

AUSTRALIAN INDUSTRY DEVELOPMENT

Introduction

- 4.1 One of the most important objectives of the Committee is to assess the impact of Commonwealth government purchasing policies on Australian industry. In 1994 the Bevis Report concluded that ‘the opportunities which Commonwealth procurement ought to provide for Australian industry development are not being fully grasped.’¹ The Committee sought to determine whether opportunities for Australian industry have improved since 1994.
- 4.2 The importance of government procurement to Australian industry development is significant. It has been estimated that the three tiers of government spend around \$45 billion a year on goods and services.² Therefore, the decision to purchase from an Australian supplier can impact on the Australian economy by influencing employment, taxation revenue, technological development, and ultimately Australia’s balance of trade. No government research is available to show the multiplier effects of purchasing from Australian suppliers. ISONET, however, commissioned research on this topic and reported that for every additional one million dollars of successful new or retained business, the following effects flow through the economy:

1 House of Representative Standing Committee on Industry, Science and Technology, *Australian Government Purchasing Policies: Buying our Future*, First Report, AGPS, Canberra, March 1994, p. xiii.

2 Productivity Commission, *WTO Agreement on Government Procurement, Potential Implications for Australia of accession*, 96/18, AGPS, Canberra, 1996, p. 4. The Productivity Commission (PC) reported that no authoritative estimates of purchasing by state, local governments and GBEs exist. The PC has arrived at a figure of \$45b based on general acceptance that expenditure by all levels of government on goods and services account for between 10 and 15% of GDP.

- \$328 105 worth of tax revenue is generated;
 - \$1 216 267 worth of value-added is generated;
 - \$210 082 worth of welfare benefits is saved; and
 - 22 full-time jobs are created.³
- 4.3 This chapter seeks to identify areas where government can improve its performance by maximising opportunities for Australian industry. Evidence from Australian industry suggested more could be done to improve access to government purchasing information, reduce bias and impediments to Australian industry, and reduce the complexity in dealing with government buyers. Chapter two discussed problems relating to access to buyers for Australian suppliers arising from devolution. Chapter three discussed the culture of government purchasing officers. Chapter five discusses electronic commerce purchasing systems and access to purchasing information by suppliers.
- 4.4 Some of the specific issues that will be dealt with in this chapter include:
- the need for agreed and universally applied definitions;
 - the commitment that agencies source at least 10% of their purchases from SMEs;
 - the application of industry development criteria to government purchases less than \$10 million;
 - the implications of ‘mega-contracting’ for SMEs;
 - the role of ISONETs; and
 - the applicability of certain aspects of the *Defence And Industry Strategic Policy Statement* to other government agencies.

The Commonwealth Procurement Guidelines

- 4.5 Principle five in the Commonwealth Procurement Guidelines (CPGs) focuses on national competitiveness and industry development. The CPGs state that ‘through its procurement, the Government seeks to promote the development of ANZ industry, including SMEs, by means that are consistent with the achievement of value for money objectives’.⁴ Some of the key statements in the CPGs include:

3 ISONET, *Submission*, p. S260.

4 DoFA, *Commonwealth Procurement Guidelines, Core Policies and Principles*, March 1998, p. 17.

- the Government maintains its commitment that Commonwealth departments and agencies will source at least 10% of their purchasing from SMEs;
 - in major procurement projects of \$10 million or more, agencies are required to identify clearly in tender documentation any industry development criteria and associated evaluation methodology and, where appropriate, opportunities for SME participation;
 - the Industrial Supplies Office network (ISONET) can help buyers, both government and non-government, to identify capable ANZ suppliers, especially SMEs; and
 - where agencies purchase overseas goods in preference to ANZ goods, they must be able to demonstrate that ANZ suppliers have had fair opportunity to compete.⁵
- 4.6 Commonwealth Procurement Circular 98/3 changed the requirement in the last dot point from a mandatory requirement to a best practise objective. The Department of Finance and Administration (DoFA) maintains that the 'ANZ industry development aspects of this requirement are already dealt with elsewhere in the CPGs by advising agencies to encourage competition, particularly from ANZ suppliers, and to 'ensure that they provide opportunities for ANZ industry, particularly small to medium enterprises, to provide a competitive offer or proposal'.⁶
- 4.7 Some groups suggested that there has only been marginal improvement in industry development outcomes since 1994. The Australian Information Industry Association commented that 'the 1994 report has largely been a wasted opportunity as the procurement practices by Commonwealth entities have not progressed in a manner that has assisted industry, particularly SMEs'.⁷
- 4.8 The Office of Small Business (OSB) commented that 'there is scope for Commonwealth departments and agencies to focus more on harnessing Government purchasing to drive Australian industry development.'⁸ The OSB reported on a number of small business concerns about government purchasing including:
- small business continues to experience difficulty winning Commonwealth contracts due to the perception by some Commonwealth departments and agencies that there is a higher level of risk associated with purchasing from small business;

5 *Commonwealth Procurement Guidelines, Core Policies and Principles*, pp. 17–18.

6 DoFA, CTC, *Commonwealth Procurement Circular 98/3*, August 1998.

7 Australian Information Industry Association, *Submission*, p. S71.

8 Office of Small Business, *Submission*, p. S315.

- small business is concerned by an emerging trend for Commonwealth departments and agencies to reduce the total number of suppliers from which they purchase goods and services. This reduction is argued to achieve efficiencies by reducing the costs involved in administering a large supplier base. The OSB submits that consideration be given to amending the CPGs to advise Commonwealth departments and agencies to carefully consider the full costs and benefits when determining the size and diversity of its supplier base;
 - small business operators generally support the Government's progress in improving Commonwealth purchasing policies and practices. However, feedback from small business and industry associations, suggests that they are on occasions confused by some Commonwealth purchasing outcomes and encounter difficulties when vying for Commonwealth business;
 - suppliers have in the past complained that the costs of tendering can be as high as 20% of the overall price for a Government contract. Complex and costly tender processes may act as a barrier to small businesses that may otherwise possess the expertise to satisfy a Government contract; and
 - there is a need to develop effective consultative forums to help small business to understand Commonwealth purchasing policies.⁹
- 4.9 The Queensland Chamber of Commerce and Industry commented that in the 'in the eyes of small business, which represents 95% of all business in Queensland, government procurement at all levels, continues to represent a disappointing stimulus to economic growth.'¹⁰
- 4.10 In contrast to these concerns, a range of groups supported the industry development initiatives set out in the *Defence and Industry Strategic Policy Statement*. For example, the Australian Institute of Purchasing and Materials Management Ltd commented that it has a high regard for 'Defence's guidelines on procurement, particularly through the Commercial Support program as these strongly support the development of Australian industry through industry development programs.'¹¹ More about the *Defence and Industry Strategic Policy Statement*, is discussed at paragraph 4.102.

9 Office of Small Business, *Submission*, pp. S310–316.

10 Queensland Chamber of Commerce and Industry, *Submission*, p. S238.

11 Australian Institute of Purchasing and Material Management Limited, *Submission*, p. S533.

Conclusions

- 4.11 The Committee, in assessing the state of industry development objectives in the Commonwealth Procurement Guidelines (CPGs), suggests that the overall performance of government has improved since the Bevis Report made its findings in 1994. This is based on favourable reports about the performance of the Department of Defence that accounts for over half of government purchasing by Budget funded agencies. As noted in Chapter 3, anecdotal evidence suggests the attitude and culture of government purchasing officers has also improved. However, it is apparent from the divergent opinions on the effectiveness of industry development objectives of government purchasing that more can be done to harness the positive impact of government purchasing, particularly for small business.
- 4.12 The Office of Small Business (OSB) advised the Committee that more could be done to ensure that government purchasing helps to drive Australian industry development. OSB raised a number of concerns made by small business. These relate to the perception amongst government purchasing officers that there is more risk associated with using small business, concerns by small business about the cost of tendering, and difficulties for small business when vying for Commonwealth business. As stated in the CPGs, the onus is on government purchasing officers to establish or verify the competence, viability and capability of the prospective suppliers to perform the contract.
- 4.13 These issues can be dealt with at three levels. At the officer level, there is the need to enhance the training, education and culture of government purchasing officers. At the departmental level, Chief Executive Officers are responsible and accountable for ensuring that the right systems are in place to maximise opportunities for Australian industry. These two issues were dealt with in Chapter 3. At the whole of government level, however, there is no specific organisation or agency that has a monitoring or oversight role in relation to the impact of government purchasing policies on small business. The OSB should take on additional responsibility and fill this gap. The Committee would support the expenditure of additional resources so that OSB could fulfil this role.
- 4.14 The Committee asserts that, in the current devolved purchasing arrangements, there is the need for an agency with an interest in small business to feature prominently in the centralised development of purchasing policy and practice. Under this arrangement, the Committee would see OSB's new responsibilities as including:
- joint responsibility with the Department of Finance and Administration (DoFA) for developing future versions of the Commonwealth Procurement Guidelines. OSB will have sole responsibility for drafting

part 5 of the CPGs relating to National Competitiveness and Industry Development. In addition, OSB will provide an impact assessment of how other parts of the CPGs affect small business;

