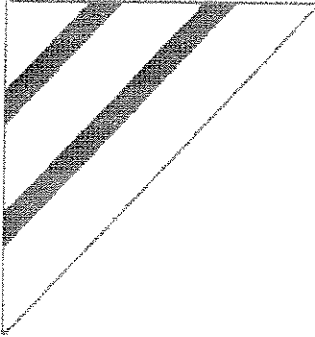


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Creating Solutions with Plastics

9th November, 2005

Mr Petro Georgiou MP
Chairman
Standing Committee on Science and Innovation
House of Representatives
Parliament House
CANBERRA ACT 2600

29 NOV 2005

Dear Mr. Georgio

Some months ago I attended hearings in Melbourne. Since then, the pressures of small business and problem solving have kept my head down.

Thank you for the opportunity to appear before the Committee at its meeting in Melbourne. It was a new and interesting experience for me. I had focussed on KCS activities and now recognise that I missed an important opportunity to put forward my views on how the government could assist KCS and others along the pathway to innovation.

I respectfully submit my views for your consideration.

KCS is a small company that on average over the last 10 years has allocated 10% of turnover to R&D activities. As a consequence, KCS is one of the few injection moulding and toolmaking businesses that can compete successfully against overseas manufacturers in the American, Chinese and European markets.

Plastics and Tooling Industry

For some years competition from overseas manufacturers, particularly from China, has had a serious impact on the size of these industries. Numbers of businesses have closed, employment has decreased as fewer and fewer companies are able to adjust to overseas competition. At this time I am aware of four injection moulding and three tooling firms on the market in Victoria alone.

Since then, all these have closed, their plant auctioned off and other companies are in difficulties. The loss of knowledge and skills too is damaging to the future of these industries.

In part, this sign of management failure to perceive industry trends and to develop successful strategies to grow their businesses in rapid technological and market changes. Several reasons might account for this response. Many within the industry have not updated or increased their technological capabilities since the Government offered an accelerated depreciation program some 20 years ago. Similarly the education of new, skilled entrants into these industries has declined as apprenticeships have become uneconomic, for small businesses in particular.

Education and Training

At KCS, we normally have at any one time at least 3 personnel undertaking either business or skill enhancement courses. The range of courses includes first aid, occupational health and safety, CAD software design, CNC machine operation as well as general management and bookkeeping courses. I see participation in such training, directed at specific business requirements as an asset to positioning and growth of the business.

At the same time, training is a considerable cost to the organisation. Apart from direct fees and other course costs, time away from the revenue generation parts of the business is a real opportunity cost.

KCS has two toolmaking apprentices in training. KCS needs to train apprentices to enable the company to maintain its toolroom skill level and to ensure a transfer of knowledge and experience from our older toolmakers. These apprentices have exposure to leading edge developments and excellent mentors. The decision to support apprenticeships and further training is purely pragmatic. The toolroom boasts over 250 years of experience in complex tooling design and construction. Over the next 5 years a number of older toolmakers are due for retirement and the company needs to plan for that eventuality.

Our greatest concern and a disincentive to additional apprenticeships is that KCS can bear the cost of apprenticeship training only to find that on completion of one's apprenticeship there is a significant ready market for the skills these young men have acquired. The decision to move is often not simply a financial one as KCS pays substantially above award wages. Journey to work and proximity to other interests seem to be major factors.

In essence, our training investment can be used to improve the business of our competitors!

The skills shortage within the tooling industry in particular is critical. KCS has been unable to find suitable people with exposure to the type of tooling knowledge we require to remain competitive. Some of our equipment is unique to our technologies so considerable additional training is required before skilled tradesmen are productive.

Better-targeted support for skills development could alleviate some of these costs.

Research and Development

KCS has claimed the tax concession for R&D almost from the inception of the scheme. Initially the concession of 150% was of real benefit to the company. In our earlier development days, the 150% concession was a significant factor in supporting the level of innovation within the company. AusIndustry has written up two KCS projects as successful case studies from use of the tax concession.

The substantial cut in the benefit of the concession has slowed our growth as more activities have to be funded from internally generated revenues. The government encourages a competitive business environment backed by regulation. It seems to me that the government has forgotten that governments too are in a competitive global environment as the numbers of Australian companies operating offshore and undertaking R&D in countries offering more generous benefits attests.

