2002

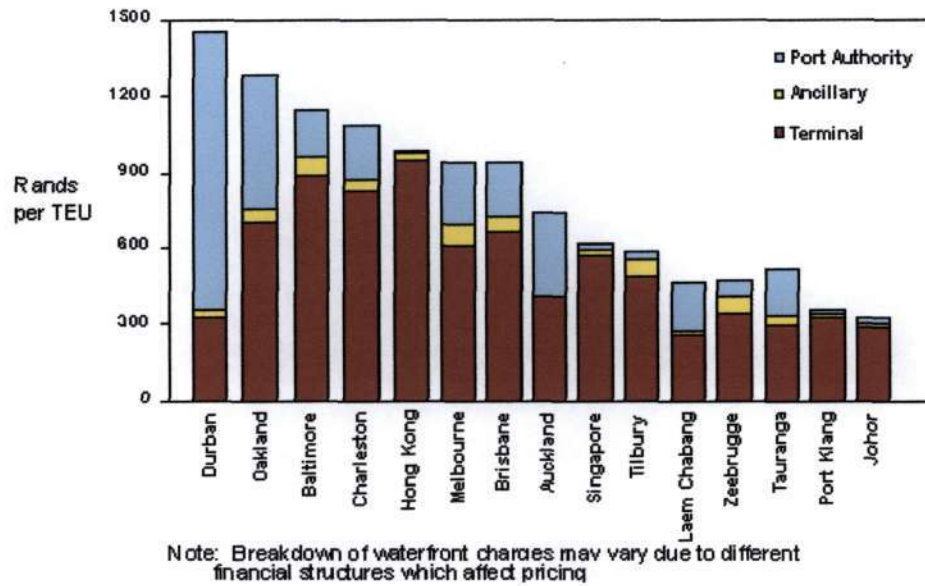
April 2002 – March 2003		April 2001 – March 2002	
Imports	Exports	Imports	Exports
1 300 402	1 446 271	1 426 607	1 255 236

Source: SARS Annual Report

The significance hereof is that increased volumes means added risk, further to this volume increases also causes congestion in the port. This effectively compromises customs ability to conduct effective compliance verifications at the same time reduces the efficiency within the supply chain.

The freight transport system was engineered to support a two pronged industrial strategy, an import substitution economy to ensure self sufficiency in a world of sanctions and uncertainty while on the other hand there was a need to generate sufficient foreign exchange by means of export orientated capabilities. While the industry was shifting to a value added export capability, the transport system of South Africa did not reflect this strategy. This is evidenced in three areas, rail general freight services, port costs and ocean freight rates. In the realm of rail, general freight performed poorly on service reliability and operating costs compared against international bench marks. As rail constitutes one of the most vital leg of inter model export chain, this creates barriers to success in achieving the new industrial strategy. Figure 3.18 indicates the port charges typical of the legacy of the import substitution regime (internet 6).

Figure 3.18 Comparisons of Port Charges



Source: Internet 6

The lack of alignment within the supply chain indicated in figure 3.19, shows the amount of time an average export container spends in each step of the transport chain, 83 percent of the time is spent travelling to its destination. This is as a result of South Africa's distance from most markets in Europe and Asia. This distance constitutes a significant disadvantage for South Africa as it competes in the Global economy. Given this distance from markets cost of freight for containerized cargo constitutes 68 percent of the transport cost on the import side while on the export side account for 60 percent of the cost of transport.

Figure 3.19 Transit Time in the Import and export Chain



Note: Based on case studies  
 Source: Industry Interviews, For the I, Spoorne I, MBA Analysis

While the South African customs is making significant strides to electronic processing, its operations are still substantially manually cumbersome. Any delays in shipping or landing cargo effectively, is worsened by customs due to its administrative requirements and physical inspections that has to be carried out.

Delays and congestions in the port are ideal situations that criminals thrive on. The growth in cross border crime such as narcotic smuggling, money laundering and gun running are on the rise due to the complexity of the types of cargo flowing through the ports and the volume that is constantly on the rise.

### 3.10 Core Competencies

Customs core competency is its human resources. The field of customs within South Africa is specialized and the intensity of training required in relation to tariff and commodity classification, valuations and administering rules of origin is vital for a successful customs administration.

The skills of SARS staff are critical in ensuring an effective organization and in enhancing the credibility of the administration. In this regard the organization invests in upgrading the technical, operational and management skills of staff. In this respect SARS embarked in designing a new business structure that will support innovation through training needs analysis, planning, research and design, assessment and bursaries. The graduate institute of technology has been appointed as a partner for the implementation of the organizations Leadership Development Program (LDP). This program is one of the projects for leadership development and talent creation within SARS.

### **3.11 Customs Modernization Program**

The World Economic Forum has launched an action plan-orientated to improve the customs processes within a target country through the development of a framework for implementation of Customs Modernization.

The Trade Enhancement Framework will enable developing countries to shape their principles, components, and deployment guidelines needed to develop a detailed blue print of the operations, and infrastructure required for effective customs implementation and governance in the global trade and commerce landscape. The Framework will provide guidelines for building and funding practical transitions/modernization strategies for implementation. The customs modernization initiative is based on the principles set out in the revised Kyoto Convention, which came into affect in 1974 with the aim of simplifying and harmonizing customs procedures in order to facilitate and encourage trade. The recommendations of the Kyoto Convention 2000 include the following:

- ✚ The maximum use of automated systems.
- ✚ The use of pre-arrival systems to drive programs and selectivity.
- ✚ Risk management techniques (including risk assessment and selectivity controls).
- ✚ Easy access to customs information's relating to rules and regulations.

Customs has earnestly commenced with the introduction of technology to speed up processing and subsequently adopted a risk management system to effectively profile cargo for inspection and audit. Customs has made use of the Danish system around which they developed ICRAS, which is a computerized risk management tool. It is this aspect of risk management that will be the focus of the preceding chapter.

### **3.12 Customs Current Risk Management Strategy**

Customs adoption of the teaming concept which was rolled out between 1999 and 2000 emphasized Customs commitment to implement the Revised Kyoto convention's principle. This was represented in the restructuring of the teams, from that of an isolated driven organization to one that was jointly performance driven by collectives focusing on achieving a uniform set of goals. Figure 3.20 indicates a typical legacy structure as compared to the structure that came into affect during 1999.

Figure 3.20 Legacy Structure

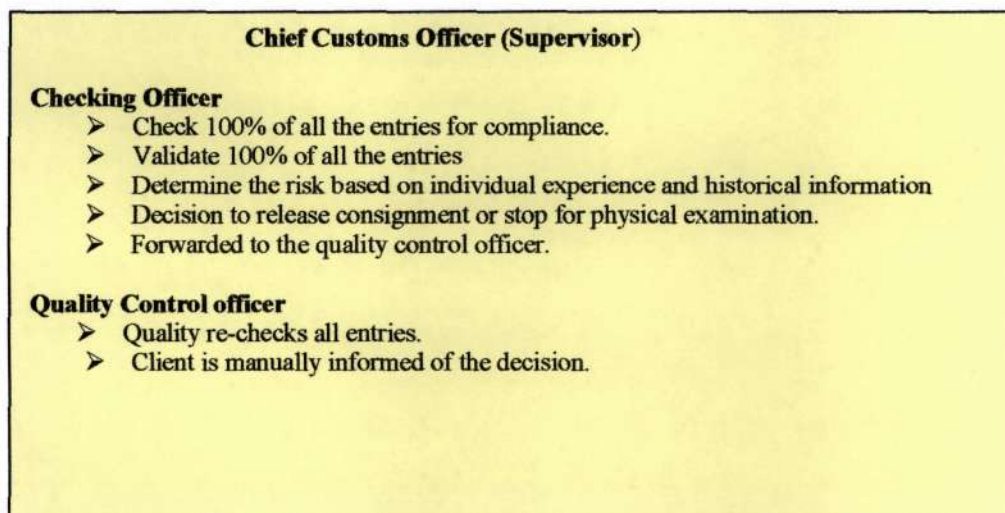


Figure 3.21 Revised Structure

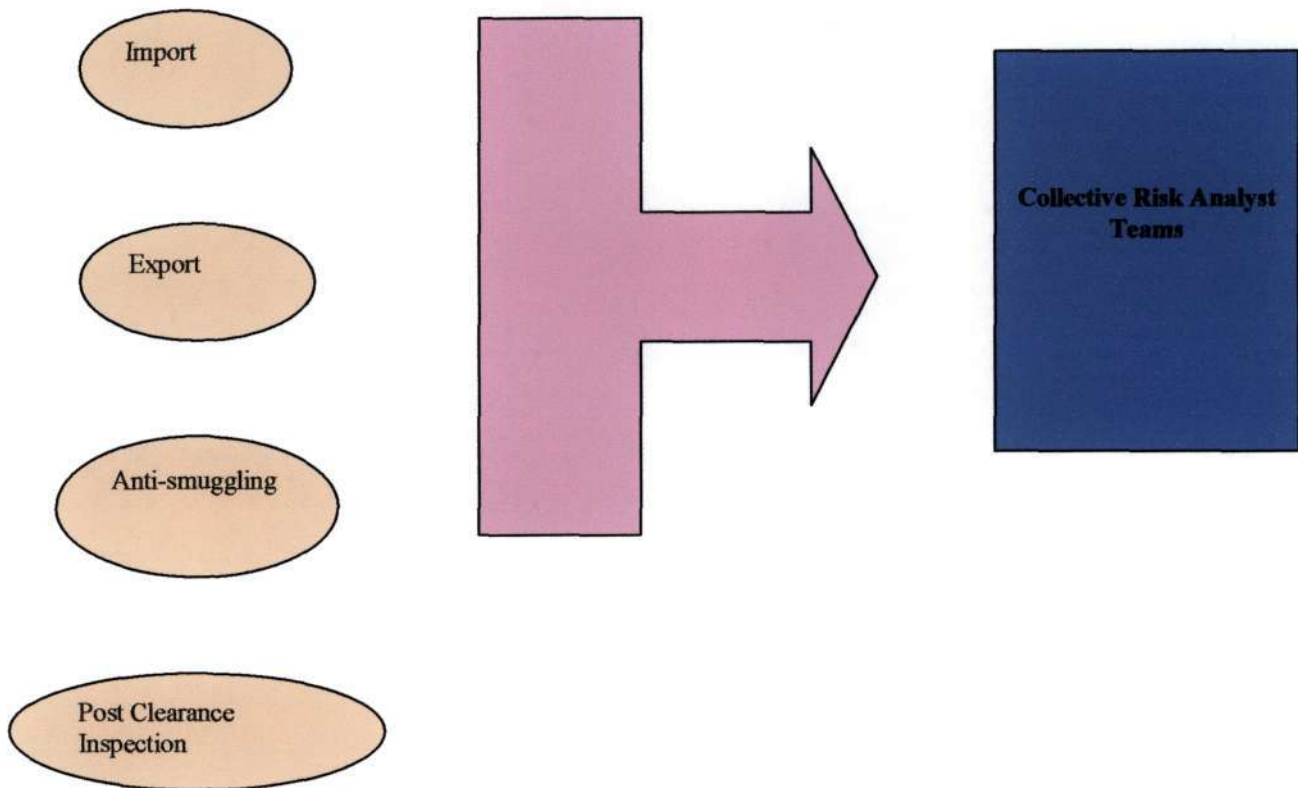


Comparisons between these two structures indicate that the legacy structure placed heavy reliance on an individual to carry out most of the functions, this included the fundamental function of risk profiling. The revised structure as depicted in figure 3.21, encouraged job specialization and a team effort in achieving the organizations goals.

Subsequent to this SARS has further modified the teaming structure as indicated in figure 3.22, by removing the risk analysts from within different teams and placing all risk analysts into one collective team.



Figure 3.22 Current Structure



### **3.13 Relationship between Risk Management and Intelligence**

The primary aim of the risk management system is produce information that is accurate on which bases decisions can be made. This includes decisions about what is happening and what will happen, in the decision maker's environment. Intelligence is what supports this decision process. Intelligence therefore can be defined as a product derived from the collection and processing of relevant information, which supports customer decision making.

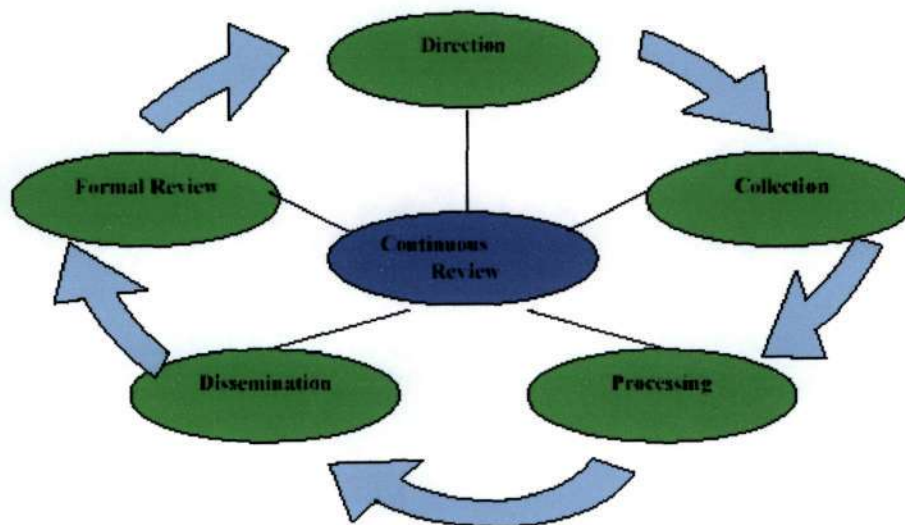
Within SARS there are three main levels of decision making. This includes policy makers who take decisions in Headquarters about SARS overall aims and objectives what policies should be

implemented and how the national resources should be allocated. This is known as SARS strategic level of decision making.

While within Regions SARS managers make decisions on how to deploy these resources and execute these policies effectively and efficiently. This is known as tactical level decision making while SARS front line staffs main objective is how to deal with non-compliant clients, provide an effective processing service, they essentially practically execute these tasks, this is known as operational level decision making.

Specific sets of activities need to be carried out to produce this intelligence to the different levels of decision makers. These activities are cyclical and feature five distinct phases as indicated in figure 3.23.

Figure 3.23 The Intelligence Cycle



Source: SARS Intelligence Manual, 2003

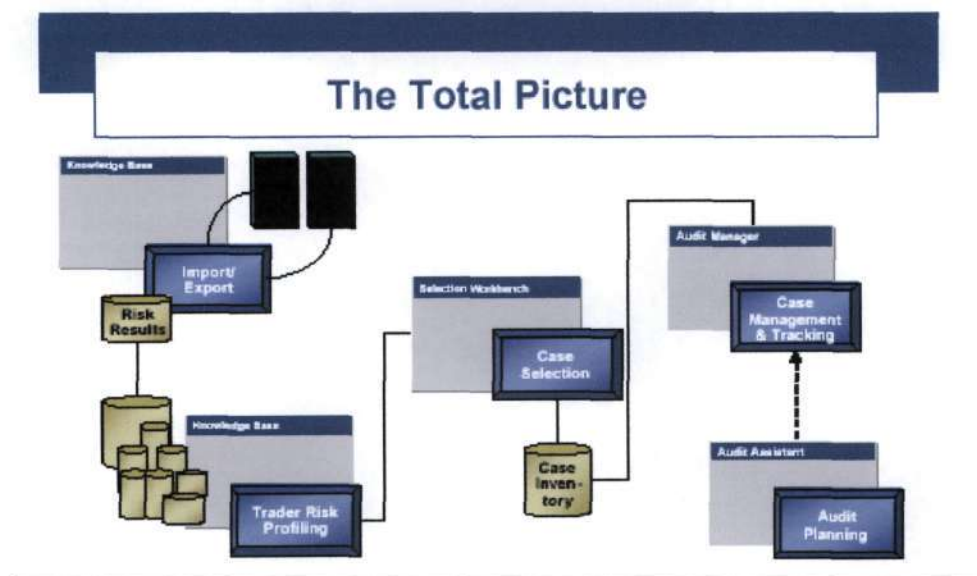
🚩 **Direction**- Establishes intelligence needed.

- ✦ **Collection-** collecting information to form intelligence.
- ✦ **Processing** – Turning the collected information into intelligence.
- ✦ **Dissemination-**Getting the intelligence to the customer.
- ✦ **Formal review-** decision makers not only require information they also expect intelligence providers to alert them of potential risks, threats or opportunities. In this phase intelligence providers need to establish how they will work through the remainder of the cycle.

Historically SARS had a one dimensional view of risk –potential non-compliance. However risk Management decisions must reflect a balance between the level of risk in terms of adverse social and economic effects against the benefits versus the costs associated with control activities.

Risk management requires SARS to have a combination of compliance research and intelligence to provide an objective and comprehensive picture of the risk posed to SARS by internal and external threats.

