SUBMISSION DEALING WITH THE PROPOSED TEXTILE, CLOTHING, AND FOOTWEAR INDUSTRY STRATEGIC INVESTMENT PROGRAM (2005 – 2009) BY BLUNDSTONE PTY LTD

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INTRODUCTION

The Federal Government recently announced a further period of financial support to the Textile, Clothing, and Footwear industry. As part of that industry, Blundstone recognises the ongoing commitment of government in facilitating the progression of the industry to a regime of lower tariffs. Blundstone is of the view that the package of assistance announced by the government will be of great assistance in improving its competitive position.

In preparing to draft legislation, an opportunity has been provided to interested parties to make submissions in relation to the scheme. Although Blundstone is of the view that the proposed scheme is of benefit, there are a number of areas of concern where the scheme could be improved.

This submission begins by providing a profile of Blundstone in order to establish the bona fides of the company as an interested party in respect of the proposed scheme. A discussion of the various issues will then follow accompanied by a set of recommendations for improving the proposed scheme.

COMPANY PROFILE

Blundstone is Australia's largest manufacturer of heavy duty work and protective safety footwear, with diversified markets throughout Australia, New Zealand, and numerous countries around the globe.

The group employs in excess of 450 people across its three primary locations, and widely dispersed sales organisation. The main manufacturing plant and head office are located in Hobart, Tasmania, where the company was founded in 1870. Another factory is located in Auckland, New Zealand, and waterproof (gumboots) manufacture is located in Laverton, Victoria.

The Blundstone factories employ the very latest manufacturing technologies, with a strong emphasis placed on technical innovation. Direct sole moulding technologies available include thermoplastic, dual density PU, rubber/PU, TPU/PU, injection vulcanized nitrile rubber, and dual density rubber. Extensive use is made of computer technology and robotics. Blundstone has in-house CAD/CAM facilities, and development of lasts, sole designs, and steel toecaps is carried out on site.

Blundstone has an unrivalled technological base, and is a world leader in the development of footwear industry methodology. The company's in-house engineering resources are focused on developing improved processes, and building the plant and tooling necessary to implement them.

The company's two greatest assets are its brand and its people. Our brand is internationally recognised and holds market leader status within Australia. It is seen as iconic. Our people contribute commitment, skills, and innovation. Blundstone maintains a strong and comprehensive program of apprenticeships, cadetships, in-house training, and development courses. The culture of the company encourages an environment that allows people to continually develop their skills, thus enhancing their value to the company and community.

Blundstone has developed technical and supply related links globally, but remains committed to maintaining a strong Australasian manufacturing presence provided it is commercially feasible. Blundstone manufactures on a scale that supports the application of highly automated and efficient manufacturing methods, and the maintenance of the required skills that underpin them.

PROPOSED STRATEGIC INVESTMENT PROGRAM (SIP)

In general Blundstone is of the view that the proposed SIP scheme is of great value in assisting the industry to further prepare for the reductions in tariffs that are scheduled to occur in 2005 and 2010. On the whole the package will provide impetus for the necessary restructuring required to remain competitive as an Australian designer and manufacturer of footwear that is both quality and price competitive in a global market.

However, there are a number of aspects of the proposed scheme that we believe could be simplified and/or enhanced to better enable achievement of helping "TCF firms and workers adjust to a lower tariff environment".

1. **Proposed Annual Cap**

The package was announced as a $500 million scheme covering the five years 2005 through 2009.

However, in reading the detail it would appear to be five mini schemes each of $100 million with no provision for rolling unspent funds from one year to the next and advancing funds between years (with a wash out in the final year) – as is the case with the current scheme.

This effectively means that over the course of the five years the funding to the industry will be something less than $500 million. The nature of capital expenditure (type 1 expenditure) means that it is very probable that over a five year period claims on the scheme will be lumpy with some years exceeding the proposed $100 million cap and other years being under spent – with excess (unspent) funds of any year being returned to general revenue.

Given that the objective of this scheme is to assist industry to prepare for the increased competition of a global market and to achieve suitable structures to improve productivity we are of the view that the approach of the current scheme is more appropriate as it better allows individual firms to match their capital expenditure requirements with their strategic planning for such expenditure which is based on a broad range of factors including supply, demand, factory structuring, cash flow and so forth. Taking the approach proposed in the scheme will at best force firms to make capital decisions that are not timely in terms of what is the most appropriate acquisition period for capital assets and at the worst lead to firms receiving a lower grant from the scheme in a given year and therefore not receiving the full benefit of the scheme.

It is also possible that an unintended outcome of the proposed $100 million cap is that firms will defer expenditure to later in the scheme due to concerns that if they purchase capital assets in the first one or two years of the scheme they may not get the full value of their grant application (i.e. less than the 40%) due to the cap being exceeded. If this approach were taken and expenditure deferred then it is likely that there will be an impact on the level of preparation that can be achieved in relation to tariff reduction.

RECOMMENDATION #1:

In order to ensure that the greatest benefits are derived from the proposed $500 million allocation Blundstone recommends that the $100 million annual cap be removed and that a rolling balance forward amount be used to ensure that the fund is not overspent in total.

2. Prepayment of Claims

The current scheme allows for a 50% prepayment of a firms claim based on each year's claim submission. This is an important aspect of the scheme as it allows for improved cash flow management associated with the acquisition of what is very costly equipment where the firm has to prepay a significant proportion of the cost to the supplier on placement of the order. There is often a substantial lead time between when the asset is ordered, delivered, and the submission of the claim.

The proposed scheme continues to allow a 50% prepayment of a claim. However, given the substantial impact on cash flow of capital acquisitions a higher level of prepayment would better enable firms to structure and manage the acquisition of capital equipment. In so doing, significant cash flow issues will be relieved and allow firms to focus greater attention on managing the process of preparing for the reduced tariff regime.