- developing consultative forums to receive feedback from, and help, small business to understand Commonwealth purchasing policies;
- perform an oversight role of Commonwealth procurement focusing on its impact on small business;
- promote and assist with the management and analysis of information arising from the Purchasing Complaints and Advisory Service; and
- produce annual statistical reports showing the proportion of purchasing awarded to small and medium enterprises at the whole of government level and by agency.

4.15 The Committee believes that these measures could help to enhance the industry development objectives of government procurement policy. OSB's knowledge and relationship with small business will complement DoFA's technical knowledge of purchasing.

The need for agreed and universally applied definitions

4.16 As the inquiry progressed, it became evident that, in some areas of the purchasing framework, there was a lack of agreed and consistently applied definitions. Consistent application and use of definitions, among other things, is essential for ensuring, across agencies, comparable data collection and performance evaluation. The definitions that attracted the most confusion and inconsistency in interpretation and therefore application included definitions relating to 'small and medium enterprises' and 'Australian made'.

Small and medium enterprises

4.17 Evidence from government agencies in relation to the definition for small and medium enterprises (SMEs) indicated that there is discrepancy in the definitions that are being applied. The Department of Agriculture, Fisheries and Forestry–Australia (DAFFA) indicated that in its procurement context it had no definition of SMEs.¹² The Department of Defence, when asked whether it had a definition of small business,

¹² Mr Martin Dolan, Department of Agriculture, Fisheries and Forestry–Australia, *Transcript*, p. 465.

commented that 'we have had many over the last few years'.¹³ Centrelink indicated that it defines an SME as 'an organisation with an annual turnover of \$20 million or less, in the manufacturing sector it has fewer than 200 employees or, in the service sector, fewer than 50 employees.'¹⁴ The Australian Taxation Office (ATO) has chosen not to define small and medium enterprises, and is waiting for an appropriate policy response from government.¹⁵ The Australian Customs Service (ACS) gave a similar response.¹⁶

4.18 The Australian Bureau of Statistics applies the following broad criteria to classify data defining SMEs:

- micro business: less than 4 employees
- small business: less than 20 employees and if manufacturing, less than 100 employees
- medium business: no definition
- large business: over 200 employees and assets over \$200m¹⁷

4.19 The *Model Industry Development Criteria for Major Projects* defines small business as 'organisations employing less than 20 persons and share a number of organisational characteristics such as independently owned, financially controlled by the owner/manager, and the business operations are usually locally based'.¹⁸ For the purpose of government purchasing, small and medium sized companies are 'essentially companies employing fewer than 200 persons.'¹⁹

4.20 The OSB acknowledged that there have been problems in arriving at an effective and universally applied definition of small business. OSB indicated that it relies on the Australian Bureau of Statistics definition, shown above, which defines small business as those with fewer than 20 employees.²⁰ OSB stated:

The Office of Small Business is very keen to see a standardised definition and we have accepted the one put out by the ABS previously which was non-manufacturing 20 and under, and for

13 Mr Mark Reynolds, Department of Defence, *Transcript*, p. 415.

14 Mr Neil Goodwin, Centrelink, *Transcript*, p. 133.

15 Mr Graham Davies, Australian Taxation Office, *Transcript*, p. 140.

16 Mr Jeffrey Buckpitt, Australian Customs Service, *Transcript*, p. 161.

17 Australian Procurement and Construction Council, Australian Procurement Ministers, *National Action on Small to Medium Enterprises in Government Procurement*, Perth 1997, p. 1.

18 Department of Industry, Science and Resources, *Submission*, p. S473.

19 Department of Industry, Science and Resources, *Submission*, p. S473.

20 Ms Lesley Tannahill, Office of Small Business, Department of Employment, Workplace Relations and Small Business, *Transcript*, p. 34.

manufacturing under 100. When the Small Business Deregulation Task Force attempted to refine the definition of small business so that it would have more meaning, they took the ABS for the 20 and 100, but they also added characteristics. The characteristics were principally owner-operator and the owner injected most of the capital and it had a turnover of \$10 million. This is generally accepted as the definition of small business, but since that time the ABS has now defined all small business to be 20 and under. That is the definition that OSB accepts for small business, but there has not been an agreement on the medium sized enterprise.²¹

- 4.21 The Queensland Chamber of Commerce and Industry (QCCI) referred to the Government's commitment to source at least 10 per cent of purchases from SMEs. The QCCI commented that 'the type of small business being used to provide the 10 per cent also needed to be clarified'.²²

Australian made and Australian content

- 4.22 In the early stages of the inquiry, Commonwealth agencies were asked to provide statistical information on aspects of their industry development objectives. In particular, the CPGs include the following commitments that Commonwealth departments and agencies will:
- source at least 10 per cent of their purchasing from SMEs;
 - investigate ANZ industry capability and provide fair opportunity for suppliers to compete;
 - recognise, in assessing value for money and whole of life costs and benefits, the commercial and practical advantages of doing business with competitive ANZ industry; and
 - when purchasing overseas goods in preference to ANZ goods, must be able to demonstrate that ANZ suppliers have had a fair opportunity to compete.²³
- 4.23 Commonwealth agencies in reporting on the previous dot points need to have a definitional base which includes, among other things, 'Australian made' and 'Australian produced'. The CPGs do not include definitions on Australian made or produced. The Australian Purchasing and Supply Consultants commented that 'maximising the opportunity for Australian and New Zealand industry to compete for Government business should

21 Ms Dušanka Šabic, Office of Small Business, Department of Employment, Workplace Relations and Small Business, *Transcript*, p. 542.

22 Queensland Chamber of Commerce and Industry, *Submission*, p. S239.

23 Department of Finance and Administration, *Commonwealth Procurement Guidelines, Core Policies and Principles*, March 1998, p. 17.

be clarified to include an unambiguous definition of made in Australia'.²⁴ The ACS when asked about the information it has on Australian purchases, stated:

The difficulty goes to the definition of what is an Australian purchase. Even if we did have that definition, I would have to admit that we have not collected that type of data to date.²⁵

4.24 The majority of Commonwealth agencies examined did not retain data on the Australian produced component of their total purchases. For example, the ACS reported that no Australian content is recorded.²⁶ The ATO stated:

Although we attempt to utilise Australian made goods and services, we have no records which indicate the country of origin of purchased goods. In many cases goods which are no longer made in Australia are sold and distributed by Australian companies. Almost all the services purchased by the ATO are from Australian companies or the Australian subsidiaries of multinationals.²⁷

4.25 Some agencies were able to report information about the proportion of goods and services purchased from Australian suppliers. Environment Australia, for example, reported that 97% of suppliers were Australian, but there was no information to determine from where these suppliers were sourcing their goods and services.²⁸

