



## **Submission**

### **House of Representatives Committee**

**Inquiry into the state of Australia's manufactured export and import competing base - now and beyond the resources boom.**

**Prepared by Industry Capability Network Ltd.**

**July 2006**

## **The Industry Capability Network**

The Industry Capability Network (ICN) is an independently managed, non-profit organisation financially supported by State, Territory and Commonwealth Governments.

The network facilitates business partnerships for the purpose of local supply, access to global supply chains and local business growth. ICN has a network of more than 24 offices located around Australia and New Zealand, staffed by experienced technical consultants with extensive knowledge of the resources and capability of local industry. It has the ability to act locally and globally.

The Industry Capability Network helps firms to find competitive local sources to meet their procurement and project needs.

## **Supplier Access to Major Projects**

ICNL also runs the Supplier Access to Major Projects on behalf of the Federal Department of Industry, Tourism and Resources. The program funds specialist consultants who are familiar with the engineering, procurement, construction and support aspects of major projects. These consultants refer people responsible for procurement of particular projects to appropriately qualified suppliers. This allows negotiation to occur directly between the project procurement people and the suppliers.

## **The Importance of Manufacturing**

With the increasing attention being currently placed on the resources boom the importance of manufacturing has tended to be neglected. While manufacturing's share of the economy has declined over the past 40 years, the sector still plays an important role in the economy.

In 2002-03 manufacturing turnover was \$309.3 billion.

In 2004-05 it generated \$97.2 billion in value added.

The total value added of the Manufacturing industry increased by 19% over the period from 1994-95 to 2004-05.

The total employment of the manufacturing industry declined from 1,121 thousand in December 2001 to 1,065 thousand in December 2005. This follows a decrease of 5.5% over the period from 1995-96 to 2000-01.

The importance of manufacturing to the economy has been declining since the early 1960s with its share of GDP going from 30% to a little over 10% currently.

This has been part of a world wide trend reflecting the strong growth of the service economy rather than a collapse of manufacturing. In recent years, manufacturing has come under increasing stress.

As shown in Table1, manufacturing was ranked fourth last in terms of the average annual growth rate over the past 10 years and second last over the past 25 years, with increases of 2.5% and 1.9% respectively.

Between 1994-95 and 2002-03, business expenditure on research and development increased from \$1932.1 billion to \$3294.1 billion. In 2002-03, manufacturing accounted for 47% of business expenditure on research and development. As innovation is an important path to improved productivity and the development of new products, these figures highlight the importance of maintaining a strong manufacturing base within Australia.

In 2005 manufactures accounted for 24% (\$31.5 billion) of Australian produce exports and increased 10% to \$31.5 billion. Exports of simply transformed manufactures (STM) rose 9% to \$10.8 billion, and exports of elaborately transformed manufactures (ETM) rose 10% to \$20.7 billion.

## **Pressures on Manufacturing**

Manufacturing is an important industrial sector in Australia, but has been under pressure in recent years through a number of factors including the:

- Lowering of domestic tariff protection;
- Increasing competition from overseas countries with lower labour costs, particularly China;
- Impact of the stronger Australian dollar arising from the resources boom;
- Continual expansion in the overall proportion of goods and services that are tradable and the industry sectors that are covered;
- Strong Australian dollar;
- The increasing importance that Multinational Companies (MNCs) are assuming in the growth of trade. Approximately two-thirds of world trade is accounted for by 'flagship' MNCs and their associated supply networks. MNCs now also play primary roles in developing local technological capabilities and local firm specific advantages.

**Table 1: Production volumes for Australian economy**

<b>Industry</b>	<b>2001-02</b>	<b>2002-03</b>	<b>Change from 2001-02 to 2002-03</b>	<b>1992-93 to 2002-03</b>	<b>1977-78 to 2002-03</b>
	\$m	\$m	%	%	%
Agriculture, forestry and fishing	27,148	20,855	-23.2	0.7	1.4
Mining	34,128	34,325	0.6	3.2	3.9
<b>Manufacturing</b>	<b>79,142</b>	<b>81,833</b>	<b>3.4</b>	<b>2.5</b>	<b>1.9</b>
Electricity, gas and water supply	16,759	16,935	1.1	1.5	2.7
Construction	39,110	45,587	16.6	5.1	3.3
Wholesale trade	37,600	39,311	4.6	4.6	2.9
Retail trade	37,671	39,411	4.6	4.0	3.2
Accommodation, cafes and restaurants	14,658	15,164	3.5	3.8	3.0
Transport and storage	35,191	37,021	5.2	4.4	3.6
Communication services	18,781	19,970	6.3	6.7	7.0
Finance and insurance	53,274	55,671	4.5	4.3	4.5
Property and business services	77,673	79,615	2.5	5.1	5.1
Government administration and defence	29,109	29,709	2.1	2.7	2.6
Education	32,978	33,435	1.4	1.7	2.7
Health and community services	42,608	44,142	3.6	3.9	3.9
Cultural and recreational services	13,017	13,134	0.9	2.8	3.0
Personal and other services	17,157	17,466	1.8	3.5	3.0
Total all industries	606,004	623,584	2.9	3.7	3.3

source: **Australian National Accounts: National Income, Expenditure and Product, June Quarter 2004** (cat. no. 5206.0).