Figure 3.24 SARS Approach to Risk Management



Source: SARS Intelligence Manual, 2003

Figure 3.24 illustrates SARS aims to make use of the risk management process at the various business areas within the transaction life cycle of a client. This includes the implementation of ICRAS (integrated Risk Management Solution), which sets established criteria's for selection of consignments for customs examinations, post clearance work and customs investigations.

On the import side ICRAS will affect the Import System (Cape System) and the Export System by means of a three phase rule.

- ✚ Phase 1- These are trap rules which are based on known rules e.g. trader A imports product B from country C, the consignment will be stopped for physical examination.
- ✚ Phase 2- This is based on a risk score as per predetermined risk values and weights e.g. county of origin, agent, and type of commodity.
- ✚ Phase 3- Random selection of consignments initially not targeted in the initial two phases e.g. every hundredth line must be stopped.

Trader risk profiling allows for the online access to client data warehouses, which will hold all electronically available client data. This provides support to central and regional activities that could use knowledge base analysis to establish profiles for clients. This in turn could be used to set up parameters for “firing” of a rule (intervening in a transaction).

Case selection, involves selecting clients that need some form of compliance action, by using a combination of compliance data from customs registers and profiles created, with the trader profiling system. These will include inspections at client's premises. Results of these inspections can be fed into to the case management and tracking system, for further action and tracking. The audit planning provides further support to the case management and tracking by, standardizing results and providing uniform storage of information.

The risk management system has been initially rolled out in the import side. The system is still in its infancy. The case management and tracking, trade profiling and audit planning are scheduled for implementation in the coming year. SARS envisaged this system to provide a

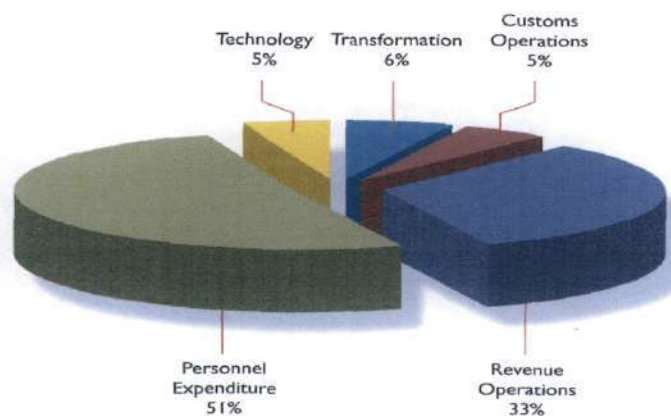
more effective communication between business divisions and intelligence, providing for greater facilitation and effective enforcement.

### **3.14 SARS Resource Plan (Budget)**

SARS customs modernization process affectively meant a change in strategy. This included the restructuring of its budget to make it more strategy supportive so that crucial projects and efficiencies could be realized within the implementation process.

SARS resourcing requirements for the 2002/03 financial year is depicted in figure 3.25 against a total revenue collection of R281.6 billion. The budget allocation for the same period was R3,4 billion, representing 1.2% of the total revenue collected (SARS corporate plan 2003).

Figure 3.25 Spread of Allocation of Financial Resources, 2002/2003 year



Source: SARS Corporate Plan, 2003/2004

During 2003/2004 SARS collected R 302.8 billion in total revenue. The budget allocation for the same period was R4.6 billion, representing 1.3 percent of the total revenue collections. Table 3.24 illustrates SARS future resource requirements

Table 3.24 SARS Future Resource Requirements

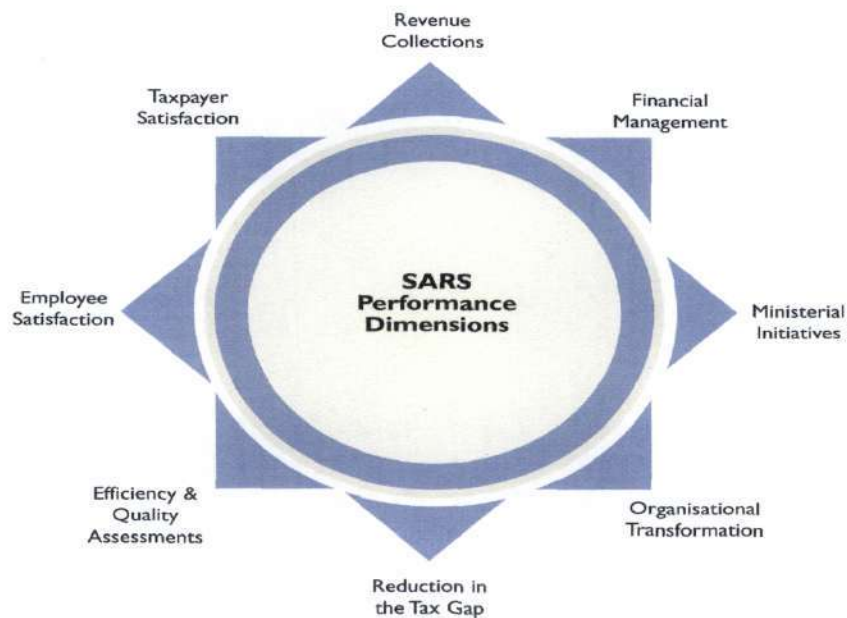
R million	2004/05	2005/06	2006/07
Total Expenditure	4,751	4,908	5,206
Total Revenue	333,694	364,449	398,608
Total Expenditure as a % of Total Revenue	1.42%	1.35%	1.31%

Source: SARS Corporate Plan, 2004-2007, pg 16

### **3.15 Measuring the Success of Implementation**

The Balance score card approach which was developed by Kaplan and Norton (1996) is being utilized by SARS, as a method of translating strategy into specific key deliverables against which you could monitor and make your strategy work. Figure 3.26 represents SARS performance dimensions.

Figure 3.26 SARS Performance Dimensions



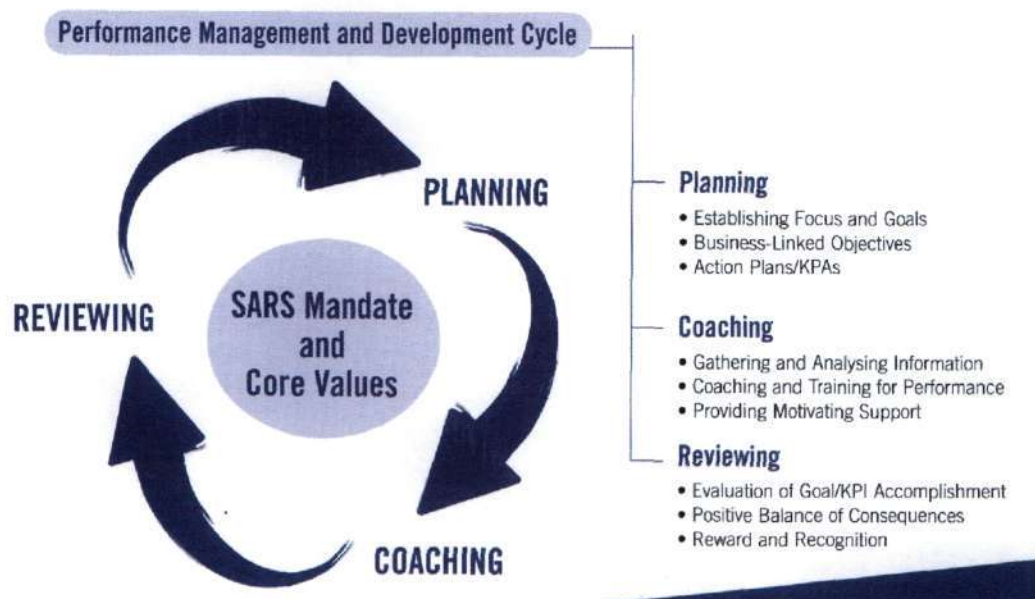
Source: SARS, Corporate Plan, 2003-2004, pg 13

SARS corporate goals each year is managed and monitored through the submission of the annual report to the minister of Finance, the Portfolio Committee on Finance in the National Assembly and a selected committee in the National Council of Provinces.

Further to this SARS will enhance the performance review through a metrics Unit in the office of the Commissioner, which has been established to monitor and review the execution of business plans, as well as implementation of initiatives and projects against the stated goals and objectives.

For the past three years SARS has made use of the Interim Performance Management System. During the coming years SARS will roll out its new Performance Development Systems as depicted in figure 3.27, that will cater for the reward of collective efforts and outstanding individual performance.

Figure 3.27 SARS Performance Management and Development Cycle



Source: SARS, Strategic Plan, 2004-2007, pg 17

### **3.16 Summary**

The role of the customs organization is changing rapidly. Heightened terrorist attacks, influx of drugs and weapons of mass destruction are constantly requiring the customs administrations to be flexible and adapt to the environment to protect and serve its citizens. Faced with the challenges of providing the resources to Treasury to fund basic services, places an added burden for customs. In this respect SARS needs to effectively challenge declarations made to customs while at the same time ensure that it does not place too much of an administrative burden on its clients.

SARS currently uses a legacy system as compared to first World countries. Interventions are directed by volume rather than quality. This essentially has created a formidable task both in terms of becoming a modernized public organization and changing the culture of its staff.

On adopting the principles of the Kyoto Convention on Trade, SARS has effectively committed itself to a process that revitalizes its activities and the way it does business. It has adopted a firm commitment on risk management as a tool to closing the gap between the legacy and the new regime of Customs Administration.



## **Chapter 4: Evaluation of SARS Present Strategy**

### **4.1 Introduction**

The present chapter will analyse SARS strategy and compare the risk management process of various customs administration to determine the similarities in approach taken by the different customs administration to risk management.

The chapter will focus on identifying specific environmental and internal challenges that could impact on the future of the customs administration. It will conclude with establishing the shortfall within the South African customs administration based on the best practises of other administrations.

### **4.2 SARS Challenges and Opportunities**

SARS successful execution of its mandate is dependant on the organizations response to its dynamic global, regional and national environment. Critical to this is to successfully transform the organization to have sustainable capabilities. In this respect a critical success factor is to anticipate and proactively address risks to the customs and revenue administration as a whole.

#### **4.2.1 Global Context**

Contextualizing the challenges and opportunities, we appreciate that the regional and global environment brings with it, their own challenges which include.

- ✚ Regional integration flowing from financial and trade liberalization.
- ✚ Promoting and integration at regional, continental and global levels.

- ✚ Pursuing economic diplomacy in order to expand, the country's economic links to Africa and internationally, thereby attracting foreign direct investment.
- ✚ Globalization, reflected in the integration of financial markets, revolution in information technology, proliferation of products to developed regions of the world, leading to massive growth in global trade.
- ✚ Increased emphasis on national sovereignty and the threat of terrorism in the wake of 9/11.

#### **4.2.2 National Context**

SARS as an organization is guided by the Government's reflection of democracy which was contained in its "Towards a Ten Year Review". Amongst the challenges and opportunities facing South Africa on a national context include:

- ✚ To address the consequences of the social transition reflected in the migration of the demography, structure of the economy, character of the labour force, average size of the household.
- ✚ An increase in the economically active part of the population.
- ✚ A changing structure of the economy which signals a shift away from public service, construction, mining towards internal trade and finance, real estate and business service sectors.
- ✚ Significant growth in a parallel economy, this comprises of a sophisticated formal sector operating alongside an informal economy.
- ✚ To improve service delivery by building the necessary institutions and initiatives.
- ✚ To promote national identity and pride, ensuring that households develop a civic responsibility, including a culture of paying for services and taking responsibility for protecting the infrastructure.
- ✚ A demand for a more effective government i.e. Government is expected to do more from less.

SARS strategic plan has to be informed by the ten years review and should aim to develop a meaningful response to these challenges. This can only be done by optimizing its revenue collection, enhancing trade and creating an efficient and effective administration.

### **4.3 Strategic Analysis of Other Customs Administrations using the Risk Management Process**

*“Customs Administrations play a vital role in the growth of international trade and the development of the international market place. The efficiency and effectiveness of the Customs procedures can significantly influence the economic competitiveness of nations. In a highly competitive world environment, international trade and investment will flow towards efficient, supportive and facilitative locations. At the same time it will rapidly ebb away from locations, which are perceived by business as bureaucratic and synonymous with high costs.*

*Customs systems and process must not be allowed to serve or be perceived as a barrier to international trade and growth. Modern production and delivery systems, linked with dramatic potential of new forms of electronic commerce, make swift and predictable Customs clearances an important prerequisite for national prosperity.”*      **World Customs Organization-WCO**

In assessing the risk management process, the chapter will concentrate on the risk management processes of the United States of America, Brazil, Chinese Taipei and the European Union.

#### **4.3.1 The United States Trade Compliance and Risk Management Process**

The U.S Customs is one of the oldest Federal agencies within the executive branch of the U.S. government. The agency is also one of the most important agencies in collecting revenue to finance government expenditure (Braga, 2001). The U.S. customs is also at the forefront in protecting its country from smuggling, contrabands, terrorism, trafficking of weapons and combating of economic crimes such as intellectual piracy.

Table 4.1 indicates the number of inspections and examinations conducted on a typical day in the U.S. Customs, in October 2000.

Table 4.1 Number of Inspections and examinations conducted in a typical day, October 2000

Item	Quantity
Passengers	1.3 million, approximately
Aircraft	2,661
Trucks and Containers	60,196
Vehicles	348,205
Vessels	522
Entries	59,055

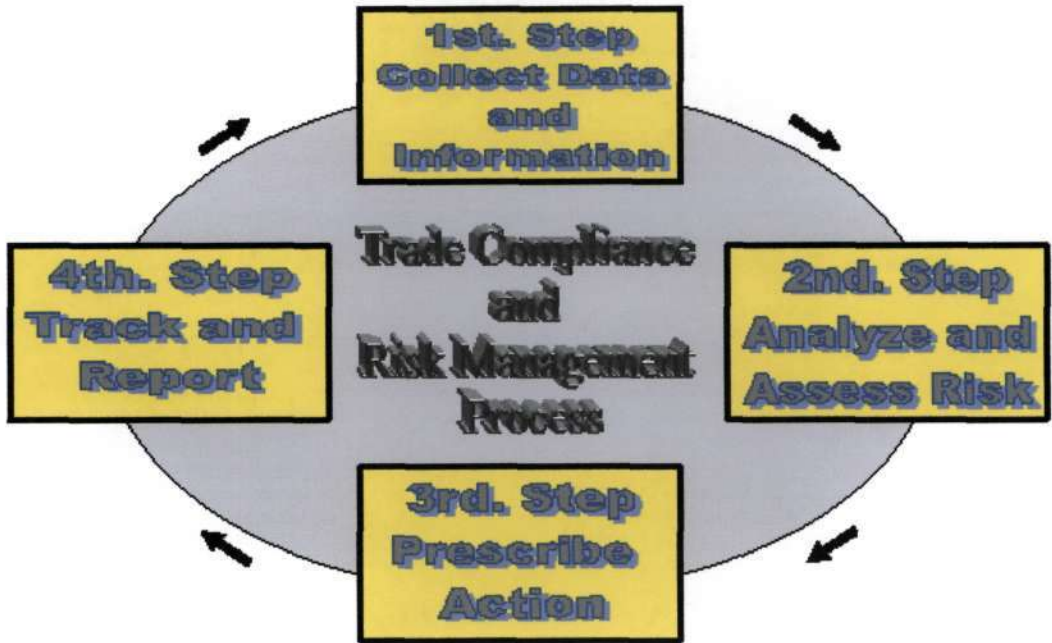
Source: U.S. Customs Service Internet Site

Performing compliance checks is a formidable task especially with the limited resources. The Administration has approximately twenty thousand personnel located in three hundred ports of entry to control four hundred and eighty million passengers and close to \$1 trillion in imports across U.S. borders. The U.S. Customs has therefore established the Risk Management Process to best allocate resources to priorities.

The U.S. Risk Management Process covers every activity related to trade. This includes pre-import analysis through to cargo arrivals, examination, release, investigation, revenue collection, liquidation and archiving of data. There has also been a shift away from focusing primarily on transactions to accounts. This involves ascertaining industry trends and measuring the compliance rate within the industries as well as the nature of actions taken that is fed back into the system to form a continuous feedback mechanism.

The U.S. Risk management process for trade consists of four processes as illustrated in figure 4.1.

Figure 4.1 The U.S. Trade Compliance and Risk Management Process



Source: The U.S. Trade Compliance and Risk Management Process, 2000

### 1<sup>st</sup> Step Data Collection

Proper risk management requires effective, efficient and reliable approach to collecting data. The data collection method needs to also be statistically accurate. Accurate and reliable data forms a sound platform for effective data analysis.

Through the collection of data and information Custom are able to determine which clients are likely to be non compliant and the nature of the non compliance. The deployment of resources can be executed more strategically focusing on areas that will pose the greatest level of non compliance. Trade patterns and historical trends will further enhance Custom to understand its import and export environment.