4.26 The Australian National Audit Office (ANAO) noted a similar concern in its performance audit of the New Submarine Project. The ANAO found that it was difficult to determine Australian content in the project because 'the definition allowed local content to include spending on payments to companies incorporated in Australia but which might, in effect, be simply the local branch of an overseas supplier'.²⁹ The ANAO concluded that the contract for the New Submarine Project should have defined local content as work undertaken locally. On this point, the ANAO indicated that the 'ANZAC Ships contract has a better definition, that is, local content is work undertaken in Australia and New Zealand'.³⁰

24 Australian Purchasing and Supply Consultants, *Submission*, p. S98.

25 Mr Jeffrey Buckpitt, Australian Customs Service, *Transcript*, p. 157.

26 Australian Customs Service, *Submission*, p. S123.

27 Australian Taxation Office, *Submission*, p. S114.

28 Environment Australia, *Submission*, p. S270.

29 Mr Tony Minchin, Australian National Audit Office, *Transcript*, p. 116.

30 Auditor-General, *New Submarine Project*, Audit Report No. 34, 1997–98, p. 118.

4.27 The *Trade Practices Amendment (Country of Origin Representations) Act 1998* provides definitions for 'Made in', 'Produced in' or a 'Product of Australia'. The purpose of the Act is to introduce a scheme governing representations about the origin of consumer goods supplied in Australia. The then Minister for Customs and Consumer Affairs, the Hon Warren Truss, MP, in his second reading speech stated:

The Trade Practices Act will be amended to establish, for the first time, a clear general test for country of origin labelling claims. This test will apply to all representations that goods are 'made in' a particular country. A separate, higher standard will be set for goods carrying the premium 'product/produce of' label. To qualify for the 'Made in Australia' label, a product will have to be substantially transformed in Australia and at least 50 per cent of the cost of producing or manufacturing the product must have occurred in Australia...This legislation will restrict the application of 'product of/produce of' labels to goods in which all significant ingredients or components, and all or virtually all production processes, have occurred in the country of origin.³¹

4.28 The Commonwealth has developed Model Industry Development Criteria for Major Projects valued at more than \$10m. The six model industry development criteria cover the core issues agencies and departments should consider when assessing the industry development potential of a major project. Criterion 1C requires tenderers to specify the 'value and nature of the goods or services the tenderer proposes to source locally in order to undertake the project'.³² In regard to a suitable definition for 'made in Australia', the criteria state 'the recent amendments to the *Trade Practices Act 1974* should be used'.³³

Conclusions

4.29 Agreed and universally applied definitions are essential for comparability and performance assessment across agencies. The Committee's investigation revealed that amongst agencies there was inconsistency in the use of definitions, and, in some cases, uncertainty and confusion. This is further evidence in support of the fact that, in a devolved environment, there must be an effective centrally developed framework of policies and principles. In this case, an appropriate coordinating agency must be responsible for consulting, developing, circulating and monitoring the use of agreed definitions that are fundamental to the procurement function.

31 Parliamentary Debates (Hansard), House of Representatives, 8 April 1998, p. 2735.

32 Department of Industry, Science and Resources, *Submission*, p. S469.

33 Department of Industry, Science and Resources, *Submission*, p. S473.

- 4.30 In relation to definitions for small and medium enterprises (SMEs) there was variation between agencies in the definitions that were being used. The Department of Agriculture, Fisheries and Forestry — Australia indicated that it had no definition for SMEs. Similarly the Australian Taxation Office has chosen not to define it and is waiting for guidance. The Office of Small Business relies on definitions used by the Australian Bureau of Statistics, but stresses that it is keen to see a standardised definition across government.
- 4.31 The Committee maintains that agreed and universally applied definitions for small and medium enterprises should be an essential part of the Commonwealth Procurement Guidelines (CPGs). A number of objectives in the CPGs relate to SMEs. Performance assessment against these objectives will be more effective if there is comparability of definitions and recording of data across agencies. Therefore, the Committee recommends that the Department of Finance and Administration (DoFA), and the Office of Small Business develop and agree on appropriate definitions to cover small and medium enterprises and circulate this information across government for universal application. The agreed definitions should be included in the next edition of the CPGs.
- 4.32 At the conclusion of this process, the Committee expects that all agencies should be using the same definition. The Australian National Audit Office should, in any relevant performance audits, assess whether agencies are complying with the use of agreed definitions.
- 4.33 In relation to definitions relating to Australian made and Australian content, again there was some confusion. These are essential definitions and relate to the industry development objective of government procurement in seeking to develop Australian New Zealand (ANZ) industry. Commonwealth agencies were, generally, able to report on the proportion of suppliers that were ANZ industry. Although all agencies that were asked could not provide detailed information on the country of origin from where goods and services were sourced. Most agencies suggested that it would be too costly and resource intensive to monitor all their contracts and report on the country of origin of goods and services.
- 4.34 The Committee is taking a realistic view on the monitoring and reporting of Australian content. There is a need for agencies to collect more informative data on Australian content. The Committee suggests that the tests for ‘made in’, ‘produced in’ and a ‘product of Australia’ as used in the *Trade Practices Amendment (Country of Origin Representations) Act 1998* are appropriate and should be used. Agencies must ensure that their procurement contracts are drafted appropriately and include relevant clauses supporting Australian content. Next, the Committee does not expect agencies to monitor the local content provisions of all their

contracts, but local content monitoring must be given the same regard as other aspects of contract management. Agencies should create a culture in which there is an expectation that all contracts are subject to random review and there will be penalties for non-compliance with aspects of a contract.

Recommendation 5

- 4.35 **The Department of Finance and Administration and the Office of Small Business develop and agree on appropriate definitions to cover small and medium enterprises, and circulate this information across government for universal application. The agreed definitions should be included in the next edition of the Commonwealth Procurement Guidelines.**

The 10% SME commitment

- 4.36 The Commonwealth Procurement Guidelines (CPGs) state the government's commitment 'that Commonwealth departments and agencies will source at least 10% of their purchasing from SMEs.'³⁴ In June 1997, the OSB and DoFA commissioned Dun and Bradstreet to determine how much Government purchasing was being awarded to SMEs. The key findings of the survey were:

- In 1995–96 Commonwealth departments and agencies sourced 24.4% of their purchases from SMEs³⁵, with more than \$1.8 billion of Federal purchasing expenditure going to SMEs'; and
- For 1996–97 the figure were 33.9% and \$1.595 billion respectively.³⁶

- 4.37 The OSB proposed that the figure of 10% be increased and stated:

Given the relative ease with which Commonwealth departments and agencies have achieved the current commitment, the OSB submits therefore that small business should be awarded a greater share of Government business that more closely reflects its

34 Department of Finance and Administration, *Commonwealth Procurement Guidelines, Core Policies and Principles*, March 1998, p. 18.

35 In this study, the definition for SMEs was taken from the *Model Industry Development Criteria Guidance Notes* which are outlined at paragraph 4.19.

36 OSB, *Submission*, p. S312.

proportionately high representation of the total number of Australian businesses.³⁷

4.38 The OSB has proposed the revised targets:

- small business (less than 20 employees) 15%
- small and medium sized enterprises 20%³⁸

Economic and industry issues

4.39 Some theoretical arguments introduce a cautionary note on the role of government procurement in domestic industry development. The theory suggests that preferential treatment for domestic industry can lead to inefficiencies and misallocation of resources which ultimately impact on national competitiveness. Porter states:

The government market becomes the focus of attention, and domestic firms lobby for unusual product standards or other regulations to freeze out international rivals. Exclusion of foreign suppliers is supposed to help domestic firms. In fact, the result in most industries is that innovation and upgrading by domestic firms slows down. Their products and services diverge in quality, features, and cost from those demanded internationally. Domestic firms are then unable to compete in international markets, and even more blatant favouritism at home becomes necessary to support them.³⁹

4.40 In order to avoid the previous negative consequences, Porter suggested that government procurement can be a positive force for upgrading national competitive advantage under the following circumstances:

- *Early demand.* Government procurement should provide early demand for advanced new products or services, pushing its local suppliers into new areas.
- *Demand and sophisticated buyers.* Government agencies should set stringent product specifications and seek sophisticated product varieties rather than merely accept what domestic suppliers offer.
- *Procurement reflecting international needs.* Government procurement that makes innovation easier works to the benefit of a nation's industry.