The problem is more significant for small companies where a relatively small gross amount of R&D expenditure can absorb a significant proportion of business expenditure. We have generally kept to our objective of 10% of turnover as the benchmark for R&D expenditure. However, only small changes can significantly affect our innovation efforts as we do not have a dedicated R&D facility. We obviously need to meet planning and production targets that can absorb all our resources, putting innovation activities on hold – otherwise KCS cannot survive.

If the 150% tax concession were re-introduced for the first \$1 million of eligible R&D expenditure all of small business and a good proportion of medium size businesses would probably find the R&D tax concession worth the administrative costs involved.

I would imagine the cost to revenue, based on our successful growth, would be minimal as additional taxes and charges flow back to the revenue stream.

The additional benefit would go some way to alleviating the up front costs associated with innovation and commercialisation.

Capital Investment

KCS boasts sophisticated items of plant. We understand that KCS has the largest rotary injection moulding machine in Australia. Similarly, KCS has acquired specialist CNC machinery, now one of only three in Australia. Investment in leading edge plant items contains both expense and risk.

Successful commissioning of our CNC equipment, for example, makes it easier for equipment salespeople to use KCS as a referenced site to make additional sales. By being innovative we make things easier for imitators to follow on without the risks associated with innovation!

In the innovative product areas we are developing, there is the necessity to access equipment beyond our resource capability. In our developments for Swinburne University, for example, we required measurements to be undertaken using an electron microscope. Clearly such an item would be inappropriate for KCS to purchase. At the same time, there are other items, such as higher resolution measuring equipment than we currently have, that would greatly improve our productivity if these were in-house assets.

Our business is restricted by our ability to fund new items to support our innovation efforts as KCS is totally reliant on what can be supported from our revenue stream.

Improved support for capital required for R&D items would assist us greatly. An accelerated depreciation program would be of benefit. Such a program would enable us to undertake additional purchases to improve or rate of innovative activities with greater confidence.

KCS was a beneficiary of a previous accelerated depreciation program. My observation of that scheme was that it enabled firms to purchase better equipment for the sake of the benefit, not for a particular business objective. Hence the short term impact of that scheme was for firms to only catch up in equipment terms. The net result for these firms was that the competition became more intense as many players had purchased better and more productive equipment but to no advantage to their business or market opportunity. Instead they found more capacity in limited markets and were only able to compete on price which is not a sustainable proposition. The accelerated depreciation can be detrimental.

An accelerated depreciation scheme requires an expenditure commitment from a potential user and provides a benefit for that commitment. As a tax payer, I believe such a scheme would need to be better targeted to firms that can demonstrate that the purchase includes use as an R&D item.

Technology Diffusion

KCS has an international reputation of which I am particularly proud. But the business opportunities are limited by an inability to fund any market promotion. My concern is that Scholl in Japan and the UK will be actively seeking to reduce its dependence on a sole supplier from Australia. One of our major risks is that those orders might cease and we have no other fall-back product range. The impact of the loss of that revenue stream would be substantial leading to our innovation program being sharply curtailed and probably the loss of 10 staff operating and working on that product line.

Opportunities for technology awareness and technology diffusion to create new markets would be of great assistance. KCS has only limited resources to undertake these activities on its own behalf. Hence our activities are responsive not proactive. It is difficult for others to be aware of our new materials and processes if they do not know where to find us. Our future business opportunities are currently at best ad hoc without the resources to implement a longer-term growth strategy.

An opportunity, such as a programmed and supported national road show of like innovative companies would be of great benefit. Such activities could go some way to demolishing the myth of nothing good and innovative from Australian firms. Incidentally, Swinburne academics scoured the world and only after being told their requirements were impossible did they hear of KCS. KCS not only met the challenge but succeeded when the rest of the world declined to offer any solution.

Conclusion

Thank you for the opportunity to add my wish list.

May I take the opportunity to invite your committee members to visit our premises at Lilydale and to see for themselves the products of our innovation activities and the new challenges we readily accept.

Yours sincerely



Kurt Schnepf
MANAGING DIRECTOR