The first step is important as it gathers data that will identify risks in the international trade process. The key to risk identification is to systematically assess the entire trade process and describe the risk in an understandable manner, then only can it be effectively managed (Braga, 2001). There are several mechanisms available to identify risks in trade which include compliance assessment of traders and agents. Assessment of traders and agents alike should be based on an account management based criteria rather than one of transaction based.

## 2<sup>nd</sup> Step-Analyse and Assess Risk

After collecting the data, the next step is to analyse the data to determine the likely hood of non compliance. Analysing the data, determining trend allows Customs to focus on the areas that pose the greatest level of risk (Braga, 2001).

Components of the analysis and assessing risk include:

A) Automated tools: Automated tools assist in analyzing data, recognizing trends and by making use of historical data can identify high risk areas. They further allow the Customs employees greater accuracy by managing high volumes at fast speeds providing information on risk areas in timely and effective manner. Table 4.2 indicates the most significant systems that assist in the Risk Management Process.

### B) Focusing On Significance And Materiality

We need to acknowledge that not all violations are of equal importance and therefore need to focus on areas that pose the most risk. In this regard facts to be considered include (Braga, 2001):

- Number of ports impacted upon
- Value and volume represented
- Portion of the industry effected
- Laws and regulations that maybe contravened
- Commercial issue involved, entries impacted, loss of revenue
- Is there a possible trend of non compliance

Table 4.2 The U.S. Customs Automated System

Systems	Commentaries
Automated Commercial System (ACS)	ACS is the old Import processing system of U.S. Customs, with more than 17 years old. The Automated Commercial Environment System (ACE) is replacing it.
Automated Commercial Environment (ACE)	The implementation of ACE, in substitution of the ACS, is introducing major efficiencies in the way both Customs Inspectors and the trade address the arrival of merchandise, providing significant benefits to Customs field operations personnel, the importing community, and most importantly, the U.S. economy. The goal is paperless imports in all modes: air, sea, road, railroad.
Automated Export System (AES)	AES related information from exporters and is used to identify violators of export laws. AES facilitates quick and efficient exporting by eliminating inaccurate information, filling our paper forms and duplication reporting.
Automated Passenger Inspection System (APIS)	The APIS is used by the U.S. Customs to obtain traveler information prior to the arrival of the aircraft. It's a strong tool for the Risk Management in the airports. It's a joint operation between Customs and air transport community, and almost 80% of the air carriers are participating of this system.

Source: US Trade Compliance and Risk Management Process, December 2001

### C) Compliance risk category

Once we have differentiated the materiality and significance of the risk we can categorise them into Compliance risk category (CRC). The CRC will enable us to determine a possible action for each type of non compliance.

- High compliance, good internal, low risks therefore minimal compliance action.
- High compliance, suspect internal control, Moderate risk, the client has a high compliance rate however does not demonstrate reasonable care in administering its business practices.

- Low compliance, the client poses a threat as he has a track record of non compliance or demonstrates behaviour that identifies him as a high risk client.

### 3<sup>rd</sup> Step – Prescribe action

Once you have collected and determined the risk, the risk need to be minimised while compliance need to be increased. Therefore an appropriate action needs to be devised and necessary resources dedicated to the risk (Braga, 2001).

Prescribing action involves 2 processes:

- Identifying the cause of the risk e.g. lack of knowledge or wilful disregard for the import and export laws.
- Designing an action and assigning resources.

Over the past years customs has used various methods to promote compliance from promoting voluntary to enforced compliance.

### 4<sup>th</sup> Step – Track and Report

The results whether positive or negative are correlated and reported back into the risk management process. This enables monitoring and corrective action to align targeting strategies. The feedback process is instrumental for the effective functioning of the risk process and can occur at any of the other three processes (Braga, 2001).

In essence the risk assessment model requires you to have a holistic approach to trade compliance by utilizing intelligence to identify and manage non compliance. The model further establishes that effective targeting increases facilitation while strategically targeting the correct consignments.



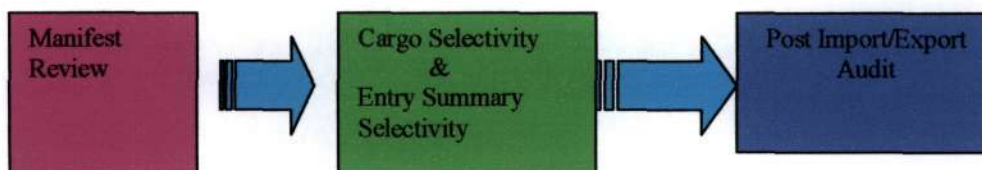
### **4.3.2 The Chinese Taipei Customs**

Taiwan is approximately 36,000 square kilometres with a population around 23 million, its gross national product (GNP) in 2000 was U.S. \$314.4 billion, this made Taiwan the 17<sup>th</sup> largest economy in the world. Its total value of imports and exports in 2000 was \$140.01 billion and \$148.32 billion respectively, this ranked Taiwan 15<sup>th</sup> and 14<sup>th</sup> in terms of imports and exports respectively in the world. The total number of transactions processed was 7,021,053 import and export declarations in 2000, as compared to 4,699,179 in 1991. The challenges to meet trade facilitation and at the same time ensure enforcement was made even difficult with the Chinese personnel decreasing from 4369 in 1991 to 4191 in 2000 (Wang, 2001). Before 2000, the examination rate for imported air cargo was 18%, while it was 25% for imported sea cargo. In order to meet the needs of the customs stakeholders Customs needed to reduce the import and export examination rate to fewer than 5%. For this purposes Chinese Taipei customs needed to adopt a risk based approach to facilitation and enforcement.

In order to enhance its Risk Management (RM) system, a task force was formed with the participation of analyzers, import specialists and cargo examiners. The features of the RM include:

1. Training and publicizing – The Customs administration advocated that all enforcement training should contain a risk management module.
2. The Chinese Taipei customs has three enforcement systems for cargo clearances as illustrated in figure 4.2.

Figure 4.2 Chinese Taipei Enforcement System

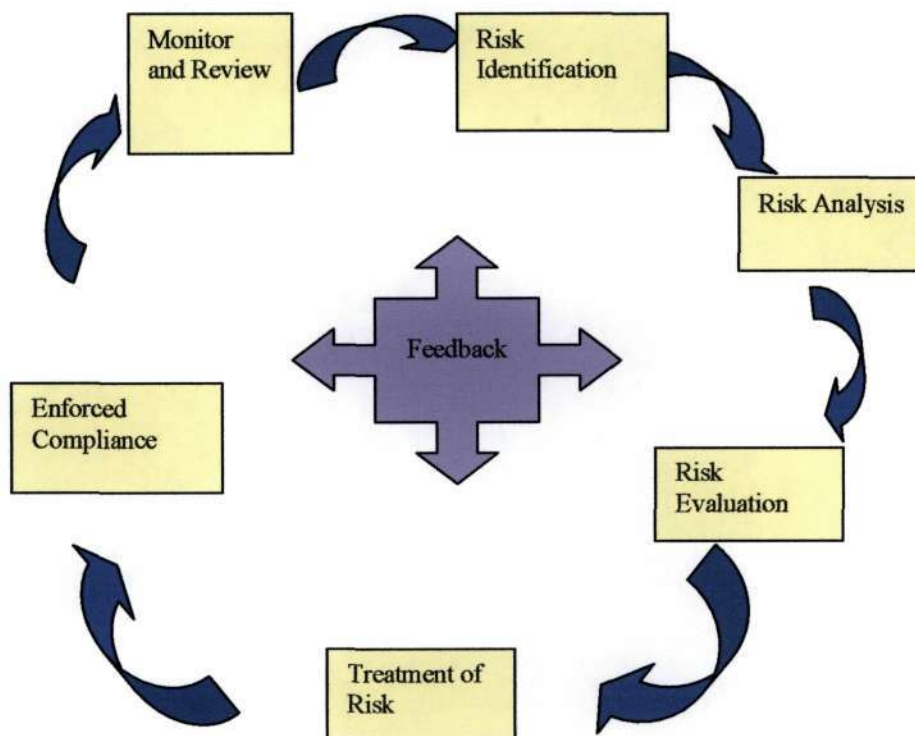


Source: Chinese Taipei Customs, 2001

Risk Management is applied in the above three systems, by:

- ✦ Computerizing the manifest review – to remove manual processing, so as to refine processing and targeting and promptly interdict non compliance prior to entries being filed.
- ✦ Cargo entry and selectivity summary – is being refined so as to provide more accurate enforcement, while facilitating trade on a real time basis.
- ✦ Regulatory post audit – to provide greater assurance of declarations by conducting post audit inspections on import and export declarations.

Figure 4.3 Risk management Process



Source: Adopted from Chinese Taipei Customs, 2001

The RM processes illustrated in figure 4.3 is being used currently by the Chinese Taipei Customs and encompasses six phases.

1. Risk identification – uses past history to predict the future. This includes prior non compliance collected from (Wang, 2001).

- ✚ Manifest reviews
- ✚ Cargo examinations
- ✚ Entry summary review
- ✚ Regulatory audit
- ✚ Judicial investigations

2. Risk analysis – the following factors are considered when analyzing risk.

- ✚ Frequency and patterns of violations and discrepancies
- ✚ Risk consequence (duty evasion, public health damage, intellectual property rights violations, etc.)
- ✚ Goods and stakeholders involved

3. Risk evaluation- The Chinese Taipei Customs has developed nine levels of risk to classify importers and exporters.

- ✚ Low risk: L1,L2,L3
- ✚ Medium risk: G1,G2,G3
- ✚ High risk: H1,H2,H3

Each category carries a different weight in cargo selectivity and entry summary stage.

4. Treatment of risk

- ✚ Informed compliance-In this respect the Chinese Taipei Customs has embarked in a process of informed compliance, by building stakeholder relationships with importers and exporters with the aim of raising the compliance level. Customs officers are

encouraged to play a pro-active role in this respect, by supplying the necessary information.

✦ Enforced compliance- wilful violators are forced to comply with customs rules and regulations by the use of tools such as:

- General selectivity criteria- set criteria's are periodically used to target a certain segment of the market to narrow the focus on wilful violators.
- Flexible selectivity criteria- this enables supervisors to set selectivity criteria daily to prevent importers and exporters from making use of cause and affect analyses to determine customs "trap rules".

5. Monitor and Review- the Chinese Taipei makes use of results files (records the effectiveness of the selectivity criteria) and history files (records who makes the changes to the criteria) to fine tune the selectivity criteria and review the performance of Operational Analysis Staff.

6. Feedback- Feedback takes place between each operational unit's finding and enforcement, as indicated in the figure 4.4.

Figure 4.4 Risk Source and Feedback

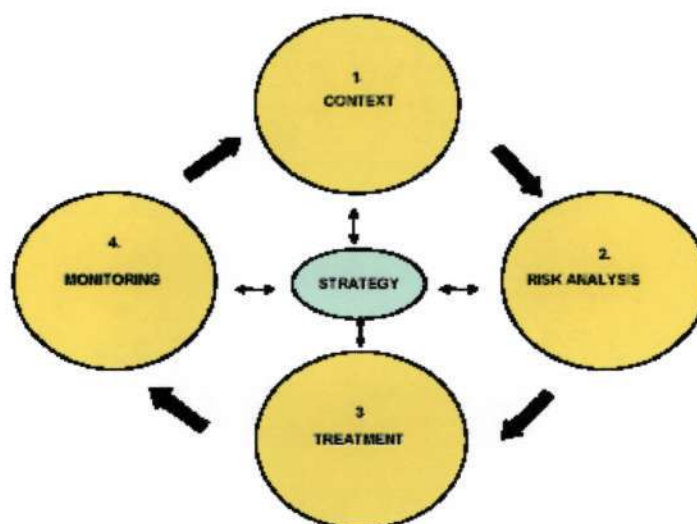


Source: Chinese Taipei Customs, 2001

### 4.3.3 Risk Management in the Customs Administration of the European Union (EU)

After the Customs Seminar in Sweden on “Risk Analysis in the new Millennium”, December 1999, a risk implementation plan was approved containing future actions that are to be taken in the risk analysis within the EU. For a good and effective risk management process appropriate tools are required together with skilled people. Figure 4.5 represents the elements of the EU risk management process.

Figure 4.5 Elements of the EU Risk Management Process



Source: Standardized framework for risk management in the EU Customs administration EU Commission, 2002

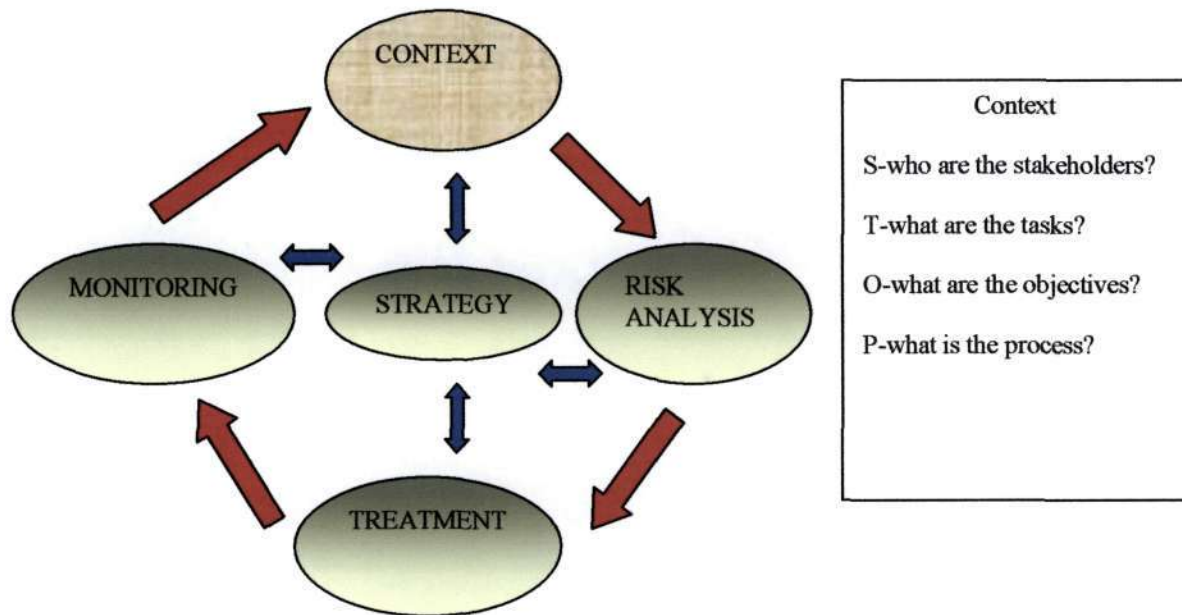
The risk management process comprises of the following elements:

- 📌 Context
- 📌 Risk Analysis
- 📌 Treatment
- 📌 Monitoring

Figure 4.5 includes strategy as it plays a primary role in the process. Each step of the process must be viewed as being interactive with the organization strategic objectives, to ensure cohesion and the delivery of these objectives.

**Elements One: Context**

Figure 4.6 Establishment of the Strategic, Organizational and Risk Management Context



Source: Standardized framework for risk management in the EU Customs administration EU Commission, 2002

In step 1 the context is actually the environment in which the risk management process is performed which is represented in figure 4.6. There are a range of elements that can affect this and include factors such as resources, political, economic, legal and social aspects that influence the environment. Figure 4.6 represents the acronym “S.T.O.P” which is used to describe the relationship between customs and its environment.

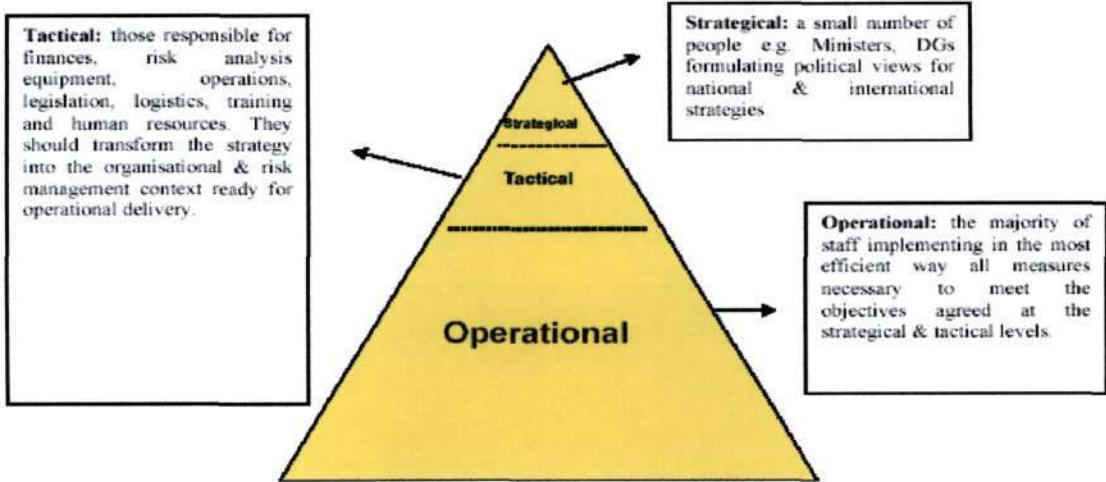
Customs focus today cannot not only be viewed as an institution that is responsible for collection of duties but also to implement and administer trade agreements, provide facilitation to ensure that goods and passengers are properly controlled. Therefore the level of risk is determined by its

international and national priorities. The responsibilities are a main feature of the strategic context within which customs function. The strategic context can be defined by ascertaining:

- ✦ **What customs are expected to achieve?** Understanding the organizations vision and mission statements will provide an understanding of the future direction for customs. This leads to the consideration of the organizational and risk management contexts.
- ✦ **How can customs achieve there strategic objectives?** Senior mangers assess and understand there strategic objectives in light of their organizational capabilities to deliver this objective. By understanding the risk involved with each strategy by taking into account a need to balance costs, benefits and opportunities with the resources and equipment available. This eventually leads to prioritizing of strategies or acquisition of additional resources to tackle the important objectives. These are all important factors to determine the risk management plan as it not only must meet the needs of customs but also its stakeholders.