37 OSB, *Submission*, p. S313.

38 OSB, *Submission*, p. S313.

39 Porter, M.E., *The Competitive Advantage of Nations*, MacMillan, 1990, p. 645.

- *Competition.* Government procurement must include a strong element of competition if it is to upgrade the local industry.⁴⁰

4.41 In 1981 the House of Representatives Standing Committee on Expenditure (the Expenditure Committee) examined the issue of preferential treatment for Australian made goods.⁴¹ Preferential treatment for Australian industry was provided for under the *Preference to Australian Goods (Commonwealth Authorities) Act 1980*. The preferential arrangements included:

- for purchases of value \$10 000 or less: 20% is to be added to the duty-paid tender price of imported goods and the tender with the lowest adjusted tender price is to be accepted whether this is Australian or otherwise. The effect is to give Australian goods a 20% margin of preference;
- for purchases of value \$10 001–\$99 999: 20% of the value of Australian content, defined as duty-paid tender price less the duty-paid value of imported goods and services, is to be deducted from each actual tender price. The tender with lowest adjusted tender price is to be accepted, unless special reasons exist for doing otherwise, even if this is not the tender with the highest Australian content. The effect is to give Australia content a 25% margin of preference.
- for purchases of value \$100 000 or greater: The same adjustment as in the previous dot point is to be made to arrive at an adjusted tender price. However, if on this basis a tender with higher Australian content would be excluded, the decision is to be referred to Ministers for consideration. Australian content is thus to be given a minimum margin of preference of 25%.⁴²

4.42 In 1981 the *Preference to Australian Goods (Commonwealth Authorities) Act 1980* was retitled and called the *Procurement of Goods, Works and Services Act 1981*.⁴³ In 1990 this Act was repealed and replaced with a non-discriminatory policy.⁴⁴ The repeal of the Procurement of Goods, Works and Services Act was not opposed. The then Member for Eden-Monaro, Mr Jim Snow stated:

40 Porter, M.E., *The Competitive Advantage of Nations*, p. 645.

41 House of Representatives Standing Committee on Expenditure, *Commonwealth Government Procurement*, Parliamentary Paper No. 107/1981, AGPS, Canberra, May 1981, pp. 39–47.

42 House of Representatives Standing Committee on Expenditure, *Commonwealth Government Procurement*, p. 39.

43 Amendment of title was made under the *Commonwealth Functions (Statutes Review) Act 1981*.

44 Repeal Act was the *Administrative Services Legislation Amendment Act 1990*.

Preference for Australian goods per se can encourage mediocrity. If a firm is assured of its sales, whether to the Australian Government or to anyone else, it is less stringent in terms of the quality of its service and the way in which it keeps down costs. We often found in the old sad days of protection that the domestic price of goods could be taken close to the overseas price, even with tariffs, of imported goods.⁴⁵

- 4.43 The Expenditure Committee considered the measures in the Preference to Australian Goods (Commonwealth Authorities) Act to be ‘more-or-less identical to a wide variety of protection policies promoted through tariffs, subsidies and tax concessions.’⁴⁶ The Expenditure Committee noted its concern with the costs associated with these preferential policies relating to procurement. First was the direct financial cost to the public sector of acquiring its inputs. The next concern related to resource allocation issues. The Expenditure Committee stated:

There is, moreover, a cost in terms of resource allocation. The structure of Australian industry, and employment is further changed from what it would be in the absence of protection, which, it is generally agreed, does have a cost in terms of potential real income foregone. The form of protection is not subject to the scrutiny of the government’s adviser on assistance to industry, the Industries Assistance Commission, and it may well involve increasing short-term support for industries that government policy would want to have reduced support in the long-term. This suggests another form of cost to be set against the benefits, but is a cost which is extremely hard to measure.⁴⁷

- 4.44 The Bevis Report also commented on preferential purchasing policies stating that ‘where switching to local content involves paying more for a local product, either directly or indirectly through a preference margin or quota, this can lead to the misallocation of resources across industry sectors and the potential development of uncompetitive local suppliers.’⁴⁸ The Bevis Report, however, disagreed with the assertion by Treasury that ‘where local suppliers are comparable to overseas suppliers in terms of

45 Parliamentary Debates, (Hansard), House of Representatives, 22 August 1990, p. 1272.

46 House of Representatives Standing Committee on Expenditure, *Commonwealth Government Procurement*, p. 41.

47 House of Representatives Standing Committee on Expenditure, *Commonwealth Government Procurement*, p. 41.

48 House of Representative Standing Committee on Industry, Science and Technology, *Australian Government Purchasing Policies: Buying our Future*, First Report, AGPS, Canberra, March 1994, p. 16.

cost and quality, Treasury considers that the 'opportunity' cost of resources may be a factor against encouraging increased local content.'⁴⁹

- 4.45 In the current inquiry, Australian Paper criticised the removal of Australian preference margins claiming that this has disadvantaged the Australian printing and writing papers industry.⁵⁰ Australian Paper commented that in view of the procurement practices of other countries, 'there is sufficient justification for Australia to re-introduce preference margins.'⁵¹
- 4.46 The Expenditure Committee did not receive detailed evidence on the costs associated with the preferential policies of the time. To address this dearth of information, the Expenditure Committee recommended that 'procedures be established for the regular collection, from all departments and authorities, of data on the additional costs incurred by the Commonwealth as a result of the application of the policy of Australian preference.'⁵²
- 4.47 In relation to the benefits of preferential policies relating to procurement, again there was a lack of information. The Expenditure Committee sought information showing the impact of the purchasing preference policies on national employment, output, productivity and balance of payments. The Expenditure Committee requested relevant economic and finance departments to provide evidence on this matter, but they were 'obliged to admit that the impact of the preference policy on its objectives is unknown and they thought, maybe unknowable'.⁵³ In conclusion, the Expenditure Committee concluded that:

...the present policy may not be highly effective. The extra protection offered by Australian preference is small in aggregate, discriminates in favour of industries relatively heavily involved in supplying government, and does not focus specifically on employment. It does not appear, however, that the policy has been subject to any form of in-depth review designed, in particular, to

49 House of Representative Standing Committee on Industry, Science and Technology, *Australian Government Purchasing Policies: Buying our Future*, p. 18.

50 Australian Paper, *Submission*, pp. S182-183.

51 Australian Paper, *Submission*, p. S183.

52 House of Representatives Standing Committee on Expenditure, *Commonwealth Government Procurement*, p. 44.

53 House of Representatives Standing Committee on Expenditure, *Commonwealth Government Procurement*, p. 42.

assess whether the extra outlay involved could be used in other ways that would increase their impact on output and employment.⁵⁴

- 4.48 Over 10 years later, the Bevis Report would be dealing with similar issues.⁵⁵ In relation to the economic benefits of government procurement in general, the Bevis Report stated that it ‘was surprised to find that little evidence was available, or had been sought by government policy organisations on the investment and employment multipliers associated with increasing local procurement.’⁵⁶
- 4.49 In the current inquiry, there was also limited information on the economic and labour market benefits arising from government procurement. What was provided came from a non-government organisation. In 1998 ISONET commissioned research on the economic impact of government purchasing on Australian industry development. ISONET commented that ‘the results indicated that for every dollar spent on new or retained manufacturing business output, benefits flow not only from increases in manufacturing activity, but also from Australian industries that provide inputs into manufacturing activity and from industries meeting the consumption demands resulting from more jobs, wages and salaries.’⁵⁷

International comparisons

- 4.50 The Bevis Report included a brief compilation of overseas government purchasing policies and practices.⁵⁸ Some of the countries reviewed included the United States, Canada, the European Community, Japan, Taiwan and Indonesia.
- 4.51 An examination of the United States provides an opportunity to critically examine the Buy American Act which was first enacted by the 72nd Congress in 1933. The sole intent of the law was job protection which was achieved through requiring federal agencies to spend appropriate funds on only domestic materials unless the materials needed are:
- not available domestically;
 - their purchase domestically would not be in the public interest; or

54 House of Representatives Standing Committee on Expenditure, *Commonwealth Government Procurement*, p. 44.

55 House of Representative Standing Committee on Industry, Science and Technology, *Australian Government Purchasing Policies: Buying our Future*.