For many manufacturing firms, the response to increasing import competition has been to continue to seek lower costs of production. This approach is ultimately unsustainable as Australia will never have the cost structures of China and other emerging exporting countries.

The new global economy is one in which most companies are permanently vulnerable. The scale of the global opportunities, the complexity of the competitive arena, and the relentless discipline imposed by capital markets will force companies either to specialise and become world class and world scale in their chosen field or exit. At the very least to prosper manufacturers will need to develop business models that emphasise specialisation through innovation and collaboration with MNCs as sources of firm specific competitive advantage.

There are new business models that make it possible for small to medium sized companies to become global companies and win and hold major parts of global

markets from Australia. Cochlear, Resmed, Bishop Technology, Billabong, Air International, Orica, Mincom, CSL are examples. These companies have their global product development and brand management activities centred in Australia, but also have invested in operations close to markets and/or in low cost centres. Their willingness to undertake these off-shore investments is essential for their continued strength in the global marketplace. These pioneering companies illustrate a general pattern that needs to be much more widely imitated.

The international exposure of Australian firms is also very limited. Only 4% of Australia firms are regular exporters compared to 16% of Canadian firms which is the next lowest level amongst members of the OECD.

Australia's SMEs face special handicaps covering information and intelligence, transaction costs and risks. In addition, past protectionist frameworks have nurtured an inward looking business culture, perhaps particularly amongst SMEs. There are notable examples of change and success by individual firms and even sectors (e.g. wine), but the aggregate data demonstrates that international engagement remains far from the norm. With its deep knowledge of local SME capabilities, the Industry Capability Network (ICN) is ideally placed to assist these firms make a transition to global engagement through global production networks.

Access to a flagship companies and their global supply networks can determine SME growth opportunities and their innovation performance. This source of competitive advantage is of increasing importance and one that ICN is investigating. In recent years ICN has had a number of successes.

As an example, Victoria ICN leveraged supply chain access off a major investment in new rolling stock undertaken by transport franchisees, National Express, Yarra Trams and Connex. Contracts were awarded to Siemens, in the case of National Express, and Alstom, in the case of Yarra Trams and Connex.

Links to MNCs however remain underdeveloped. While several hundred of the top 500 global firms have some presence in Australia, mostly this is to access the domestic market. Less than 20 of these firms use Australia as a significant product development, technical or production centre for a global business operation. A larger number use Australia as a base for regional business, e.g. Toyota. Meantime, Australia's profile as a location for R&D is also low. A US Commerce Department report on global R&D lists 200 US company R&D facilities abroad in 22 countries, but no facilities in Australia are mentioned. Levels of participation are far below what might be expected of a country of Australia's wealth and technological capacities.

## **Impact of the resources boom**

It is not clear how long the resources boom will last. China has a long way to go before it reaches the level of wealth of Western countries and the scope for expansion is still vast. This also applies to other Asian economies such as India. This growth will ensure that the demand for Australian raw will remain high for many years to come. It also means that Australian manufacturing will remain under continuing stress.

The rapid expansion of China has not been totally negative for Australian manufacturing as to meet the demands of China massive investments in infrastructure and resource extraction and processing have had to be made. This will generate continuing opportunities in the next several years. Second, Australia's distance from major markets, while a diminishing barrier, remains an important factor in sustaining workload for local firms, particularly where through-life support or speed of response is an imperative.

The underlying competitive strengths and capabilities of many Australian firms place them in a sound position to compete for, and participate in, major investment projects. Australian firms continue to demonstrate their ability to provide high quality goods and services to nationally significant projects across a range of industries.

Australia manufacturing needs to maximise any opportunities that emerge from the resource boom. Many Australian firms, however, face challenges in gaining access to international supply chains and major investment projects. The relative small size of the Australian economy, coupled with its geographical distance from the major markets of Europe and North America, and the trend towards greater use of established supply chains by international investors, can create significant impediments to Australian industry participation in major projects.

Even if these projects continue the long term issue is whether the relationships and competitiveness that Australian firms will have built in the domestic market during the boom are sufficient to be capable of winning international business in a downturn.