The EU Risk Management framework has created a model of an organization structure necessary for establishing a strategy, organizing the risk management context and delivering results is indicated in figure 4.7.

Figure 4.7 Organizational Structure necessary for a risk management model



Source: Standardized framework for risk management in the EU Customs administration EU Commission, 2002

Table 4.3 further illustrates the EU Commission (2002) need to understand the environment in which customs functions, to enable customs to effectively implement its risk management process.

Table 4.3 Key Questions that enable Customs to Understand the Context

<p>What is the policy, the process or activity?</p>	<p>For example at the EU level a strategy for the Customs Union has been published by the Commission [Com (2001) 51 dated 08.02.2001] in which it is indicated that customs role is changing from collecting duties to protecting health and safety of the European society and its citizens.</p>
<p>Determine the risk areas "Risk areas" means customs regimes, procedures and other areas where the customs authorities exercise their responsibilities. This also applies to traders.</p>	<p>Scrutiny of the existing Community and national legislation requiring customs checks can reveal risk areas. New legislations or changes in existing rules may give rise to new areas. For instance new anti-dumping legislation on a particular product originating in a given country, adopted during a given year, should alert customs to the possibility of diversion. This in itself enables a risk area to be identified, serving as basis for proper risk analysis.</p> <p>Similarly, the appearance of new trade flows which may affect economic activity, consumption patterns or public safety should be noted. This may give rise to new risk areas, perhaps necessitating a risk analysis.</p> <p>An individual trader or a group of traders may constitute a risk area. Traders are very important factors. As a rule, structures, operating methods, reputation and financial standing are good indicators of whether a particular trader represents a risk area and should be subjected to risk analysis.</p> <p>Evaluation of the results of control should be conducted over extended periods so that a wide perspective of risks can be considered.</p>
<p>What are the anticipated major outcomes?</p>	<p>It could be the collection of duties and taxes or effective controls on prohibitions and restrictions. Alternatively the main focus could be improvements in the operations of the single market to make it more competitive for business.</p>
<p>What are the strengths, weaknesses, opportunities and threats of the system?</p>	<p>Engaging the staff in a simple SWOT analysis will expose these areas and enable appropriate action to be taken.</p>
<p>Who are the organisations stakeholders?</p>	<p>Stakeholders could be the Commission (collection of own resources-standardised controls and external frontier of the EU), National Parliament (fight against fraud), trade (increase the use of simplified procedures). The stakeholder's interest and any threats related to these interests should be defined and prioritised.</p>
<p>What are the crucial elements-internal and external-which influences the risk management process.</p>	<p>These might include elements such as the organisational structure, human resources, political influences, finance and equipment. Each of this may support or impair the risk management process.</p>

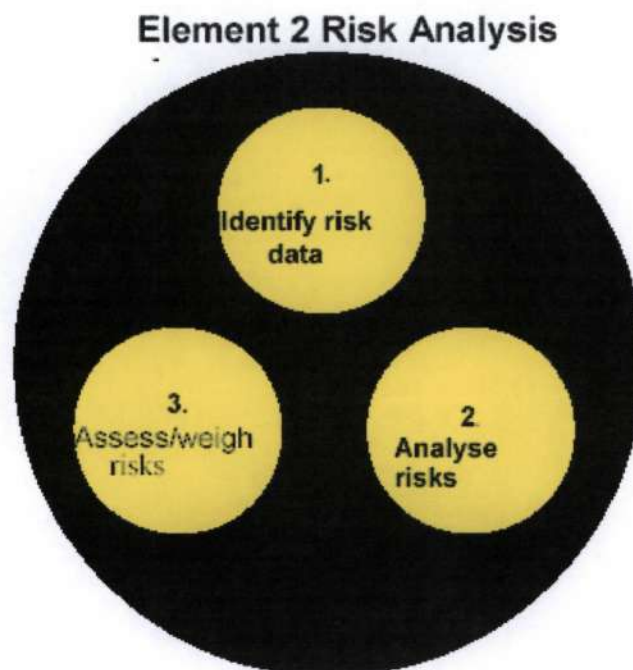
Source: Standardised Framework for risk management in Customs, EU Commission, 2002



## **Element Two: 2 Risk Analysis**

Figure 4.8 indicates the second process in the EU risk management process. In this process all available data is examined as it could form sources of potential risk. This process is also used as a tool for departments to make legislative changes.

Figure 4.8 Risk Analysis



Source: Standardized framework for risk management in the EU Customs administration EU Commission, 2002

Elements used in this process include the following;

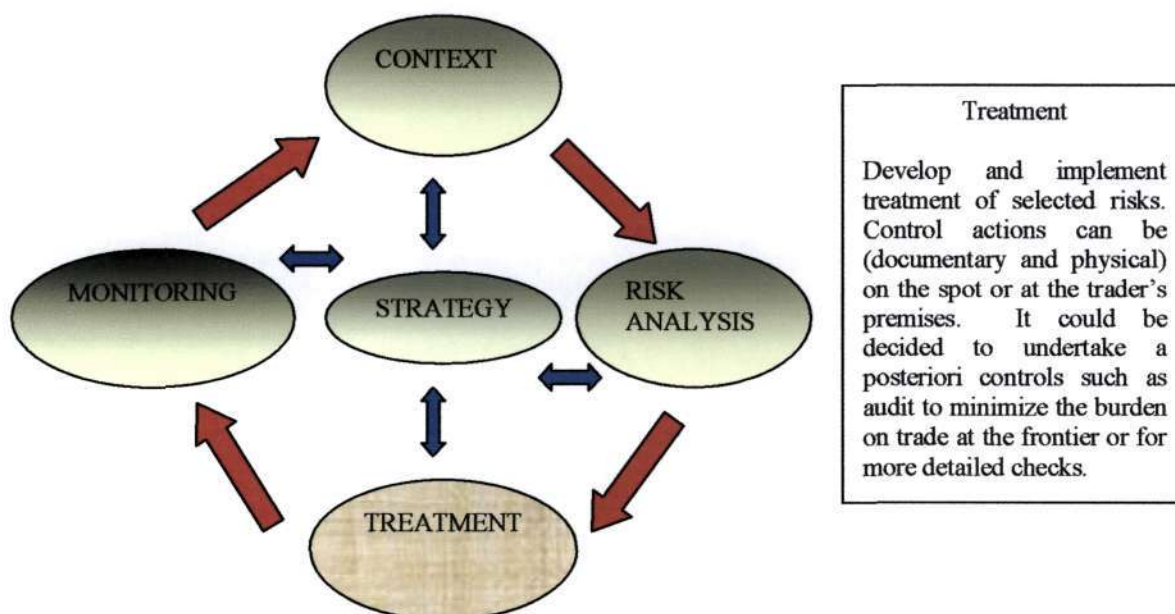
- ✚ Trade flows
- ✚ Declarations submitted
- ✚ Timing of payments made and the level of debt.

Using the risk data each element within the context is assessed. This is done by analyzing proven risk, these are historical facts which are available on previous irregularities surrounding certain cases and through potential risks. Potential risks are risks that are not yet uncovered but are suspected. A further source of information used is through exchange of information between, member states. Analyzing the threats against the likelihood and consequences will establish the how likely an event is considered to occur with what the potential consequences and their importance. Combining these elements provides a weight of the risk.

The risks are assessed into high medium and low. High risks are likely to occur and have severe consequences. Treatments of these risks are highly visible and intrusive interdictions. Medium risks may less likely occur, with the consequences being less severe. Treatment of medium risk could be by non intrusive means or documentary checks. Low risks are acceptable risks and assessed by standard or routine procedures in some cases no actions is taken.

**Element Three: Treatment of risk**

Figure 4.9 Treatment of risk



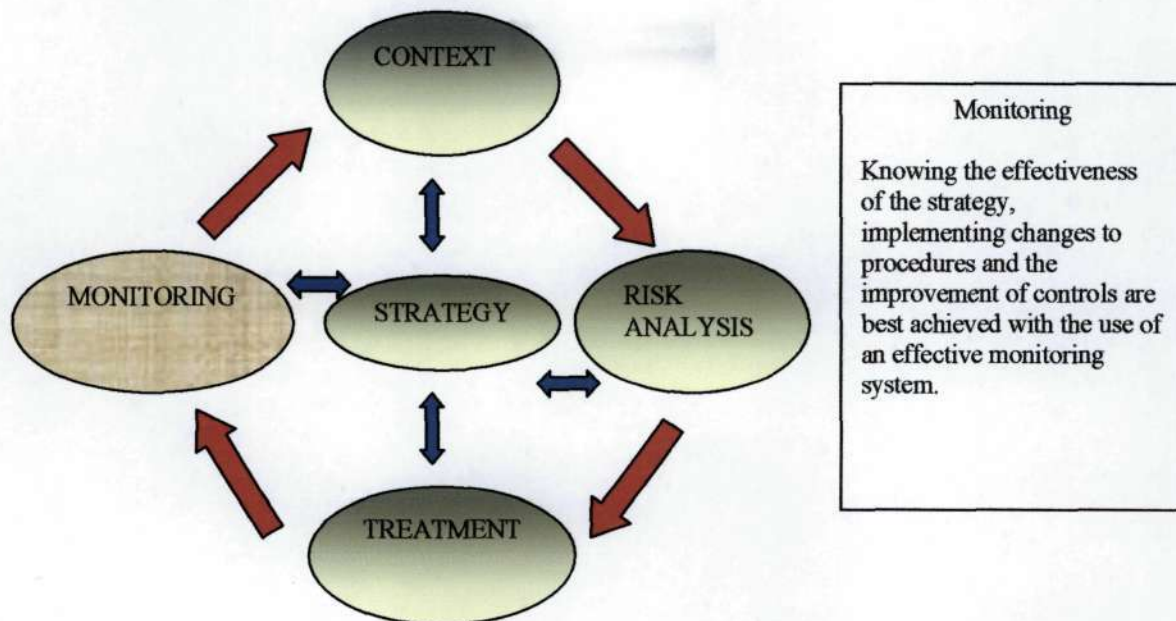
Source: Standardized framework for risk management in the EU Customs administration EU Commission, 2002

Control actions can be documentary and physical at the time of entry of the consignment or at the trader's premises. In certain instances as customs controls the supply chain it may be necessary to conduct post audits to minimize the burden on trade at time of importation or to conduct more comprehensive verifications.

When ever a transaction is selected for control it should be documented to the extent that the type of control taken, even if no control is taken it should be indicated as it form an important source of data in element two of the process.

**Element 4- Monitoring and reviewing**

Figure 4.10 Monitoring and reviewing



Source: Standardized framework for risk management in the EU Customs administration EU Commission, 2002

Figure 4.10 represents the fourth element of the risk management process and should be considered an interactive step as it forms a link between the context, risk analysis and risk treatment phases. In order to establish the effectiveness of the strategy, implementing changes to procedures and the improvement of controls, effective monitoring of the system is required. The monitoring and review process must be consistently applied to the elements within the risk management process. Figure 4.11 illustrates the monitoring system of the Danish Customs.

Figure 4.11 Danish Example

#### Danish example

In Denmark the risk analysis work is based at the Customs Control Office (8 customs centres) in a kind of "intelligence unit" relating to the commercial trading.

After all the transactions have passed through the customs and the risk analysis system, the high risk transactions will be subject for control. Mostly physical control and/or audit. After the control the local official will document the results and control experiences in the customs system. All data concerning the customs declarations, risk analysis and control results are saved in a Data Warehouse enabling subsequent preparation of reports and statistical overviews.

The intelligence unit is therefore able to receive the following reports from the system:

- ❖ Report on all control results.
- ❖ Report on dynamic parameters inserted by Customs Centres or by the Administration.
- ❖ Report of risk sector which are marked as "high-risk".
- ❖ Report on number of transactions received in a period by a Customs Centre.
- ❖ Report on physical checks run related to the total number of transactions.

This system requires current monitoring and action at the Customs Centres to evaluate and implement control results all the time.

Source: Standardized framework for risk management in the EU Customs administration EU Commission, 2002

#### **4.3.4 Brazilian Model**

In the past years the Brazilian customs has managed to control the continuous growth of foreign trade by implementing computer based procedure, especially those related to customs clearances. The system used by the Brazilian customs is known as "Siscomex"- integrated system of foreign

trade. This has been the first system in the world to integrate seaports, airports and land frontiers, allowing even for the automatic calculation of duties.

From the Brazilian customs point of view the most significant change was the use of automated selection of operations to be examined in four different levels. The selection criteria are based on objective parameters which include (Antonella, 200):

- ✚ Tariff classification
- ✚ Country of origin
- ✚ Tariff system
- ✚ Valuation

The only subjective parameter used, is the identification code of the importer. Random selection of consignments is also used to minimize the predictability of the model. Each parameter is associated to an examination channel, which determines the procedure to be adopted in checking.

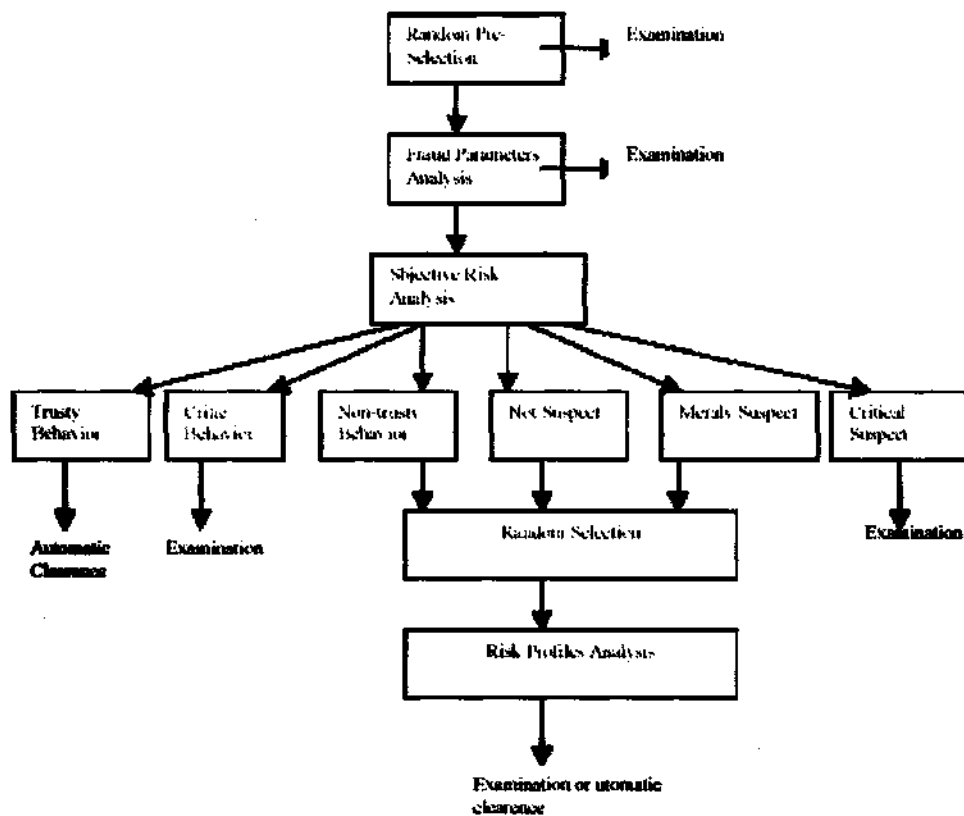
- ✚ The green channel allows for goods to be automatically cleared.
- ✚ The yellow channel allows for the examination of documents only.
- ✚ The red channels allows for the customs officers to check the documents as well as the goods.
- ✚ The grey channel means that the customs value of the goods has also have to be checked.