56 House of Representative Standing Committee on Industry, Science and Technology, *Australian Government Purchasing Policies: Buying our Future*, p. xiii.

57 ISONET, *Submission*, p. S260.

58 House of Representative Standing Committee on Industry, Science and Technology, *Australian Government Purchasing Policies: Buying our Future*, pp. 164–167.

- their cost, domestically, would be unreasonable.⁵⁹
- 4.52 In 1979 the Buy American Act was challenged by measures introduced in the Trade Agreement Act of 1979. This Act was created because the US became a signatory to the Agreement on Government Procurement which was one element of the Tokyo round of the General Agreement on Tariffs and Trade. The Agreement on Government Procurement provides for equal treatment between domestic and foreign suppliers for the provision of goods to government. The agreement excluded the treatment of services.⁶⁰
- 4.53 In 1980 an assessment of the cost of protectionist policies on the US economy was undertaken. Goehle states:
- ...the direct cost of all American protectionist policies to US consumers was estimated to be \$58.4 billion (\$255 per person). Of that total, tariffs were the cause of \$45.8 billion, or 78%. The Buy American Act and quotas, voluntary marketing agreements, and regulation barriers made up the remaining 22%.⁶¹
- 4.54 Notwithstanding these costs, Goehle reports that the 'Congress in response to various lobbies and other influences, continues to require compliance to the Buy American Act.'⁶² However, the operation of the Act is becoming more difficult with the rise of multinational companies that make it difficult to define 'nationality'. The Buy American Act does not deal with the issues of foreign ownership or foreign firms manufacturing in the US. Under these situations the original intent of the Act being job protection is not compromised. In 1989, Goehle concluded:
- ...the Buy American Act is still operating, and could even be enlarged to address concerns over foreign influences in the US economy. In any event, the law will surely remain on the books and will continue to have significant implications for both domestic and foreign firms and governments, despite the fact that internationalisation will continue to make it harder to define the nationality of a product or service.⁶³

59 Goehle, D.G., 'The Buy American Act: Is it Irrelevant in a World of Multinational Corporations', *The Columbia Journal of World Business*, Vol. 24, No. 4, Winter 1989, p. 11.

60 Goehle, D.G., 'The Buy American Act: Is it Irrelevant in a World of Multinational Corporations', p. 12.

61 Goehle, D.G., 'The Buy American Act: Is it Irrelevant in a World of Multinational Corporations', p. 12.

62 Goehle, D.G., 'The Buy American Act: Is it Irrelevant in a World of Multinational Corporations', p. 12.

63 Goehle, D.G., 'The Buy American Act: Is it Irrelevant in a World of Multinational Corporations', p. 15.

Conclusions

- 4.55 Statistics compiled by Dunn and Bradstreet show that the government's commitment to source at least 10 per cent of their purchases from small and medium enterprises (SMEs) has been achieved. In 1995–96 Commonwealth departments and agencies sourced 24.4% of their purchases from SMEs, with more than \$1.8 billion of Federal purchasing expenditure going to SMEs. For 1996–97 the figures were 33.9% and \$1.595 billion respectively. The Office of Small Business has proposed that the 10 per cent commitment be increased to 15 per cent for small business and 20 per cent for small and medium sized enterprises.
- 4.56 The Committee notes the performance of Commonwealth agencies against the 10 per cent commitment. In view of this and the proposal by OSB, the Committee recommends that the Government upgrade its commitment so that Commonwealth departments and agencies will source at least 20 per cent of their purchases from SMEs.
- 4.57 In making this recommendation, the Committee is aware of the recent history of Australian Government procurement and, in particular, preferential treatment and its implications for national competitiveness. The Government's current commitment that agencies should source at least 10% of their purchases from ANZ SMEs, and the Committee's recommended increases, are not preferential policies.
- 4.58 The Committee interprets the 10% commitment as a target that agencies should seek to achieve after applying the principles of value for money and open and effective competition. Agencies should seek to achieve the 10% commitment through non-discriminatory means. This includes being proactive in informing and educating SMEs in available purchasing opportunities and encouraging suppliers, as appropriate, to improve their performance in terms of cost, quality, time and responsiveness. The Commonwealth Procurement Guidelines include a series of measures that agencies should apply in seeking to increase ANZ industry development. The Committee does not support preference margins like those that existed in the repealed *Procurement of Goods, Works and Services Act 1981*. These policies were flawed and did nothing to promote national competitiveness. The Committee, however, does support the principle raised by other Parliamentary Committees that where ANZ products are equal to overseas items in terms of value for money and other principles in the Commonwealth Procurement Guidelines, then the ANZ products must be purchased.

Recommendation 6

- 4.59 That the Government upgrade its commitment so that Commonwealth departments and agencies will source at least 20 per cent of their purchases from SMEs.

Recommendation 7

- 4.60 That where Australian–New Zealand (ANZ) products are equal to overseas items in terms of value for money and other principles in the Commonwealth Procurement Guidelines, then the ANZ products must be purchased.

Industry development criteria for \$10m projects

- 4.61 The Commonwealth Procurement Guidelines (CPGs) include instructions for major procurement projects of \$10 million or more. In managing projects of this size, agencies are ‘required to identify clearly in tender documentation any industry development criteria and associated evaluation methodology and, where appropriate, opportunities for SME participation.’⁶⁴ In addition, agencies ‘should consider and, where appropriate, use as part of the tender documentation the model industry development criteria to be developed by the Minister for Finance and Administration; the Minister for Industry, Science and Tourism; and the Minister for Workplace Relations and Small Business’.⁶⁵
- 4.62 *Model Industry Development Criteria For Major Projects, Guidance Notes* (the Guidance Notes) were released in February 1999. The Guidance Notes are divided into two parts. Part I sets out six core industry development criteria that Commonwealth departments and agencies should consider when determining the industry development criteria for tender documentation. The six criteria include:
1. Development of long-term, internationally competitive industry in Australia

64 Department of Finance and Administration, *Commonwealth Procurement Guidelines, Core Policies and Principles*, March 1998, p. 18.

65 Department of Finance and Administration, *Commonwealth Procurement Guidelines, Core Policies and Principles*, March 1998, p. 18.

- a. Commitment to sustainable long-term industry development
 - b. Development of long-term, strategic alliances between local companies and companies that operate in global markets
 - c. Enhancement of Australia's export potential and/or import replacement
2. Value adding activity
 3. Opportunities for participation by Small and Medium Enterprises
 4. Existing industry development activity and proposed new investment
 5. Innovation, research and development
 6. Employment, training and skills development, and initiatives in regional areas⁶⁶

4.63 In relation to the third criteria, the Guidance Notes state:

SMEs make a significant contribution to the Australian economy, delivering flexible, innovative solutions and job creation. The supply of goods and services to Commonwealth departments and agencies presents a valuable business opportunity for SMEs. Even on major projects SMEs may make a major contribution through partnering arrangements or as sub-contractors to big business. The Government is committed to ensuring there are opportunities for SMEs, either as prime contractors or sub-contractors, to participate in government purchasing activity and that they are not discriminated against in securing government contracts.⁶⁷

4.64 Part II of the Guidance Notes provide a methodology to assist government purchasing officers to evaluate tenders against the industry development requirements that have been set for a particular contract. The industry development requirements are applicable to agencies and departments that come under the *Financial Management and Accountability Act 1997*. The Department of Defence and AusAid have their own industry development programs.⁶⁸ Under each of the industry development criteria in Part I of the Guidance Notes, tenderers are expected to demonstrate how they will satisfy the criteria. For example, under criterion 3, 'the evaluation will favour tenderers that are prepared to contractually commit to using nominated SMEs and the value of the work that will flow through to

66 Department of Industry, Science and Resources, *Submission*, p. S468.

67 Department of Industry, Science and Resources, *Submission*, p. S468.

68 Department of Industry, Science and Resources, *Submission*, p. S465.

SMEs.⁶⁹ If a tenderer ceases a relationship with an SME nominated in the tender then they must notify the relevant Commonwealth agency and show evidence of a new relationship with another SME.