The approach of MNCs requires special action to join their global networks if Australian firms are to have more than token opportunities. This is confirmed by Western Australian and Queensland experience. ICN WA found that Australian suppliers were being offered only token participation in major contracts with most work assigned to suppliers who had pre-qualified on the Engineering Procurement Construction and Management (EPCM) global chain. It therefore located staff in the UK head office of Kellogg, Brown and Root to gain access for Australian suppliers to the NW shelf development projects.

This experience in winning contracts from developers of major projects is being repeated outside the resources sector. The Australian electronic industry was built on the back Telstra while it was a monopoly supplier of telecommunications. This situation changed dramatically with the introduction of competition into telecommunications. The management of Telstra now emphasise the need to compete with other telecommunication companies, develop share holder value and now disavow any responsibility for nurturing Australia's electronic industry. While the new position of Telstra is understandable it does highlight the difficulties domestic firms will face in gaining contracts without a distinctive advantage based on innovation and collaboration with world companies.

This implies the rosy prospects for infrastructure may not translate as readily as in the past into workload for Australian-based companies without a strengthening of the Industry Capability Network and expanding the role it plays.

## **Impact of the Industry Capability Network**

Analysis of the statistics for the 2004-05 year show that Australian companies enjoyed contracts to the value of \$646 million which might otherwise have gone to overseas destinations. This brings the total contracts since ICN started collecting national statistics to \$5.5 billion. Given that every \$1 million dollars spent locally generates or maintains 17 jobs then the economic benefits are obvious.

Last year SAMP grants to a value of \$754,000 were issued and from these contracts for Australian companies amounted to \$213 million. Since its inception in July 1997, SAMP funds have assisted 88 projects at a cost of \$5.9 million. ICNL estimates that under SAMP, Australian companies have won contracts worth around \$1.6 billion for work that might otherwise have gone to overseas competitors. This represents an extremely good return on investment.

Traditionally ICN focussed on import replacement by helping major projects within Australia to identify local capabilities that can match their specifications without compromising on price, delivery, quality or safety. In recent years the focus has shifted towards helping manufacturers become suppliers to the world and to the global production networks of multinational enterprises.

Reflecting this change in focus, Budget 2006–07 provided an additional \$4.2 million over four years for SAMP to increase opportunities for Australian industry participation in major projects overseas. This emphasis on winning contracts in major projects overseas recognises the imperative of Australian manufacturers to become involved in exporting if they are to be sustainable and prosper.

## **Australian Industry Participation (AIP) Program**

The Australian Government recognises the barriers faced by local suppliers and has adopted a vigorous approach to ensure that Australian industry has full, fair and reasonable opportunity to participate in major projects, in Australia and overseas.

This approach seeks to assist Australian industry to gain a foothold in major projects by encouraging Australian industry to innovate, develop competitive capability and take advantage of investment opportunities. There is a strong emphasis on industry development, in particular the formation of strategic alliances, to position capable Australian industry to leverage opportunities and integrate into global supply chains.

In 2001, the by Australian, state and territory governments all signed the AIP National Framework. The Framework provides a unified national approach to maximising Australian industry participation in major investment projects, in Australia and overseas.

For companies planning investment projects in Australia, the Department encourages the development and implementation of Australian Industry Participation (AIP) Plans. These plans outline how the company will provide full, fair and reasonable opportunity for Australian industry to participate in major projects. Companies implementing AIP Plans may be able to claim through the Department a duty concession on eligible goods for their projects under the Enhanced Project By-law Scheme (EPBS).

In 2004-05, 91 EPBS applications were received for 85 new major projects, with a combined value of more than \$36.8 billion. Since the scheme's inception, 285 applications worth more than \$88 billion were received. Major users of the program include the mining sector with projects worth \$41 billion, gas supply projects worth \$18 billion, resource processing worth \$15 billion and the manufacturing sector worth \$10 billion.

## **Conclusion**

The Industry Capability Network has played a major role in ensuring that capable and competitive Australian manufacturers are given full fair and reasonable access to major projects. It is the major Government program that aims to assist Australian manufactures to derive benefit from the resources boom. ICN exists in every State and Territory and is coordinated by Industry Capability Network Limited in Canberra.

Traditionally ICN has focussed most heavily on import replacement, but in recent years the importance of export and connecting to global supply chains has assumed increasing emphasis. With tariffs almost eliminated and the dominance



of multinationals in trade it is recognised that to prosper and grow firms need to think and act globally. ICN is changing to reflect this new dynamic.

The ICN has delivered benefits far greater than the level of assistance provided.

## **Policies for realising these suggestions**

1. That the committee notes the important role that the Industry Capability Network has played in ensuring that Australian manufacturers gained benefit from the resources boom.
2. That the ICN continue to be supported by the State and Territory and Commonwealth Governments.
3. That support continues for the Supplier to Major Projects Program.
4. That the ICN be enhanced in order for it to further develop its work on assisting firms to access the global supply chains of multinational companies.

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