Although this model has been effective in adapting to the volume with the available resources, by providing faster clearance. This model has been unable to guarantee the quality of the selection made. This has effectively lead to a higher volume being examined, approximately 17% for the red channel and 16% for the yellow channel and 1% for the grey channel. This has also lead to officers reviewing some green channel entries to ascertain non compliance which with other wise be released. This effectively has compromised examination quality as the work force inadvertently is sacrificed with volumes of work that is higher than originally anticipated.

This was one of the reasons that gave rise to an urgent need for a risk management approach within the Brazilian customs that can provide an effective response to detecting fraud and non compliance.

The Brazilian model was further enhanced by means of a selection algorithm as represented in figure 4.12.

Figure 4.12 Selection Algorithm



Source: Brazilian Customs Risk Management Model, 2000

The Brazilians risk model was split into objective and subjective risks. Experiences derived from managing the parameters to determine the criteria for the selection of operations for

examinations, indicates that the subjective risk is preponderant to the objective risk as an indication of detecting non compliance.

The selection of operations to be examined in the customs clearances will be determined by the application of an algorithm that establishes a hierarchy of precedence among the different components and dimensions of the customs risks identified. The algorithm commences with a random sample and then proceeds to the next step were operations not selected will be checked against the “fraud” parameters. Should this indicate positive results the transaction will be selected for examination.

The following steps involve the subjective components which analyses the behaviour of the importer. These include the following type of clients:

- ✚ Known importer- the behaviour of a known importer is categorized as trusty, non trusty or critical. This is based on the degree of voluntary compliance to the rules and regulations. In the instance of a known importer the goods will be automatically cleared. Should the behaviour be known and critical or unknown and critical the operation will be selected for checking.
- ✚ For other categories there will be assigned different levels of random selection, according to the level of risk for each one.

The probability of selection or checking can be adjusted in the following ways to increase or decrease the interdiction:

- ✚ Change the limits according to the risk befitting the importer category.
- ✚ Adjusting the percentage applied to categories non-trusty, merely trusty or not suspect.
- ✚ Redefining the weights associated with each risk profile.

The enhancement of Siscomex will enable the effective profiling and selection of risk while at the same time allows cargo to be effectively facilitated.

#### **4.4 Evaluation of SARS Present Strategy**

The challenges posed by the South African compliance environment highlights the importance of a comprehensive approach to managing compliance. The SARS Compliance strategy represents an enterprise wide integrated approach to improving compliance levels.

Key features of this approach are (SARS corporate plan, 2003/2004):

- ✦ Differentiated strategy for engaging with traders and taxpayers.
- ✦ Incentivising the behaviour of complaint clients through greater turn around time and communication.
- ✦ Improving literacy levels through targeted education and outreach programs.
- ✦ Managing the interaction and relationship with stakeholders throughout their lifespan.
- ✦ Creating a single view across tax product types.
- ✦ Holistically managing the SARS core processes with emphasis on pre-engagement, registration, filing and assessment.
- ✦ Targeting enforcement action on high risk areas and sectors supported by intelligence activities.
- ✦ Conducting risk based and random audits on clients to ensure maximum visibility and deterrence.
- ✦ Pursuing an approach that build strategic alliances and seeks collaboration with industry and professional bodies.

The key to the compliance strategy will be to encourage voluntary compliance, through taxpayer education and discouraging non compliance by improving detection and through the ability to address and penalise non-compliance. This compliance strategy will effectively inform SARS for the coming years.



#### **4.5 The affect of Protectionism within the South African Market**

Protectionism occurs when a country reduces its level of imports to:

- ✚ Protect infant industries- new growing industries producing new technological goods etc, need to be protected against established foreign producers this may include measures such as tariff or quota's to restrict there entry into South African Markets.
- ✚ To prevent unfair competition from foreign countries that receives subsidies from overseas countries.
- ✚ Reducing imports improves the balance of payments.
- ✚ To protect strategic industries, that provide essential goods e.g. ESKOM.
- ✚ To protect declining industries from creating further structural unemployment.

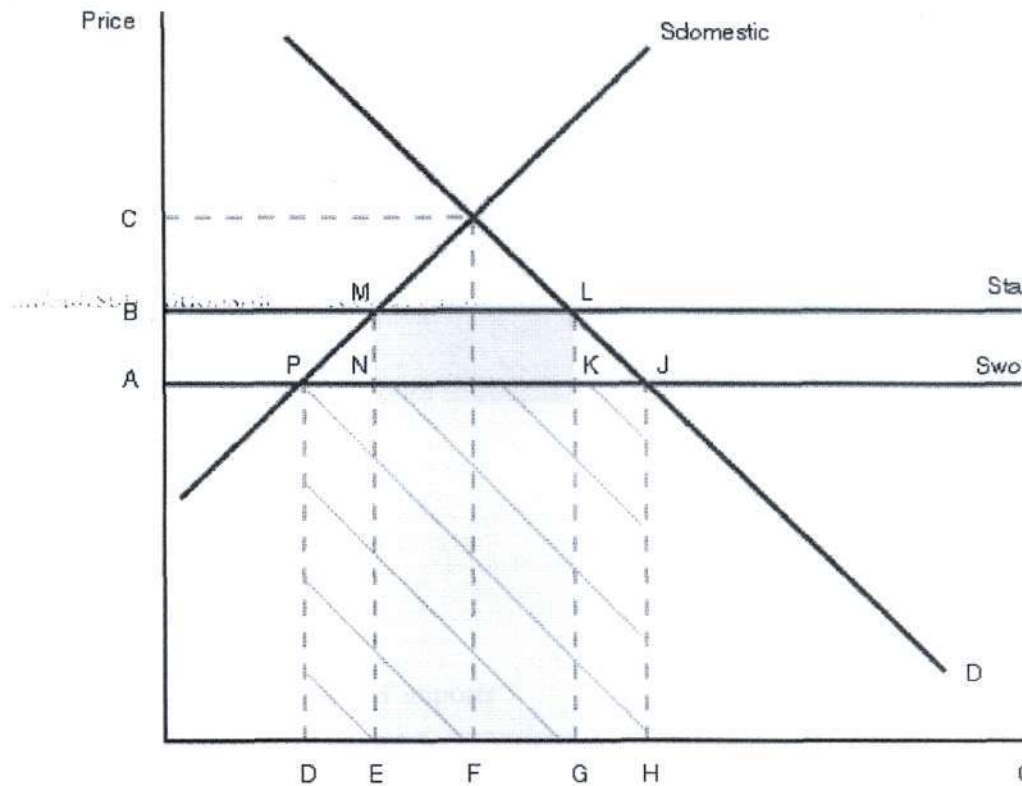
#### **Disadvantages**

- ✚ Prevents countries from enjoying the full benefits from international specialisation.
- ✚ Invites retaliation from foreign governments.
- ✚ Protects the inefficient industries from foreign competition, consumers pay more for inferior goods.

#### **4.6 The Affect of Tariffs and Quota's on Consumers**

Local buyers of goods imported from abroad are affected by a tariff. Consumers end up paying a higher price or buying less of a product. Figure 4.13 represents the demand and supply graph indicating the effect of tariff on prices. If the world price is "A" and the imposition of the tariff pushes the domestic price to "B". The tariff raises the prices consumers must pay for the product. This in affect means that consumers have to give an extra price of "KL" to the obtain the same quantity of "G". Other consumers may feel that the price is not worth the product and decrease the quantity purchased from "H" to "G".

Figure 4.13 Demand and Supply Graph



Source: International Trade and Management Notes, 2003

Affects of Tariff

- ⬇️ Raises the price of imports
- ⬇️ Reduces the demand for imports
- ⬇️ Encourages the demand for home produced substitutes
- ⬇️ Raises customs duty and vat for SARS

Quotas

Quota's restrict the actual quantity of goods allowed into the country

- ⬇️ Raises the price of imports

- ✚ Reduces the volume of imports
- ✚ Encourages the demand for domestically produced goods.

#### Other Protection Techniques

- ✚ Administrative delays can discriminate against imports through customs deliberately setting specifications met by domestics, but not foreign producers.
- ✚ Exchange control restrictions may prevent domestic residents from acquiring sufficient foreign currency to pay for imports.

#### **4.7 Key Success Factors**

The key success factors relating to the facilitation of goods include:

- ✚ Transparency
- ✚ Predictability
- ✚ Simplification
- ✚ Harmonisation and standardisation of procedures
- ✚ Minimum bureaucracy and no delays at national borders
- ✚ Cost effectiveness
- ✚ Modernized communication (Electronic Data Interchange)

#### **4.8 Benefits that will accrue from Trade Facilitation**

- ✚ More focused and cost effective control.
- ✚ More focused interception of illicit goods.
- ✚ Lower costs for both government and industry.
- ✚ No loss of revenue.
- ✚ Easier for small and medium sized companies to trade internationally.
- ✚ Less corruption

- ✦ Development of risk management
- ✦ Appropriate implementation and enforcement of customs rules.

#### **4.9 Customs Administration**

In assessing the Customs administration the following factors are considered.

##### **4.9 External Environment**

**Political Shifting-** Governmental priorities has given rise to increased need for delivery of essential services which include sanitation, piped water and electricity. These services place an added strain on the revenue services to deliver the resources necessary to fund these projects.

**Geographical-** President Thabu Mbeki's dream of an African Renaissance has had positive affects within the African countries. The New Partnership for African Development (NEPAD), has liberalized trade within the African countries, customs administrations are working together to modernize and harmonise procedures to influence the supply chain positively. Transnet is instrumental in the awakening of the "African Giants", providing the infrastructure necessary for the movement of goods.

In terms of destination the main markets for South African exports is indicated in table 4.4. The total share of imports from South Africa has risen between 1995 and 2000 from 28.9% to 38.5% (Cassim, 2002). This confirms the findings that the geographic pattern of trade is increasingly becoming concentrated among particular countries.

Table 4.4 Top 10 Export Destinations (1995-2000)

RANK	1995	1996	1997	1998	1999	2000
1	UK (15.9)	UK (10.8)	UK (11.5)	UK (11.0)	UK (11.1)	UK (15.4)
2	US (7.3)	US (7.9)	US (8.1)	US (10.0)	Canada (7.1)	US (11.3)
3	Japan (6.2)	Japan (7.0)	Japan (8.4)	Japan (6.5)	US (7.3)	Japan (7.5)
4	Germany (5.1)	Germany (4.5)	Germany (4.8)	Germany (6.1)	Japan (4.8)	Germany (7.2)
5	Zimbabwe (4.8)	Zimbabwe (4.3)	Zimbabwe (4.0)	Netherlands (3.7)	Netherlands (4.3)	Netherlands (3.7)
6	Switzerland (4.2)	Belgium (2.9)	Netherlands (3.1)	Zimbabwe (4.7)	Belgium (3.6)	Belgium (2.8)
7	Belgium (3.5)	Switzerland (2.9)	Taiwan (2.7)	Switzerland (3.6)	Italy (3.2)	Switzerland (2.8)
8	Italy (3.1)	Netherlands (2.7)	Belgium (2.6)	Belgium (3.0)	Zimbabwe (3.2)	Italy (2.7)
9	Netherlands (2.8)	Taiwan (2.3)	Korea (2.6)	Italy (2.7)	Norway (2.8)	Zimbabwe (2.4)
10	Taiwan (2.7)	Korea (2.3)	Italy (2.4)	Taiwan (2.0)	Norway (2.8)	Norway (2.2)

Source: Customs and Excise

Source: State Of Trade Policy in South Africa, 2002, pg 125

**Economic-** Increased trade volumes inadvertently create a daunting task for the customs administration to maintain control while still appreciating the need to effectively manage the supply chain. Fluctuations in the exchange rate create additional finance costs when it comes to servicing the government external borrowings. This further challenges SARS to improve collections through innovative tax and duty schemes.

**Technological-** sophisticated global data processing and exchange has further complicated customs roles in maintaining control over softer non compliance issues such as under valuations and misappropriation of freight charges etc.

**Socio-cultural factors-** The beliefs and values of the community and institutional pressures has further created a behaviour that may not be conducive to enhancing the compliance morality. This is evidenced by communities supporting the parallel informal sector in respect of purchasing counterfeit goods engaging in smuggling of endangered species thus promoting an environment of non compliance.

#### **4.10 Internal Environment**

**Legal-** The need for consistent and a stable base for operations is a prerequisite for effective functioning of the organisation and promoting predictability within the international arena. This provides for greater assurance within the international community and improved desire to invest within South Africa.

**Organisational Structure-** SARS organisational structure is consistently changing. This creates uncertainty and lack of focus towards achieving the mission of the organisation.

**Financial resources-** Lack of effective financial management, planning and responsibility. The resources provided by treasury to the Government sector are more directed towards essential services like health and security. The effective use of limited resources is paramount to meet the objectives.

**Automation-** SARS has made great strides to automate as compared to its counterparts in the public sector. It however lacks behind international standards. Unless it can effectively adopt the modernisation program as dictated by the Kyoto Convention and the World Customs Organisation attaining a sustainable competitive advantage in light of the other developing countries will be difficult.

#### **4.11 Other Institutions and Measures that affect Trade**

Beyond the institutions and policies that support exports. There are other institutions usually government that affect trade. These include institutions for purposes of proper valuation and classifications of goods, sanitary, and phytosanitary as well as technical standards. The strength of these institutions is normally dependant on the ability of customs who acts as administrator of these laws to detect and appropriately refer the matters to the relevant institutions. Tariff and valuations classification in developing countries is vital as compared to industrialised countries as it forms a major source of budgetary revenue. The existence of regulations to address technical

and other standards is crucial for the effectiveness of domestic organisations as well as for the protection of the health of the public. Non adherence to international standards and weak domestic institutions can result in South African exports being denied access to foreign markets. For this purpose South Africa has to effectively bring its valuation procedures into conformity with the World Trade Organisation. While it has made substantial progress in adopting the WTO agreement on Customs valuation, the skills level and implementation within the organisation has not been effective. The proper and unbiased implementation has been further complicated by third party consultants acting on behalf of certain industrial sectors e.g. electronics industry. Due to increased external competition from abroad domestic producers have utilised services of these consultants to monitor import values and report to customs for interdictions. Consultants not totally understanding the basis for costing have provided arbitrary figures to Customs officers on the field. This has lead to consignments being detained and delays. This has resulted in customs improperly applying the WTO rule on valuations based on theses information received and handicapping the supply chain.

Countries have established regulations regarding sanitary and phytosanitary measures. In South Africa this is controlled by a certificate and permit system. Details of prohibited and restricted goods are detailed in an encyclopaedia detailing goods that maybe allowed based on a permit or certificate into the country and those that are prohibited from being entered into South Africa. A major weakness in the system is the technical ability of staff to comprehend the vast and far reaching requirements of the various institutions moreover SARS database and risk management system has not been updated regularly specifying changes to the rules contained in the prohibited and restricted list.

These weaknesses severely compromise SARS ability to pro actively act on behalf of other institutions, thereby effectively diminishing there effectiveness to protect the society and set high standards for sustained international competition.

#### **4.12 Gap Analysis**

*“Strategy is not only about deploying the firms resources it is also about building it’s resources to extend its competitive advantage-Robert M Grant”.*

In analysing the gap within Customs, in table 4.5, we will evaluate the resources and capabilities that are needed to achieve its strategic objective which is to optimize revenue collections and promote a better standard of living for its citizens.

Table 4.5 Resource Based Analysis

Resources	Importance	SARS relative strength	Comments
R1- Finance	9	7	SARS currently is the only government department that gets 100% of the finances as requested by the Commissioner.
R2- Technology	8	4	
R3- Human Capital	9	2	SARS is one of the most under sourced Customs agency in the world. The total compliment of customs staff is 2200 as compared to EU and U.S. who have a compliment of between 10 000 and 12 000.
R4-Interdiction equipment	7	1	SARS lack scanners and non intrusive equipment to conduct inspections. This affects turnaround time.
Capabilities			
C1-Technical skill of staff	9	4	SARS has recently undergone transformation and with it a significant number of traditional privileged staff has left who also had the necessary skills. SARS work force now stands with almost 60

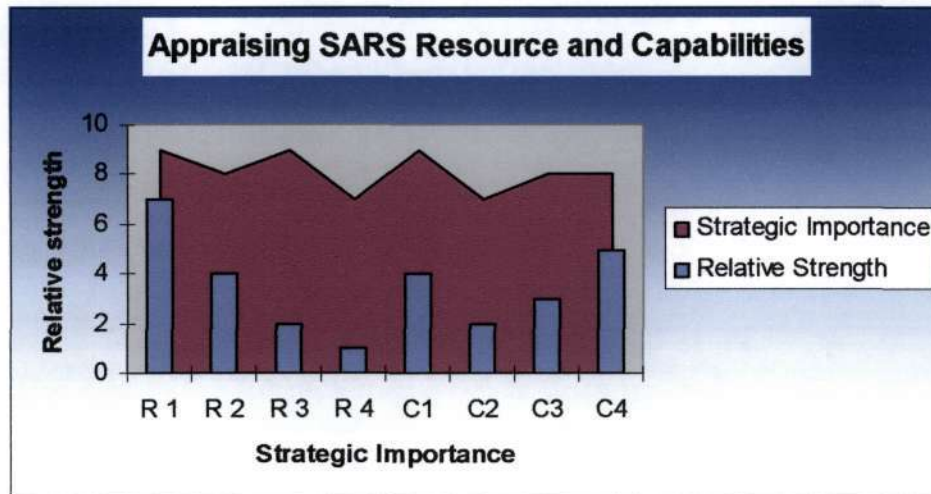


Table 4.5 Continued			
			percent of the human capital who are under 3 years in the service.
C2-Strategic partnership	7	2	SARS has not effectively utilised its accreditation program and built relationships with Portnet and other government departments as well as vessel lines. Information handled by these role players could play strategic role for customs in its risk management and intelligence system.
C3-Innovation	8	3	The human resources within SARS still use traditional approaches to compliance e.g. Checks and balances to determine fraud. More innovative use of other government departments and forensic auditing techniques are lacking.
C4-Management and planning skills	8	5	While SARS has extensively benched marked best practises in modernising customs. The mangers at the ground lack the ability to plan and implement corporate strategies.