4.65 The Guidance Notes advise agencies to establish mechanisms to monitor compliance of successful tenderers' industry development commitments. The following principles are suggested for evaluating a broad range of contracts:

- set objectives for assessing tenders, and the milestones to be reported against;
- use surveys, polls or audits to gather information on an organisation's performance;
- analyse statistical and qualitative information to establish any trends or other findings;
- prepare an evaluation report, including recommendations where appropriate, that accurately reflects the survey results; and
- present the report, discuss its recommendations and take any appropriate action.⁷⁰

4.66 The Guidance Notes also include instructions in the event that a tenderer does not comply with their industry development commitments. Agencies are advised to include the following types of remedial action in their contracts:

- a formal warning that continued non-compliance will lead to sanctions;
- exclusion from tendering for contracts for a specified period or above a certain amount;
- agreed public reporting or progress against industry development requirements; and
- liquidated damages clauses.⁷¹

4.67 In relation to compliance requirements, the Guidance Notes state:

Agencies should ensure that compliance arrangements are established as a condition of the tendering process and that prospective tenderers understand how any liquidated damages would operate in the event of a breach of contract. Dollar amounts

69 Department of Industry, Science and Resources, *Submission*, p. S470.

70 Department of Industry, Science and Resources, *Submission*, p. S472.

71 Department of Industry, Science and Resources, *Submission*, p. S472.

should be specified in each tender to indicate the amount(s) payable to the Commonwealth in the event that specific commitments are not met.⁷²

- 4.68 Evidence to the Committee regarding the use of industry development criteria for projects of \$10 million or more focused on the appropriateness of the dollar level at which the industry criteria should apply. Australian Business disagreed with the \$10m threshold commenting that ‘smaller Government procurement contracts can have significant impact on industry development’.⁷³ Australian Business called for the removal of the threshold so that ‘smaller suppliers substantiate the importance of a particular purchase to the development of their industry.’⁷⁴ A delegation from Australian Business and the Australian Chamber of Commerce and Industry stated:

One of those particular areas is the idea that industry development criteria should only be applied to projects with a minimum threshold of \$10 million. We think that contracts much smaller than that can have a very significant industry development opportunity and there should be some mechanism allowed for it, whereby industry itself substantiates the importance of this particular purchase for the development of their industry. That should be taken into account rather than just the blanket, ‘Below \$10 million it does not come into account’.⁷⁵

- 4.69 Australian Business pointed out that, from an Australian industry development perspective, tenders of the order of \$1 to \$2 million can have a significant impact in regional areas.⁷⁶
- 4.70 The Department of Defence, which is not subject to the model industry development criteria, has mandated Australian industry programs for purchases which exceed \$5 million.⁷⁷
- 4.71 The Office of Small Business (OSB) suggested that the \$10 million threshold was too high and commented ‘that a system be developed to ensure industry development for the high volume of purchases below the current \$10 million threshold for industry development’.⁷⁸

72 Department of Industry, Science and Resources, *Submission*, p. S472.

73 Australian Business, *Submission*, p. S330.

74 Australian Business, *Submission*, p. S330.

75 Mr Graham Chalker, Australian Business, *Transcript*, p. 311.

76 Mr Peter Anderson, Australian Business, *Transcript*, p. 530.

77 Dr Graham Kearns, Department of Defence, *Transcript*, p. 408.

78 OSB, *Submission*, p. S330.

- 4.72 The Department of Industry, Science and Resources defended the current \$10 million threshold and stated:

We thought it was a satisfactory level to capture major purchases. The decision that we have to make is at what level to target our efforts—where we actually get the best return on targeting our efforts. Purchases above \$10 million did seem to us to be reasonably significant. The majority of purchases that we have dealt with under major projects have been significantly above that.⁷⁹

- 4.73 Australia Post pointed out that it is required to prepare Industry Impact Statements (IIS) for projects over \$30 million. Between 1994 and 1996 agencies, authorities and Commonwealth companies were required to prepare IIS for projects valued at over \$10 million. This requirement was an extension of an earlier decision that Government Business Enterprises prepare IIS for projects over \$30 million.⁸⁰ The Department of Industry, Science and Tourism (DISR) commented that the purpose of preparing IIS was ‘to help government buyers identify possible opportunities for industry development early in their procurement processes, and prior to a major contract going to tender.’⁸¹ DISR stated:

Generic criteria, including the potential for increasing exports, involving SMEs or developing strategic or international alliances, were developed to assist agencies to identify possible industry development opportunities. Agencies were also encouraged to seek the advice of the Industrial Supplies Office network to help them identify Australian industry capabilities.⁸²

- 4.74 DISR reported that the IIS system ‘was in place for only a limited time and related to a small number of purchases across a wide range of sectors’.⁸³ The system did not lead to long-term benefits and, therefore, was terminated in relation to agencies and departments under the *Financial Management and Accountability Act 1997*.

79 Ms Patricia Kelly, Department of Industry, Science and Resources, *Transcript*, p. 428.

80 Department of Industry, Science and Tourism, *Submission*, p. S450.

81 Department of Industry, Science and Tourism, *Submission*, p. S450.

82 Department of Industry, Science and Tourism, *Submission*, p. S450.

83 Department of Industry, Science and Tourism, *Submission*, p. S451.

- 4.75 Australia Post indicated that preparing IIS for those projects that exceed \$30 million is 'time consuming and expensive' with three months required to undertake the necessary work. Australia Post, therefore, warned against lowering the current threshold for GBEs commenting that 'lowering the floor would make it more difficult to operate efficiently in an increasingly competitive business environment.'⁸⁴

Conclusions

- 4.76 For major procurement projects of \$10 million or more, Commonwealth agencies that come under the *Financial Management and Accountability Act 1997* are required to apply industry development criteria. The Department of Defence and AusAid are excluded from this requirement as they have developed their own industry development criteria.
- 4.77 Model Industry Development Criteria have been developed which set out six key industry development criteria for tender documentation. The model criteria provide guidance notes to assess tenderers against each criterion, mechanisms to monitor compliance of the successful tenderer against industry development commitments, and instructions in the event that a tenderer does not comply with their industry development criteria.
- 4.78 The focus of concern in the inquiry was the appropriateness of the \$10 million threshold. Australian Business and the Australian Chamber of Commerce and Industry suggested that the \$10 million threshold was too high and there were opportunities for Australian industry development outcomes with smaller contracts. For example, these groups suggested that tenders of the order of \$1 to \$2 million can have significant impact in regional areas.
- 4.79 The Office of Small Business also suggested that the \$10 million threshold was too high and proposed that a system be developed to ensure industry development for the high volume of purchases below the current threshold. Australia Post noted that Commonwealth Government Business Enterprises are subject to a \$30 million threshold for industry impact statements. Australia Post warned against lowering this amount because of the additional cost and time that would accrue in having to develop industry impact statements.
- 4.80 The Committee is encouraged by the development of the *Model Industry Development Criteria for Major Projects, Guidance Notes*, and its goals and objectives. The Guidance Notes provide a clear framework for agencies to maximise opportunities for Australian Industry. Further, the Guidance

Notes provide advice on assessing tenderers against the criteria, monitoring, and compliance against Australian industry commitments.

- 4.81 The information and requirements in the Guidance Notes do, however, lose their influence because the threshold is too high. It is possible that more could be gained for Australian industry and the quality of government procurement from lowering the threshold such that the Model Industry Development Criteria apply to smaller value tenders. Therefore, the Committee recommends that, for agencies under the *Financial Management and Accountability Act 1997, Model Industry Development Criteria for Major Projects* should apply to procurement projects of \$5 million or more. The Committee notes that the Department of Defence is already using a threshold of \$5 million.
- 4.82 The Committee notes Australia Post's concerns regarding the \$30 million threshold for GBEs. The cost and time of applying Australian industry development criteria is noted, together with the market competition faced by some GBEs. However, weighted against this is the industry development outcomes that could accrue for Australian industry. No detailed costs and benefits have been provided to the Committee for it to consider, in detail, both sides of this argument. In view of this, the Committee suggests that the Minister for Communications, Information Technology and the Arts, and the Minister for Finance and Administration review the \$30 million level for Australia Post at which Industry Impact Statements must be applied. In conducting this review the Ministers should focus on selecting a threshold which maximises Australian industry development.

Recommendation 8

- 4.83 **That, for agencies under the *Financial Management and Accountability Act 1997, Model Industry Development Criteria for Major Projects* should apply to procurement projects of \$5 million or more.**

Mega-contracting

- 4.84 Some industry groups reported that certain tender processes may be disadvantaging SMEs. Most concerns focused on the practice of 'mega contracting'. This occurs when a single large supplier provides a range of goods and services to an agency. The Australian Chamber of Commerce and Industry (ACCI) claims that mega-contracting has led to small business becoming entirely reliant on sub-contracting as a source of

business. However, the ACCI claims that 'many contracts are being won by consortiums dominated by multinational enterprises that have no connections with, or interest in, smaller Australian enterprises looking for sub-contracts, particularly in regional areas.'⁸⁵

4.85 The Commercial Furniture and Industry Association reported that there was a trend by Commonwealth agencies to group together in the one tender dissimilar products such as stationary and furniture. The implication was that it was unlikely that ANZ SMEs could fulfil the requirements of such a disparate tender.⁸⁶

4.86 The Department of Industry, Science and Resources (DISR) was asked about the implications of the trend towards mega-contracting by government agencies. DISR responded in a general sense that 'in the procurement guidelines themselves there is a stipulation that agencies should not specify things in such a way as to make it difficult or impossible for Australian suppliers or SMEs to tender.'⁸⁷ The relevant parts of the CPGs state:

- agencies should ensure that they provide opportunities for Australian and New Zealand industry, particularly small to medium enterprises, to provide a competitive offer or proposal; and
- when setting selection criteria, agencies should ensure that they encourage participation by SMEs as direct suppliers or as subcontractors. Unless there is a strong reason to do otherwise, agencies should not attribute weightings to particular criteria that might discriminate against small business.'⁸⁸

4.87 The issue of mega-contracting and its effects on SMEs was discussed at a meeting of Procurement and Construction Ministers in Perth on 8 August 1997. It was acknowledged that public sector buying was changing rapidly, and consequently 'this change is influencing the role, scope, scale and impact of government buying with a significant effect on SMEs seeking to supply to government.'⁸⁹ The Procurement Ministers identified the following challenges for SMEs when doing business with government:

85 Australian Chamber of Commerce and Industry, *Submission*, p. S320.

86 Mrs Genevieve Power, Commercial Furniture Industry Association of Australia, *Transcript*, p. 302.

87 Ms Patricia Kelly, Department of Industry, Science and Resources, *Transcript*, p. 429.

88 Department of Finance and Administration, *Commonwealth Procurement Guidelines, Core Policies and Principles*, March 1998, p. 7 and 18.

89 Meeting of Procurement and Construction Ministers, Australian Procurement & Construction Council, *National Action on Small to Medium Enterprises in Government Procurement*, Perth, 1997, p. 1.

- a reduction in the direct purchasing of goods by government, until recently a prime market for SMEs, which has resulted from outsourcing of large scale services;
- increased efficiency by governments through rationalisations to reduce time and complexities in the management of contracts, subsequently limiting potential contractors to those offering a broad range of goods, or services on a larger scale;
- partnering arrangements and strategic alliances with larger organisations able to meet a broad range of government needs. SME access to government contracts in such arrangements tends to focus on sub-contracting relationships;
- variations in government procedures, within and between jurisdictions, that appear complex to suppliers with limited resources to devote to tender preparation; and
- the increased use of electronic commerce to simplify processes within government, can inhibit SME access due to initial costs for equipment and low transaction frequency.⁹⁰

4.88 In view of these concerns, the Procurement Ministers agreed to promote measures that:

- reduce the cost of doing business for SMEs and for government;
- encourage greater participation by SMEs in the contract chain;
 - ⇒ ensuring that SMEs are made aware of the opportunities and the benefits of subcontracting to primary suppliers;
 - ⇒ encouraging the formation of joint ventures, consortia or partnerships which might enable SMEs to join the contract chain at the prime or subcontracting levels;
 - ⇒ assisting SMEs to enhance their commercial skills to enable them to identify suitable subcontracting opportunities and to compete successfully for them;
 - ⇒ encouraging prime contractors to identify contract components which might be subcontracted out to their own advantage;
- promote the benefits to SMEs of the use of electronic commerce; and
- give greater consideration to the regional impact of government procurement decision making.⁹¹

90 Meeting of Procurement and Construction Ministers, Australian Procurement & Construction Council, *National Action on Small to Medium Enterprises in Government Procurement*, p. 1.

91 Meeting of Procurement and Construction Ministers, Australian Procurement & Construction Council, *National Action on Small to Medium Enterprises in Government Procurement*, p. 3.

Conclusions

- 4.89 Evidence to the inquiry suggested that public sector buying was tending towards mega-contracts whereby a single supplier provides a range of goods and services to an agency. The Australian Chamber of Commerce and Industry suggested this could have significant implications for Australian SMEs when contracts were won by multi-national enterprises that have no connections with, or interest in, smaller Australian enterprises seeking to sub-contract.
- 4.90 In August 1997, Procurement and Construction Ministers noted that changes in public sector buying were influencing the role, scope, scale and impact of government buying with a significant effect on SMEs seeking to supply to government. The Procurement Ministers encouraged greater participation by SMEs in the contract chain.
- 4.91 The Committee supports measures promoted by Procurement Ministers, and reminds Commonwealth agencies of their responsibility to encourage participation by SMEs as direct suppliers or as subcontractors. Agencies should, therefore, seek to develop initiatives that will enhance opportunities for Australian New Zealand SMEs. This will include greater use of contractual requirements on contractors to include ANZ SME participation. The Model Industry Development Criteria should be used for this purpose.
- 4.92 The Committee asserts that analytical information is needed regarding market patterns and trends in government buying. This would provide indicative information on how market conditions are affecting Australian and New Zealand SMEs. With this information, government will be able to develop more effective strategies to maximise opportunities for ANZ SMEs. The Committee, therefore, recommends that the Office of Small Business and the Department of Industry, Science and Resources conduct research into Commonwealth Government buying trends and their implications for Australian New Zealand small and medium enterprises.

Recommendation 9

- 4.93 **That the Office of Small Business and the Department of Industry, Science and Resources conduct research into Commonwealth Government buying trends and their implications for Australian New Zealand small and medium enterprises.**

ISONETS

4.94 The CPGs states that the 'Industrial Supplies Office network (ISONET) can help buyers, both government and non-government, to identify capable ANZ suppliers, especially SMEs.'⁹² ISONET Ltd is a company funded by the Commonwealth Government through the Department of Industry, Science and Resources. ISONET's key objectives include:

- to provide and facilitate the supply of Australian/New Zealand products and services to the Commonwealth and New Zealand Government and their agencies; and
- to promote and facilitate Australian industry participation in the supply of products and services to major procurement projects and other resources and construction projects of national significance and those sponsored by the Australian Government.⁹³

4.95 ISONET stated:

Since its formation, ISONET has been instrumental in promoting and fostering a more cohesive ISO network, with the ability to provide a national response to enquiries about ANZ industry capability. ISONET has introduced across the network a common and consistent database of industry capability, synchronised daily to ensure up to date information is available to network offices. ISONET coordinated the national activities of the ISO network, and facilitates linkages with major project developers to ensure maximum opportunity is given to local producers to supply those projects through early involvement in project development.⁹⁴

4.96 The Committee sought to establish the extent to which agencies are using the services of ISONETS. Most agencies responded that they had signed memorandum of understandings with ISONET. However, representatives from ISONET reported that Commonwealth agencies, excluding the Department of Defence, did not seek out their services to any great extent. ISONET stated:

...we do not get the same response from the departments because the departments do not bring us in—with the exception of Defence—to be involved in the development of those major

92 Department of Finance and Administration, *Commonwealth Procurement Guidelines, Core Policies and Principles*, March 1998, p. 18.