Source: Adopted from Grant, Contemporary Strategy Analysis, 2001, Pg 136-137

Having identified some of the principle resource and capabilities required to develop a World Customs agency. These two dimensions will be plotted against figure 4.14 to explain the strength and weaknesses so that developments can be made in these areas.

Figure 4.14 Appraising SARS Resources and Capabilities



Source: Adopted from Grant, Contemporary Strategy Analysis, 2001, Pg 136-137

#### **4.13 Strategic Analysis of SARS Risk Management and intelligence Unit**

The SARS Risk Management Unit, the Customs Risk Profiling and Analysis and the Revenue activation Business intelligence Unit amalgamated into a single unit named the SARS Business Intelligence unit (BIU). This was a pro active move by SARS in engaging its client in one single approach. Although there are aims to structure the business intelligence unit into a research and analysis division, case selection and risk profiling, in depth profiling, technical support and Operations and external liaison, this has not been realised as yet.

Significant improvements have been attained by the implementation of ICRAS at the time of importation however this has not been fully implemented in areas of post clearance inspection, case selection and tracking and trader profiling.

An evaluation of the real time clearance as benchmarked with other administrations indicates the following:

- ✚ Each business area must be able to configure and maintain its knowledge base for risk analysis.
- ✚ “Trap Rules’, must be flexible and be managed from a local as well as a national level.
- ✚ The level of risks is determined by the importance of the headers and fields within the declarations, however this can be supplemented by historical information.
- ✚ The risk analysis must be performed in real time.
- ✚ All changes in the knowledge base has to be logged to establish who made changes and when?
- ✚ The results of the risk analysis must be stored in the “Risk Profile Management Data base”.
- ✚ This must be readily available in a form that can be interpreted by the inspectors.
- ✚ The local office must be able to adopt the workload to the present resources available in the various customs offices.

While the systems provide for increased precision, no system is effective without strategic information telling it what to do. In this regard when compared to other customs administration we see that the primary focus to intelligence gathering is through the risk management continuum, which includes:

- ✚ Collection and interpretation of data.
- ✚ Analysis of data.
- ✚ Evaluation of risk
- ✚ Treatment
- ✚ Monitor and control

Although SARS has made significant in roads to adopting the Revised Kyoto Convention, its implementation has not been in the same vane. The Business Intelligence unit of SARS lacks a proper structure. This has further delayed the implementation of its risk management systems in terms of post clearance inspection. Currently post clearance inspection is manually driven based on individual or team’s knowledge base. The risk management continuum is non existent within the post clearance inspections creating a further risk as non compliance detected is not inputted

into the system for ICRAS to make future interdictions. While significant moves have been made on the real time processing to facilitate trade with the hope that post clearance inspections will play an increasing role in conducting audits to maintain integrity of declarations with minimal interruptions, this strategy seems far from being realised currently.

Further gaps have been identified on the export part of customs clearances. The export system has just lately been computerized. This system however is run independently from the import system and has no selectivity parameters. Risk based interdictions is done manually. While this causes immense delays to time critical consignments it also forms a major area of risk as certain duty suspension is dependant on goods being re-exported. Due to the volumes being exported it is not practical to examine all cargo, therefore no level of control is exerted over the goods and the incentive scheme being administered by SARS.

#### **4.14 Summary**

The coming years are bringing with it new challenges that customs organisations throughout the world will face. The World Trade Organisation has indicated that customs modernisation is a necessity for sustained global competitiveness. In this respect trade facilitation and enhanced supply chain mechanisms are crucial. Customs by investing in modernisation will reap short term payoffs in revenue collection and long term national prosperity by means of effective utilisation of resources and maintenance of control over high volumes that could pose a risk to the country.

The risk management process, as a tool is crucial in achieving customs modernisation. Countries have developed a two pronged approach to risk management that of intelligence gathering and a pro active manner of using this intelligence to identify and treat risk. The risk management process is central to the strategy of SARS and in order to effectively utilise this system a proper analysis must be conducted of its environment and the motivation for the behaviour of its stakeholders.

While SARS has adopted the risk management approach to trade compliance and facilitation, it has yet to develop intelligence to effectively utilise the risk management process. SARS has limited resources and capabilities this creates a further challenge in achieving its objective however the crucial challenge that lies ahead is that of the ability to provide technical skills and knowledge to the staff to actively participate in the process of risk management.

## **Chapter 5: Recommendations and Conclusions**

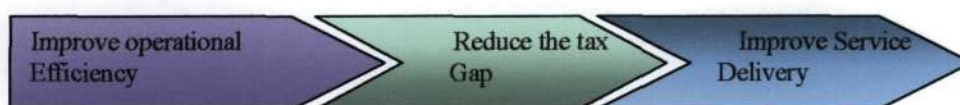
### **5.1 Introduction**

This chapter will form the basis for formulating an effective risk management system based on the best practices of other customs administration. The best strategies cannot be materialized if not appropriately implemented in this regard the structure and automated tools necessary to support the risk management process will be recommended. The chapter will conclude by assessing the effectiveness of a risk management system in delivering the dual objective of trade compliance and facilitation by using the suitability, acceptability and feasibility tests.

### **5.2 Strategic Outcomes**

SARS activities will be geared to achieving the following strategic outcomes as indicated in figure 5.1 (SARS Strategic plan, 2004-2007):

Figure 5.1 SARS Strategic outcomes



- ✚ Improve operational efficiency- to continuously enhance quality and turnaround outputs from core processes in customs operations. This entails making use of the most up to date technology to achieve efficiency gains.
- ✚ Reduce the tax gap- this focus area seeks an appropriate response to the dualism of the South African economy with the intention of addressing non-compliance while still promoting trade. This entails the adoption of a comprehensive compliance approach

underpinned by understanding the behaviour of stakeholders and the level of risk they represent.

- ✚ Improve service delivery- this strategic outcome endeavors to enhance service delivery by meeting stakeholders expectations regarding the provision of information and to ensure a seamless interaction with the clients.

To achieve each of these strategic outcomes table 5.1 includes the initiatives that are recommended to support each focus area (SARS, 2004-2007).

Table 5.1 Strategic Outcomes

Strategic outcome	Key Performance Areas	Action Plan
A) Improve operational efficiency	1. Adequate and accurate capturing of client information.	<ul style="list-style-type: none"> <li>✚ Improve the use of third party information and reconciliation to verify details provided by stakeholders.</li> <li>✚ Improve the skills of front line staff.</li> </ul>
	2. Minimize client errors when submitting customs declarations.	<ul style="list-style-type: none"> <li>✚ Train targeted stakeholders and professional bodies such as the South institute of freight forwarders.</li> <li>✚ Simplify and enhance the requirements made on declarations.</li> </ul>
	3. Reduce data capturing.	<ul style="list-style-type: none"> <li>✚ Promote more clients to make use of EDI submission by improving turnaround time.</li> </ul>
	4. Improve the quality of assessment generated by customs core processes and	<ul style="list-style-type: none"> <li>✚ Expand capacity and upgrade key skills.</li> <li>✚ Use of risk profiling and business intelligence to screen clients.</li> <li>✚ Increase the use of non intrusive inspection devices such as scanners.</li> </ul>

Table 5.1 Continued	prevents re-works.	
	5. Actively managing payments	<ul style="list-style-type: none"> <li>✚ Refine the payments process for greater efficiency through improved management of the electronic funds transfer.</li> <li>✚ Use of a robust financial management system such as “SAP”.</li> </ul>
	6. Ensure effective audit coverage and capability.	<ul style="list-style-type: none"> <li>✚ Use risk to select cases for audits.</li> <li>✚ Implement an annual audit plan.</li> <li>✚ Improve audit tolls and templates.</li> <li>✚ Entrench quality assurance across audit process.</li> <li>✚ Increase the number of accreditation audits.</li> <li>✚ Increase interventions conducted in rail and mail movements.</li> </ul>
	7. Effective debt management	<ul style="list-style-type: none"> <li>✚ Implement a risk model for debt management.</li> <li>✚ Improve customs collections process and enhance the use of liens, seizures to limit the raising of the debt and securing of revenue.</li> </ul>
	8. Ensure effective document management.	<ul style="list-style-type: none"> <li>✚ Ensure adequate storage and physical security over SARS files and documents.</li> </ul>
	9. Remove corruption and collusion.	<ul style="list-style-type: none"> <li>✚ Enhance controls in high risk areas such as cash halls, face value document handling, cheque payments, budgets and systems access.</li> </ul>



Table 5.1 Continued

<p>B) Reducing the tax gap</p>	<p>1. Build and effective compliance model.</p>	<ul style="list-style-type: none"> <li>✚ Adopt a differentiated strategy for engaging with clients based on client behaviour.</li> <li>✚ Incentivise the behaviour of complaint clients through improved service and communication.</li> <li>✚ Improved customs literacy levels through targeted education and outreach programs.</li> <li>✚ Manage the interaction and relationship with the client throughout their lifecycle.</li> <li>✚ Create a single view of a SARS client across all tax products.</li> <li>✚ Target enforcement action in high risk areas and sectors supported by intelligence activities.</li> <li>✚ Conduct risk based and random audits of primary industry clusters to ensure maximum visibility and deterrence.</li> <li>✚ Pursue a strategic approach that builds alliances as well as collaboration with industry and professional institutions.</li> </ul>
	<p>2. Increase client registration.</p>	<ul style="list-style-type: none"> <li>✚ Implement a targeted education strategy that focuses on organizations and individuals who are part of the informal sector to register in terms of customs laws e.g. illegal brewers of alcohol.</li> </ul>
	<p>3. Implement effective screening and validation checks on</p>	<ul style="list-style-type: none"> <li>✚ Re-train front end staff to execute basic validation.</li> <li>✚ Build systems to support validation</li> </ul>

Table 5.1 Continued	new registrations.	checks.
C) Improve service delivery	1. Effective management and resolution of queries, correspondence, objections and appeals.	<ul style="list-style-type: none"> <li>✚ Implement a independent monitoring office to resolve customs disputes.</li> <li>✚ Expand the call centre unit within SARS to handle customs queries.</li> <li>✚ Implement a management procedure that handles objections and appeals in terms of the Administrative Justice ACT.</li> <li>✚ Ensure coordinated effort to resolving queries through streamlining front and back office relationships.</li> </ul>

SARS strategic objectives form the basis for development of a risk management strategy within Customs. In any organization it is stated that the strategies are paramount before the development of an organization structure. Therefore the next sections will focus on the recommended risk management strategy within SARS and suggest an appropriate structure.

### **5.3 Risk Management as a process for Customs Modernization**

The ultimate aim of SARS risk management strategy is to:

- ✚ Significantly improve the organizations chances of delivering on its mandate and meeting its corporate goal.
- ✚ Minimize the chance of unwanted risk.
- ✚ Improver service delivery to the clients.
- ✚ Improve internal efficiencies and maximize return on resources.

This strategy will be pursued through the following objectives:

- ✚ Formalize the organizations risk activities.
- ✚ Develop a common risk language.
- ✚ Build enterprise wide risk management capabilities.
- ✚ Embed risk management within the organization.
- ✚ Ensure that identification, assessment, management and monitoring of risks throughout the organizations occur within established policies, processes and methodologies.
- ✚ Provide a portfolio view of risk management facing the organization.

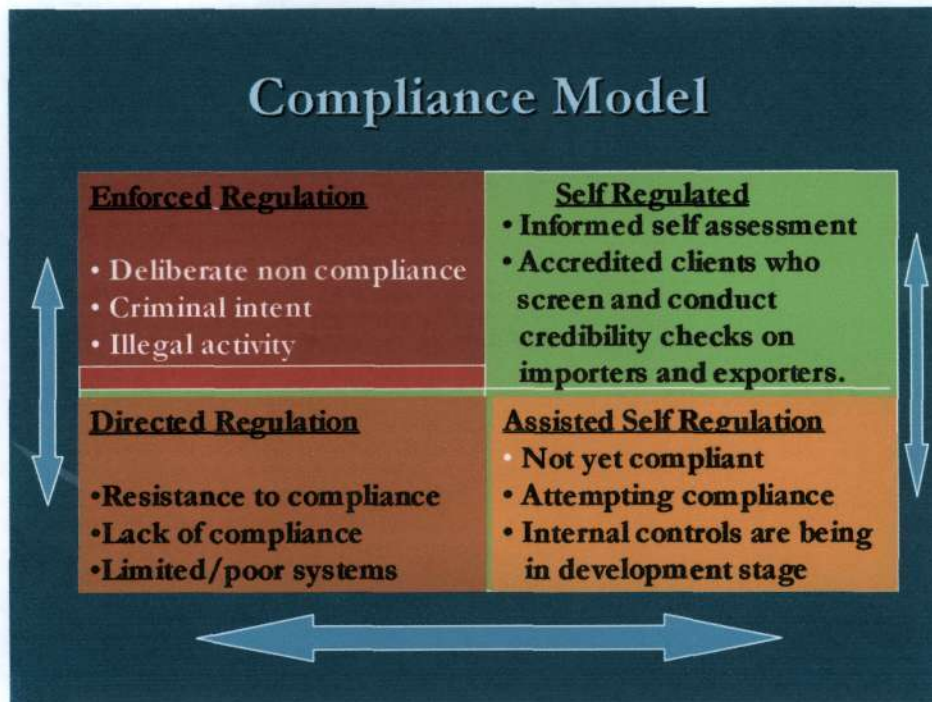
SARS is making use of integrated Customs Risk Analysis Solution (ICRAS), to assist customs to perform and manage risk within the various business areas. Currently the risk analysis is done manually, this leads to high risk of errors and delays in turnaround time. The use of an effective risk management process will benefit SARS in the following ways:

- ✚ Optimal revenue collection
- ✚ Improve trade facilitation
- ✚ Improve business performance
- ✚ Enforced alignment between business objectives and SARS performance measures.
- ✚ Reduce the tax gap
- ✚ Focuses the deployment of resources in the correct areas.
- ✚ Combat smuggling and fraud

In proposing an adequate risk model cognizance must be taken of the environment and the behaviour of the clients within the environment. The model in figure 5.2 is recommended as a basic model for understanding of the behaviour of SARS clients.

- ✚ The nature of our operational work is governed by the behaviour of our clients which is characterized by the risk they or their cargo represent.
- ✚ In order to manage these risks we need to understand our business environment.
- ✚ Our risk identification is at the basic level of pre-arrival, at arrival and post clearance.
- ✚ Using the compliance model clients maybe segmented according to the risk they pose.

Figure 5.2 Compliance model

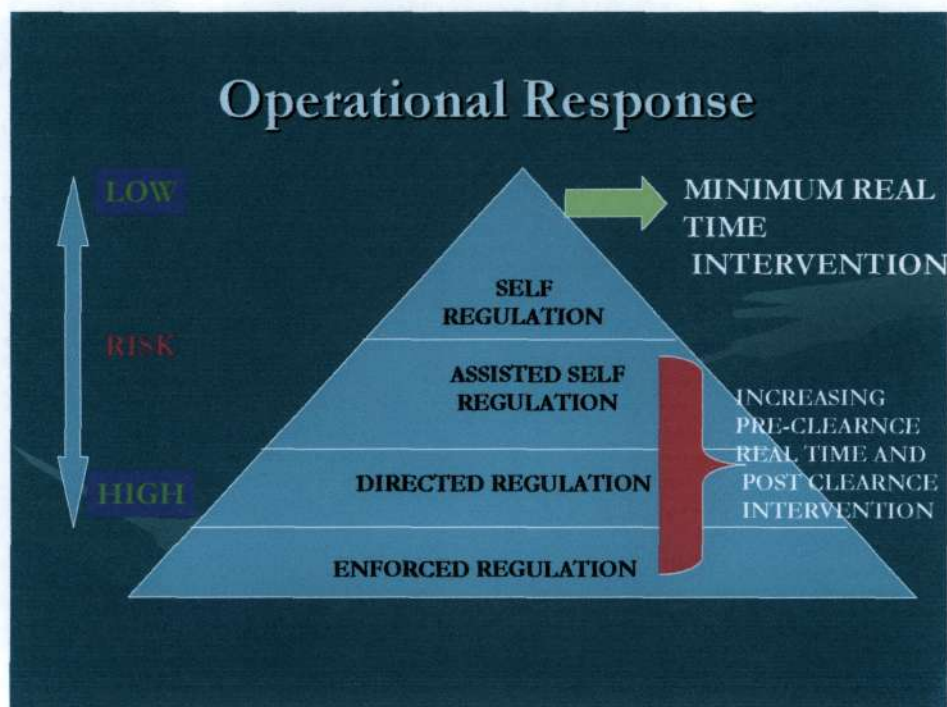


Once the behavior of our clients can be accurately as possible ascertained we can then develop an operational response to determine the level of intervention and the time at which the intervention will be performed. Figure 5.3 indicates the type of interventions and the time at which they will take place.

- 📌 Clients, who indicate a behaviour that is self regulated, include those that are accredited and willingly comply with customs rules and regulations. These clients will have minimum real time intervention however random maintenance audits can be conducted from time to time.
- 📌 Assisted self regulated behaviour, indicates that there is a move towards compliance however poor internal control and lack of knowledge inhibit these clients from achieving the status of a self regulated client.

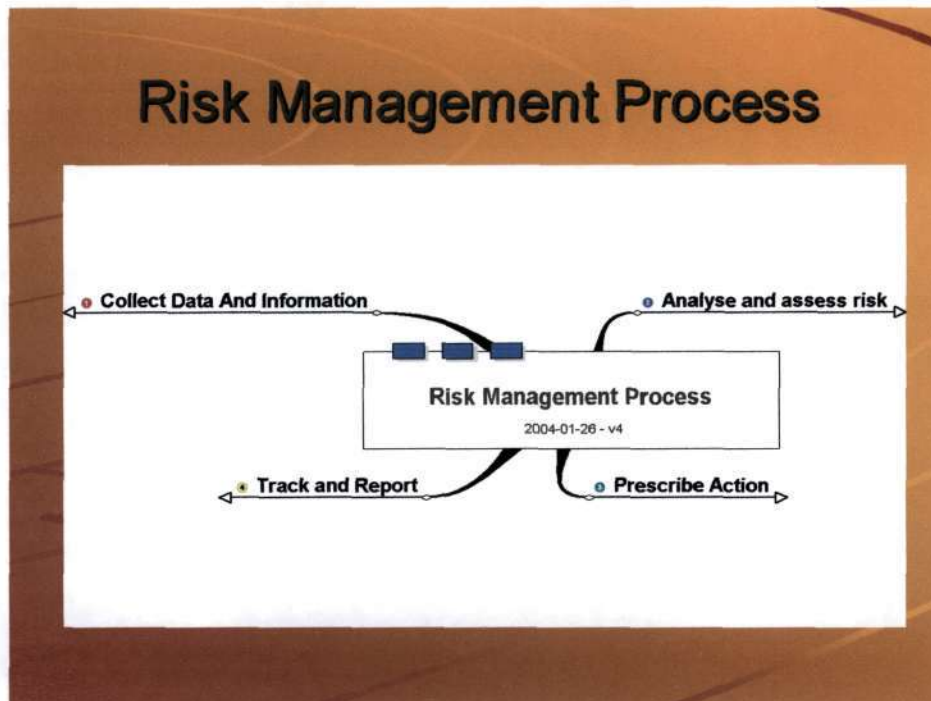
- ✦ Directed regulations, indicates a resistance to compliance together with poor systems as a deliberate attempt to contravene a rule or regulation to obtain a benefit. In this instance interventions can be made prior to clearance, by means of detentions from the manifests, and at real time and post clearances.
- ✦ Enforced regulation, involves an intentional attempts to defraud the state or conduct illegal activities with criminal intent. In this instance interventions can be made prior to clearance, by means of detentions from the manifests, and at real time and post clearances.

Figure 5.3 Treatment and Timing of Interventions



The risk management process is only as effective as the intelligence that is fed into the system. In this respect the business intelligence unit plays a crucial role. Figure 5.4 indicates the process of gathering information so that it becomes intelligence that can be used in the risk management process.

Figure 5.4 Risk Management process



Currently Customs officers based their profiling on experience or information that are contained within isolated pockets of the organization. This has caused irresponsible actions on the part of customs officers inhibiting the free flow of trade and in some instances victimizing certain sectors of the industry that attract high duty rates as potential non conformers e.g. textile industry. The need for a systematic recording of information and analysis has become a prerequisite in light of globalization and trade facilitation.

Based on the models presented by the U S and the EU Customs, a similar approach to data mining and analysis is advocated. The steps as outlined in figure 5.4 become the foundation for development of intelligence that can be systematically utilized by the automated ICRAS to accurately profile and detect consignments that are considered to be high of risk.

The steps included in this process are as follows:

1. **Collect information:** Within the context of collection of information the political, technological, economic and social factors impacting on client behaviour has to be considered. The collection stage should involve an initial assessment of the reliability of the information source and the accuracy of the information itself. According to the SARS intelligence manual it is recommended that information sources be graded according to a five step evaluation system, which includes the following grades:

- A. **Always reliable:** This is normally a source that in the past has always been reliable and there is no doubt to the authenticity, trustworthiness and competence of the source or the information.
- B. **Mostly reliable:** A source where previous information has mostly proved to be reliable.
- C. **Sometimes reliable:** Sources where previous information has been mostly unreliable. In this instance information must not be acted upon without collaboration.
- D. **Unreliable:** A source that has been proved to be unreliable in the past or where there is doubt about the authenticity, trustworthiness and competence of the source or information.
- E. **Untested source:** Information from this source has to be approached with caution however it does not mean that the information is unreliable.

This grading system is recommended as it provides a good basis for providing strategic information that can be used in the process of analysis. Increasing trade has placed an immense pressure on the static levels of limited and already stretched resources. Customs need to establish a partnership with trade having them share part of the responsibilities of facilitation and enforcement.

It is recommended that customs set up strategic partnerships with stakeholders by means of entering into memorandum of understanding (MOU), by granting partners preferential treatment such as reduced examination rate and mandatory supervisions of cargo in return the partners

should allow customs to utilize their sophisticated shipping systems to target high risk groups and provide customs with information leading to seizures of goods and prosecution of offenders.

2. Analysis and risk assessment: This stage within the risk management process involves examining the components of collected information to establish patterns and relationships which can be meaningfully interpreted. The risk of not correctly evaluating the information are:

- ✦ That information could be given the wrong weight and therefore the wrong level of significance when it comes to risk.
- ✦ Suspect information maybe discarded, when it comes to some use.

This is also the stage where automated tools can be used to categories risks into categories. Based on the information the level of risk will inform customs on the likely behaviour of the client which will stimulate a response either prior to cargo being cleared, at the time of clearance or at post clearance of cargo.

In the process of analysis understanding the context within which SARS function is paramount to success. Figure 5.5 demonstrates a mythology that can be used to systematically identify potential gaps by using the information gathered from a macro level to ascertain and prioritize areas and elements that pose the highest risk.

3. Prescribe action: Prescribing action involves 2 processes:

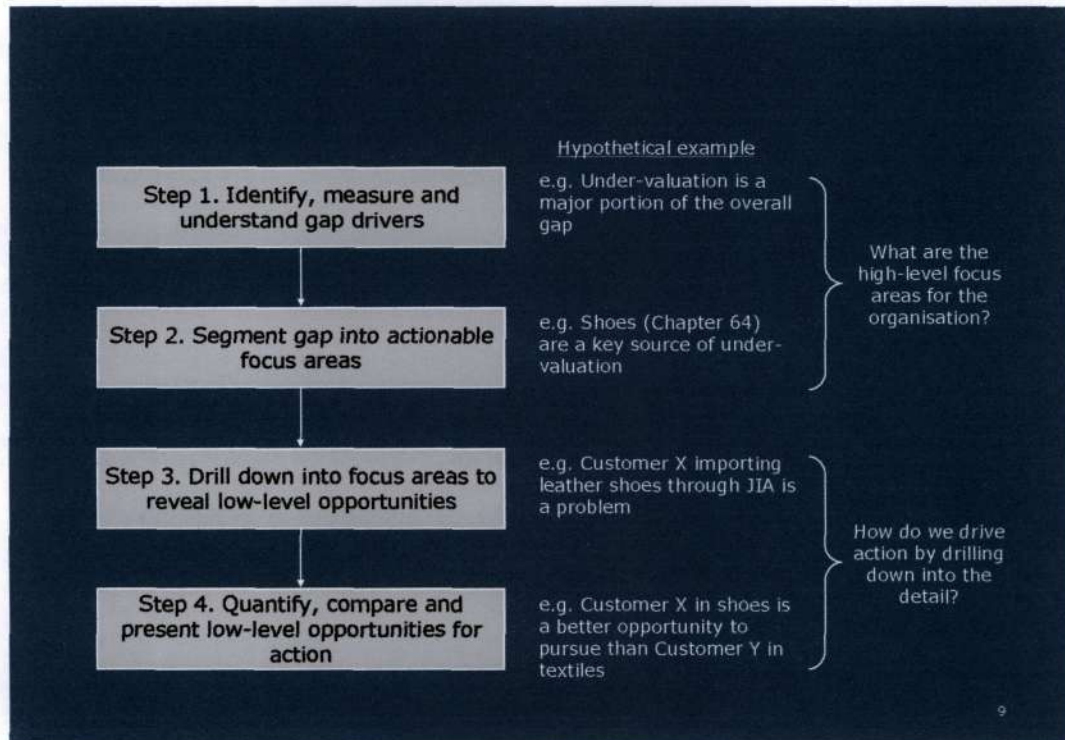
- ✦ Identifying the cause of the risk e.g. lack of knowledge or wilful disregard for the import and export laws.
- ✦ Designing an action and assigning resources.

In this regard Customs has implemented its first stage of the risk management process within SARS. By making use of ICRAS at the time of import goods are automatically profiled by the information contained within the system and an appropriate action is signalled according to the risk level. This system although in its infancy has reduced turnaround time on the processing of



import cargo from thirty six hours to within four hours. However, due to the lack of intelligence the profiling within the system has not been very effective. This has placed added strain on the post clearance inspection teams to act as the last resort of enforcement.

Figure 5.5 Structured Mythology for Analysis



Source: Revenue Management 5<sup>th</sup> edition, 2003

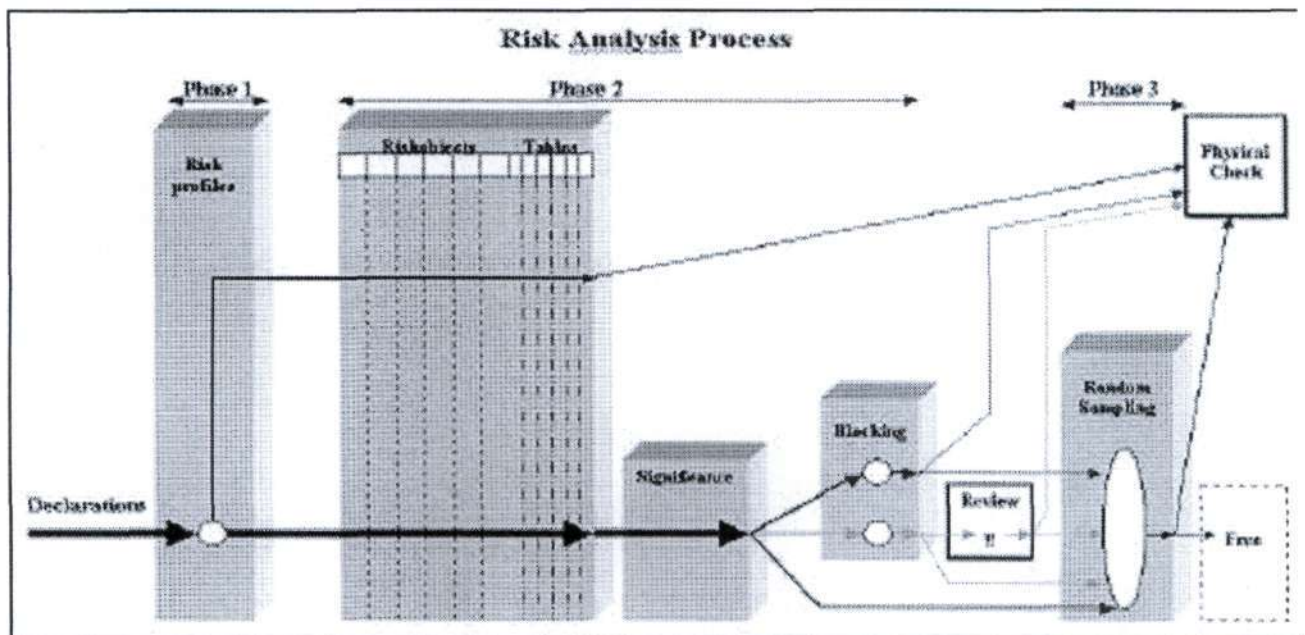
While ICRAS as an automated tool shows great potential its effectiveness can be enhanced by proper intelligence. The following recommendation is made to enhance the risk management system.

- ✚ Weekly risk committee meetings to be held by the various branch offices to compare the success rate of risk criteria's within the system.
- ✚ Initial data collected should be strictly graded according to the grading scale and ranked according to the level of risk.

- ✦ Risk should be branch specific as the nature of industries differ between regions and therefore the type of non compliance maybe more sophisticated in regions where “heavy” industries are situated e.g. transfer pricing as compared to regions such as the neighbouring states that could pose more a risk in terms of narcotics etc.
- ✦ Publicise risk management to make employees understand their role in the overall risk management strategy of the organisation. Computerization assists conveying the elements of risk management in the areas of manifest targeting, cargo selectivity and entry summary, post clearance, export audit, smuggling, fraud and passenger analysis.
- ✦ By performing informed compliance stakeholders should be made aware of changes in policy and regulations. This will enable customs to achieve voluntary compliance and focus its resources on wilful violators.
- ✦ The adoption of non intrusive means of intervention to achieve facilitation and enforcement.

Figure 5.6 indicates the current risk management system within the import and export stream.

Figure 5.6 Import and export risk management system



Source: SARS internet site

Risk or “trap rules” are based on a three phases.

- ✚ Phase one includes trap rules based on known traders e.g. Trader A imports product B from Country C, the consignment will then be stopped for physical examination.
- ✚ Phase two is risk scoring based on predetermined risk values that are assigned to importers, exporters, agents, products, country of origin and country of destination.
- ✚ Phase three risks is a random sampling of consignments not detected in the first two phases e.g. every 100<sup>th</sup> entry. This also serves to limit the predictability of the system over time to clients.

The system also allows for information to be sent to the database after an intervention is conducted, which allows the risk analysis team to evaluate and monitor the effectiveness of the “trap rules”.

This import and export system is recommended, as it achieves the purposes it is intended for that is:

- ✚ Improve the turnaround time thereby facilitating trade.
- ✚ Improve risk profiling as it provides for an effective feedback system as all data is recorded in the database.
- ✚ It provides support to the post audit inspections team as the information contained in the database can be used as historical information for Trader Profiling.
- ✚ Limits the client’s ability to predict the trends in the risk selection.

The current ICRAS system has not been implemented further than the import and export teams. Therefore the post clearance audits are still done manually based on the experiences of officers and selection criteria’s used by individual teams. The disadvantage of this type of approach includes:

- ✚ Lack of proper data base for recording information.
- ✚ Information on cases is manually written in dockets which are filed in registry. Vital information contained in these files are not disseminated to other branch offices.

- ✚ Files can be easily lost or misplaced and only one person at a time can use the information contained in the files. Limiting sharing of intelligence.
- ✚ There is no proper case management and tracking system that can effectively provide input to the risk analysers.

It is therefore recommended that a robust and flexible Risk management system be used to profile cases for audits based on predetermined risk and historical information on traders. The cases so assigned to the audit team should be managed and tracked to ascertain progress.

It is therefore recommended that Customs makes use of the risk trade profiling system within ICRAS to profile clients and identify clients for possible post clearance inspection. This system should use external information obtained from banks, clearing and forwarding agents as well as historical information to profile the behaviour of clients and subsequently the risk they pose.