93 ISONET, *Submission*, p. S258.

94 ISONET, *Submission*, p. S258.

projects or procurement projects as they are starting to move down the path.⁹⁵

- 4.97 When ISONET was asked why agencies had a low response rate, a definitive answer was not available. DISR advised that there has not been any systematic monitoring of the quality and effectiveness of the working relationship between Commonwealth agencies and ISONET.⁹⁶

Conclusions

- 4.98 The Committee supports the role and work of the Industrial Supplies Office Network (ISONET). Commonwealth agencies, in promoting Australian New Zealand industry, should wherever possible use the services provided by ISONET. However, ISONET did not indicate, apart from the Department of Defence, that it was having a productive relationship with Commonwealth agencies.
- 4.99 In order to rectify this situation, the Committee recommends that all Commonwealth agencies, if they have not already done so, sign a memorandum of understanding (MOU) with ISONET. This MOU, among other things, must guarantee lines of communication between the agency and ISONET, and include commitments to maximising the involvement of ISONET in the purchasing process. An agency will be expected to include, in its Annual Report, confirmation of its MOU, initiatives that it will be taking to increase the involvement of ISONET in agency procurement, and an appraisal by ISONET of the agency's performance against objectives set out in the MOU. This will provide ISONET with an opportunity to report on the performance of Commonwealth agencies and provide further information for parliamentary scrutiny of agency performance.
- 4.100 In addition, the Department of Finance and Administration should amend the Commonwealth Purchasing Guidelines to reflect the need for all agencies to sign an MOU with ISONET, and to develop initiatives to maximise the involvement of ISONET in agency procurement.

95 Mr David McLachlan, ISONET Ltd. *Transcript*, p. 51.

96 Ms Patricia Kelly, Department of Industry, Science and Resources, *Transcript*, pp. 430–431.

Recommendation 10

4.101 That all Commonwealth agencies, if they have not already done so, sign a memorandum of understanding (MOU) with ISONET. This MOU, among other things, must:

- guarantee lines of communication between agencies and ISONET; and
- include commitments to maximising the involvement of ISONET in the purchasing process.

An agency will be expected to include, in its Annual Report, confirmation of its MOU, initiatives that it will be taking to increase the involvement of ISONET in its procurement, and an appraisal by ISONET of the agency's performance against objectives set out in the MOU.

The Defence and industry strategic policy statement

4.102 The Department of Defence (Defence) generally accounts for over half of all Commonwealth purchasing by Budget funded agencies. In 1997–98, the value of purchasing by Defence was \$5.5 billion which accounted for 62.5% of the total value of purchasing by the Commonwealth exclusive of government business enterprises. In view of this information, an examination of Defence's policies and processes is required.

4.103 The *Defence and Industry Strategic Policy Statement* (the Defence industry statement) was released in June 1998.⁹⁷ Some of the key objectives in the Defence industry statement, relating to procurement, include:

- to improve the understanding and application of value for money;
- to embrace industry as partners in developing, manufacturing and supporting Defence's capabilities;
- all junior Defence project personnel will be given procurement competency training from the time they join;
- to improve access by SMEs to smaller defence purchases, Defence will publish electronically the reasons its officers have gone offshore for goods and services for all purchases worth \$100 000 or more;

97 Department of Defence, *Defence and Industry Strategic Policy Statement*, 1998.

- Defence will require tender responses for acquisitions worth \$5 million or more to demonstrate that tenderers have made systematic efforts to consult the Industrial Supplies Office Network when seeking opportunities for local industry participation and development; and
 - Defence will conduct annual surveys of its military and civilian officers to help evaluate the success of initiatives outlined in this statement as drivers for cultural change.⁹⁸
- 4.104 The Australian Industry Group, Defence Council endorsed the Defence industry statement commenting that ‘industry particularly welcomes the partnership approach embodied in the statement and the recognition that Australian industry is integral to the development of an efficient and effective defence force’.⁹⁹
- 4.105 Other groups that supported the initiatives outlined in the Defence industry statement include Australian Business and ISONET Ltd. Australian Business commented that ‘many of the initiatives announced by the Government in its ‘Defence and Industry Strategic Policy Statement’ should be adopted for civilian procurement’.¹⁰⁰ Adacel Technologies commented that the Defence industry statement provides ‘very good guidelines for our industry.’¹⁰¹ ISONET in criticising the performance of Commonwealth agencies, excluded the Department of Defence from this criticism commenting that ‘Defence has a firm policy on developing local industry as a credible, capable and competitive support base into the future.’¹⁰²

Conclusions

- 4.106 The Department of Defence (Defence) accounts for over half of all government purchasing by government funded agencies. In 1997–98, Defence purchasing was \$5.5 billion which accounted for 62.5% of the total value of purchasing by the Commonwealth, exclusive of government business enterprises.
- 4.107 Defence, through the *Defence and Industry Strategic Policy Statement*, has sought to enhance its industry policy and reform its procurement processes. Defence is seeking to create a procurement process which is flexible, responsive, innovative and efficient.

98 *Defence and Industry Strategic Policy Statement*, p. 23, 27, 37, 38 and 50.

99 Australian Industry Group, Defence Council, *Submission*, pp. S38–39.

100 Australian Business, *Submission*, p. S335.

101 Mr Ian Russell, Adacel Technologies, *Transcript*, p. 456.

102 ISONET, *Submission*, p. S263.

- 4.108 The Committee supports Defence initiatives to better understand and apply the value for money principle, provide procurement competency training and, in order to help improve access by SMEs, publish electronically the reasons its officers have gone offshore for goods and services for all purchases worth \$100 000 or more. The Committee supports the accountability aspects of this initiative and recommends that all Commonwealth agencies be required to account for why goods and services over \$100 000 are purchased from overseas suppliers.
- 4.109 In addition, the Committee supports the use of annual surveys of its military and civilian officers to help evaluate the success of initiatives outlined in its statement as drivers for cultural change.
- 4.110 During the inquiry, it was suggested by some groups that elements of Defence procurement could be adopted by other agencies. There is merit in this proposal. Defence has because of the scale of its purchasing had greater opportunity, than smaller agencies, to enhance and seek to perfect its purchasing processes. It is logical, therefore, that other agencies should benefit from this experience and knowledge. There are two approaches to achieving this result. First, individual agencies on their own discretion could consult with Defence on an ad-hoc basis. This could be administratively time-consuming and lack standardisation. The second approach is for the Department of Finance and Administration to consult with Defence and amend the next version of the Commonwealth Procurement Guidelines to incorporate superior elements of the *Defence and Industry Strategic Policy Statement*.
- 4.111 The Committee supports the second approach and maintains that it is totally appropriate for the Department of Finance and Administration to conduct this coordinating role. As outlined in Chapter 2, the Commonwealth's devolved arrangements still require a range of centrally developed policies and principles. The Department of Finance and Administration as the author of the Commonwealth Procurement Guidelines must seek to develop a highly regarded product. The Committee asserts that the Commonwealth Procurement Guidelines will be improved by the inclusion of Defence procurement processes. Therefore, the Department of Finance and Administration should consult with the Department of Defence regarding Defence procurement initiatives, and amend the next edition of the Commonwealth Procurement Guidelines to incorporate superior elements of the *Defence and Industry Strategic Policy Statement*.

Recommendation 11

- 4.112 **To improve access by SMEs to smaller purchases, all Commonwealth departments and agencies will publish electronically the reasons why officers have gone offshore for goods and services for all purchases worth \$100 000 or more.**