This will provide better support to customs officers by providing:

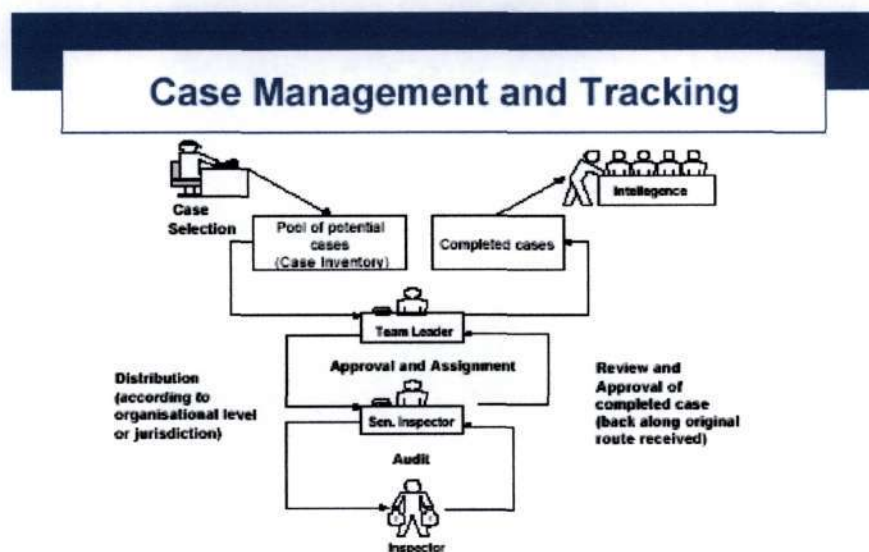
- ✚ Online access to client data warehouse, which will hold all the data of the client in electronic form.
- ✚ Making use of knowledge based analysis to establish profiles of clients.
- ✚ Can automatically be programmed to activate audits on certain categories of clients at different frequency levels.
- ✚ Data base can be used to track progress of selected cases in the case management and tracking system.

4. Track and monitor: The activity of customs has to be constantly monitored and reviewed, so that new strategies can be adopted and policies revised. This process also form an integral part as it informs the risk management process as to the effectiveness of the interventions and also serves as a basis for providing historical information that is reliable and accurate.

In this regard the case management and tracking system can be used. This system essentially form an effective communication channel between the risk management team the post audit team and the intelligence team. This system allows the audit team

flexibility to choose from a pool of available profiled cases for audit. The cases can be controlled either by the senior officer within the team or the team manager who can distribute cases for audit to inspectors. Once completed they can be reviewed by the senior officer and channelled to the intelligence division to build on the profile of the client. Figure 5.7 indicates the channel for the flow of information between the risk management team and the audit team.

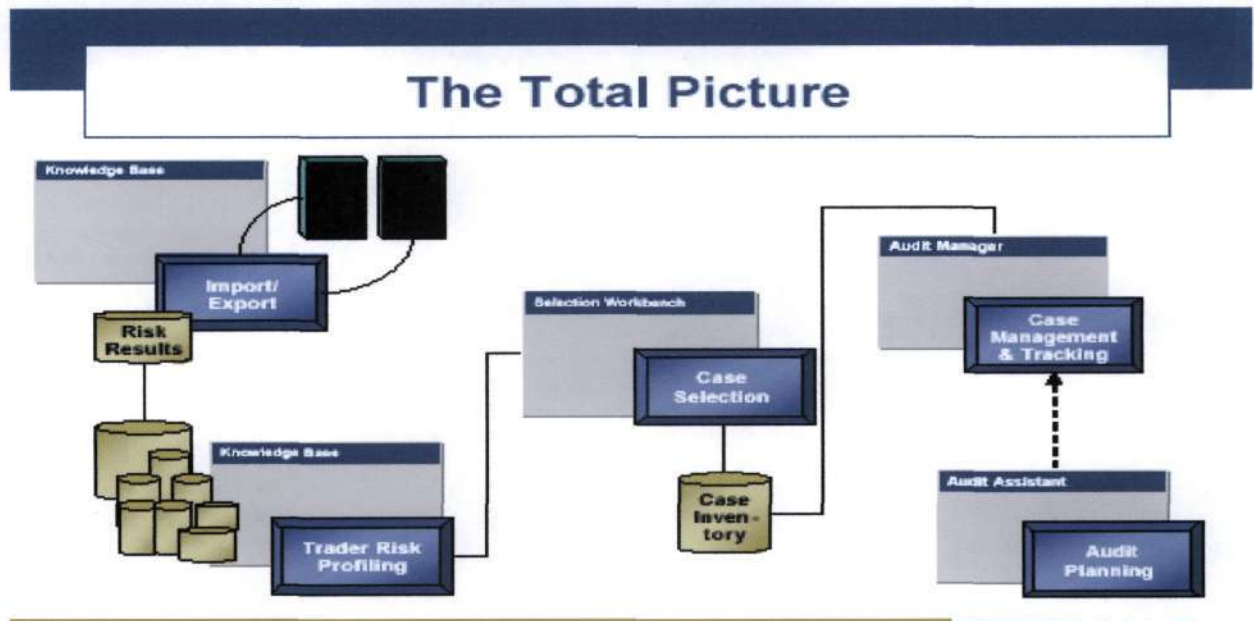
Figure 5.7 Case Management and Tracking



Source: SARS business intelligence unit manual

The total process of the risk management is provided in figure 5.8. This system will enhance customs ability to maintain a balance between trade facilitation and enforcement.

Figure 5.8 The Total risk management system



Source: SARS Intelligence manual, 2003

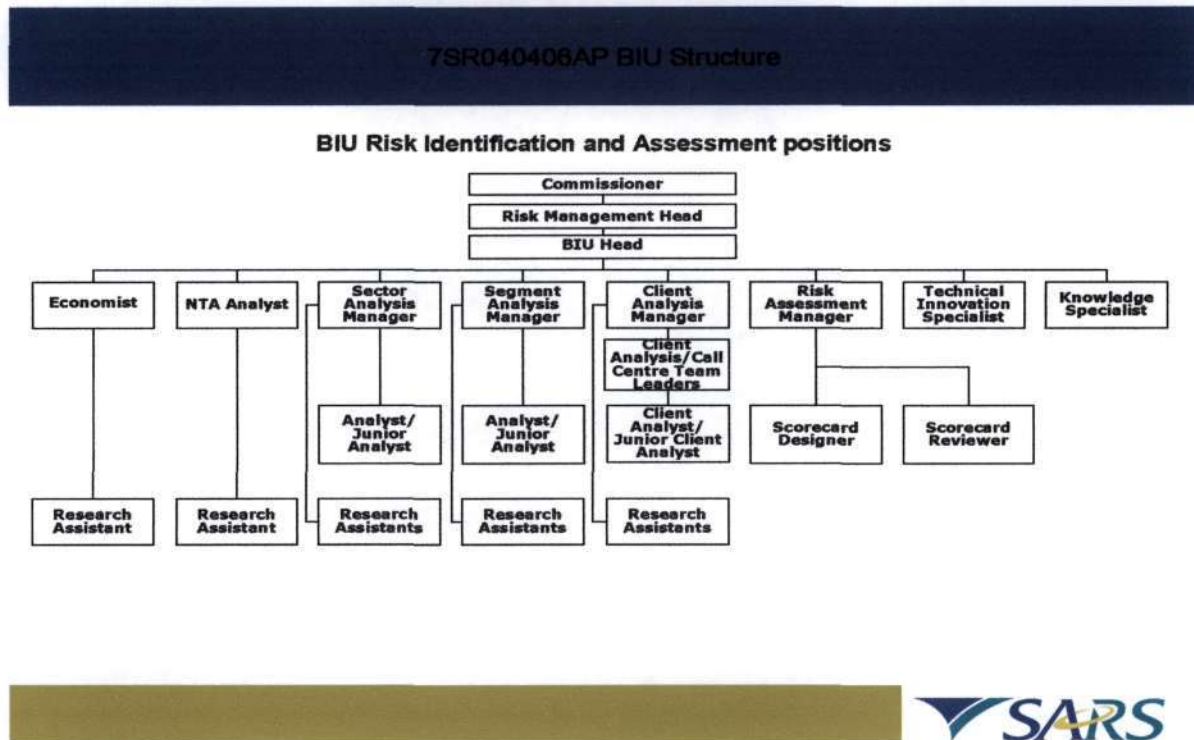
#### **5.4 Installing Total Quality Management within the Process**

- ✚ Combined Risk Strategy Team- Senior offices from each team will meet on a weekly basis to report on non-compliance areas and formulate tactical plan for holistic approach from all teams.
- ✚ Quality assurer becoming actively involved in the assessment process by enforcing basic principals of assessment
- ✚ Strong focus on quality of targeting strategies and not quantity
- ✚ Quality control of stop note reports
- ✚ Supervision of examination process by quality assurer
- ✚ Ensuring that each team's compliance activities contributes to the data base
- ✚ Considering that "Released cargo" is also a success in terms of reducing risks and in terms of understanding our operating environment

## 5.5 Structure for the Risk Management Division

Figure 5.9 forms the basis for the recommendation of a proposed structure for the Risk Management division.

Figure 5.9 Recommended Structure for the Risk Management Division



Source: Internet 10

The division has to be seen and lead independent of the normal operations divisions within customs.

## 5.6 The Implementation of the Risk Management System

Once the risk management process has been chosen, it is imperative for the organization to address the following issues regarding implementation. The leaders of the organization must remain focused on the task at hand and inspire all stakeholders to drive the process forward towards achieving the objectives. Stakeholders must be motivated and buy into the likely

benefits of change. Figure 5.10 indicates the recommended implementation plan for the risk management process.

Figure 5.10 The implementation process



Source: Adopted from SARS Business Intelligence Unit, 2003

- ✚ The first and crucial part of an implementation strategy is to set up a project plan. This should include predetermined schedules for the implementation of specific projects within the risk management system.
- ✚ Knowledge acquisition session involves obtaining the necessary skills and information to inform the staff and stakeholders.
- ✚ The next step will be to identify potential trainers and train the trainers and filter the information within the organization.
- ✚ A road show can further be recommended to the various branch offices to attain buy in to the new system.
- ✚ The SARS intranet can be used to filter information and create play pens that staff could use to practice the new system.



- ✚ Handouts can be distributed detailing key dates and information regarding the new system.
- ✚ The best way to attain buy into the system is to make use of champions identified from within the staff compliments to be part of the process.
- ✚ The implementation on the first phase has been done by visiting each office for the import system while the export system will be done at a much greater pace as it compliments the imports system.
- ✚ The post clearance including the trader profiling and case selection and tracking should follow the similar route.

### **5.7 The SARS Intelligence Customers and Products**

SARS Risk Management will provide information to the following customers.

- ✚ SARS Management
- ✚ Auditor general
- ✚ Enforcement divisions
- ✚ Central enforcement units
- ✚ Large business offices
- ✚ Internal Investigations unit
- ✚ Regional criminal investigations unit
- ✚ Revenue activation program investigation unit
- ✚ Customs
- ✚ Operations divisions

The products that will be delivered to the above customers are included in the table 5.2:

Table 5.2 Customs Intelligence products

Type	Description
Threat assessment and analysis (National and regional)	Annual and periodic product that defines strategic issues regarding tax-gap, industry risk, economic factors, revenue trends and tendencies, business risk, tax-types and similar.
Industry research, analysis and profile	Analysis of sectors or industries as highlighted in the threat analysis defining the layers and characteristics, trends and tendencies, profiles and prevalence of non-compliance and related information to level of entity-profile.
Tactical alert message	Information to be provided to functional arm in SARS that

	requires immediate and urgent action and response to specific matter. (Customs, Audit, CI or Collections)
Operational alert message	Periodic information to be provided to functional arm in SARS that requires immediate and urgent awareness to a general trend or tendency. (Customs, Audit, CI or Collections)
Case recommendation	Matter recommended to functional arm in SARS that requires further investigation - examination, inspection or investigation. (Customs, Audit, CI or Collections)
Profiles (company and individuals)	In-depth profile and link analysis of particular taxpayer upon request by functional arm in SARS - case-specific.
Operational information requirements	Personal information of particular taxpayer upon request by functional arm in SARS whilst in the field - e.g. registration details - case-specific
Assistance during investigations	Surveillance, audio, photographic, videos type requirements upon request - case-specific.
Statistical information (S Soni)	Management information based upon feedback
	(incident reports) from functional arms in SARS

Source: SARS Business Intelligence Unit, pg 29

## **5.8 Evaluation Of the strategy**

The evaluation of the risk management process being an effective strategy to provide a balance between enforcement and facilitation is examined against the suitability, acceptability and feasibility criteria's.

### **5.8.1 Suitability**

The international trade arena is in the growth phase. Therefore a strategy for customs that can enhance the trade facilitation while at the same time allowing customs to have maximum control over the activities surrounding importation and exportation of goods is crucial for success. The risk management process takes in to account the environmental context of customs activities and provides a structured approach in assessing the behaviour of its clients thereby allowing for effective mitigation of risk. The risk management process is therefore an effective strategy for customs to achieve its objective.

### **5.8.2 Acceptability**

Customs tax gap within the past years has increased to more than R1.5 billion. This tax gap is going to constantly increase if customs cannot promote compliance within the industry. The total burden imposed by SARS through the imposition of taxes of which duties form a significant portion is between 23%-25% of gross domestic product (SARS Annual report, 2003). Optimal collection of revenue due to the state especially in the form of duties reduces the burdens on SARS and the Department of Trade And Industry to review duties to higher level to meet its expenditure. In affect this creates a favorable climate for foreign direct investment. In this regard the risk management is an effective tool to achieve this objective. The risk management process not only endeavors to ascertain risk but also to correct policies and procedures that could pose an internal risk and lead to duty avoidance. The need for improved delivery with the minimal resources indicates that a risk based approach is an acceptable solution.

### **5.8.3 Feasibility**

The success of the strategy is dependant upon two factors:

1. The culture, skill and resources available within the organization.
2. The commitment of senior managers and staff to implement the strategy.

SARS has commenced with an aggressive transformation campaign, this included employee awareness and regular feedback on developments within the organizations. This has invariably geared the staff to expect changes. The Commissioners determination and commitment to the staff to the affect that no staff will loose there jobs during the process created stability and security for the staff. This has created a climate of acceptance and a culture that permeates the need for change and modernization.

SARS has committed itself towards training and developing existing staff to meet the future demands of a world class customs, these include programs such as train the trainer and risk management etc. This has effectively geared the staff for the future. SARS has been until recently the only Government department that attained the full share of its requested budget from treasury. Further to this strong commitment to adopt the risk management process by outlaying its own funds during the initial phases has shown SARS commitment to adapting to the ASEA Conference on Risk Management. This has stimulated interest from donor groups like Danida (Danish donor), who are prepared to provide SARS with financial banking on the acquisition of certain technology for the risk management process as well as scanners for purposes of non intrusive examinations.

The commitment from staff to achieve the objectives of SARS has been stimulated by an effective performance management system that monitors and measures key outputs that are required to be met on special initiatives such as the risk management process. The improved ability of the staff to adapt to change, the financial banking and the commitment of the staff makes the strategy feasible.

## **5.9 Summary**

The environmental context within which SARS operate is dictated by the behaviour of its clients and stakeholders. The need to understand this behaviour is crucial if we are to understand the risk these behaviour's pose. The risk management system is an effective strategy to understand the extent of the risk and implement appropriate measures to negate these risks.

The main feature of the risk management process is intelligence driven, as data is collected, analyzed, treated and continuously fed back to the system. This intelligence is able to enhance customs decision making ability in the pre-clearance, post clearance and export clearance stages, thereby contributing to trade facilitation and enforcement.

When analyzed according to the criteria's required for a successful strategy, the risk management process meets all requirements in terms of suitability, acceptability and feasibility. The system is therefore adequate to deliver that which is required in terms of SARS to achieve its strategic objectives.

## **5.10 Conclusion**

Changes in the global environment have impacted on the ways of conducting business. The move to a “just in time” economy the need for faster and efficient service delivery has made it mandatory for countries to adopt the customs modernization program. South Africa is no exception, as China, Malaysia and India become the fore runners in attracting foreign direct investment SARS has to adopt a strategy that is conducive to creating an environment that makes it conducive to attract investment.

The risk management process as a core tool for this modernization has to be used in order to achieve efficient processing while at the same time ensuring that customs has maximum control over the goods being imported or exported. The risk management process is an interactive process and will require strategic partnering with professional bodies and other stakeholders. The risk management system should also be a system that Incentivising compliant behaviour by allowing minimal non intrusive actions.

The risk management process cannot be effectively implemented if it is not supported by strategic business intelligence information. In this regard the professional know-how of the employees for the modernization of customs is essential. As customs places greater importance on analyses, audits and investigations skills levels have to be improved from being one of front line face value checks to that of in depth strategic analyses. The modernization process has to be supported by the appropriate technology that can support the risk management process and provide effective data storage and manipulation capabilities.

The only certainty that exists is that the environment will continually change and so will the risk. The organization has to become a learning organization, to be able to adopt and change to circumstances.

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