This issue will be heightened should the Government decide not to adopt Blundstone's first recommendation as the date for final payment will be deferred to allow for 'modulation' calculations to be performed each year.

RECOMMENDATION #2:

That the proposed scheme allow for a 75% prepayment of each year's grant for the first four years of the scheme.

3. Branding

The new scheme broadens the scope of what may be claimed under the category of "branding" and Blundstone sees this as a very positive aspect of the scheme. As indicated in the Company Profile, Blundstone has a long and proud tradition of being an Australian manufacturer of footwear and has established a strong brand presence and recognition not only in Australia but throughout the world.

Much of Blundstone's promotional expenditure, both in Australia and throughout the world, is geared at brand promotion rather than product promotion. However, much of this expenditure is carried out in conjunction with Blundstone's direct customers in that Blundstone provides funds to individual customers who then use these funds, in conjunction with added funds of their own, to promote the Blundstone brands – this is true of our domestic and international customers. This format allows for a leveraging of the funds to obtain greater brand promotion than if Blundstone where to engage in this activity alone. This approach is of strategic importance as it builds strong relationships with our customers.

RECOMMENDATION #3:

To ensure that this approach (as outlined above) to brand promotion is not disadvantaged under the proposed scheme, both direct and indirect brand promotion – through third parties such as a firm's customers – should be allowable as a Type 1 claim.

A specific aspect of branding that Blundstone has considered from time to time has been the establishment of retail outlets in key markets in order to enhance brand awareness in those markets. However, the costs of establishing these outlets has so far been outside the capacity of Blundstone. Although it may be argued that such outlets are product focused the reality is that analysis shows that they have very little potential to be profitable in their own right. Notwithstanding the establishment costs, we still hold the view that such outlets have significant potential for increasing brand awareness.

The inclusion of expenditure associated with the establishment of retail outlets in key markets as eligible branding expenditure under Type 1 expenditure would facilitate this type of branding expenditure.

RECOMMENDATION #4:

That the definition of eligible branding expenditure allowed under Type 1 be broad enough to allow for expenditure where the dominant purpose of the expenditure is that of branding as demonstrated by the firm making the claim and that the definition be broad enough to capture expenditure such as outlined in the preceding paragraphs.

4. IT Expenditure

Production related IT expenditure is currently allowable expenditure under Type 1 and the proposed scheme continues this allowance. However, the proposed scheme extends to the inclusion of non-production IT expenditure by clothing and finished textile firms. This is an extension that has not been allowable to the footwear industry in the current scheme and which is not being made available to the footwear industry in the proposed scheme.

One of the key areas that is available to a firm to obtain productivity gains is that of IT. This is true in all areas of a firm's operations – both production and non-production. To be competitive, Blundstone will need to establish strong links with its customers, consumers, and suppliers.

Obviously, given the advances being made in global communications, a significant part of establishing stronger links is the integration of IT systems that allow for information transfers between the interested parties. As with expenditure on production assets, expenditure on IT related assets require significant funding. By excluding the footwear industry from claiming as eligible expenditure non-production related IT expenditure, Blundstone is being put at a significant disadvantage in relation to many of its competitors who are engaged in both the textile, finished clothing, and footwear industries.

It is highly unlikely that a firm that crosses industry boundaries will be able to distinguish non-production IT expenditure according to industry classification and they will therefore by default obtain a funding advantage, and potentially an IT advantage, that is denied to a single industry firm such as Blundstone.

Although it may be argued that the community would be best served by directing Program monies towards those firms able to be viable in the long term and that this should be the sole determinant for eligibility under the fund, Blundstone recognises the political realities facing the Government and therefore can understand the decision to provide for greater access to the Program for those industries facing the greater tariff reduction imposition. However, the chosen method to achieve this places Blundstone at a distinct commercial disadvantage and we do not believe this to be the intent of the decision. Perhaps the Government's aim could still be achieved by providing a greater claim eligibility for IT expenditure for those industries facing a greater tariff step down but while still maintaining eligibility for some form of claim for the rest. This would act to lessen the disadvantage and make the scheme appear to be fairer.

RECOMMENDATIO #5:

That the eligibility of non-production IT expenditure be extended to the footwear industry to ensure that single entity firms such as Blundstone are not disadvantaged and that the footwear industry are also given the additional support necessary to exploit the competitive advantages to be derived from the advance in IT technology.

5. Innovation

Perhaps the most difficult and troubling aspect of the current scheme has been the definition that has been attached to what is "innovative". In assessing what is considered to be innovative under the current scheme are the terms "novelty" and "high levels of technical risk". These terms are ones often associated with the conduct of pure research and development by firms that are oriented significantly towards research and development tasks.

Following the briefing sessions conducted recently by the Department, it is our understanding that this definition is to continue under the proposed scheme.

The use of this definition puts many of the firms engaged in the TCF industry at a disadvantage due to the nature of research and development processes within smaller and medium size firms where research and development activities are somewhat integrated with production and product design processes.

A recent example of an innovative project that Blundstone engaged in was a modification to a piece of machinery that allowed the speed of the machine to be increased and a manual process to be eliminated. The machine is one that is widely used in the manufacture of footwear throughout the world and the issue that was solved by the Blundstone modification is one that all manufacturers who use this technology face. No other firm that uses this technology or the machine manufacturer have solved this particular issue (not a flaw in the machine, but rather an issue of machine productivity). Blundstone is of the view that the process that was implemented was novel and innovative. Additionally, it had the benefit of being successful.

This project was not allowed as Type 2 expenditure when claimed as it was not considered to be innovative on the grounds that it could not be considered to have a "high level of technical risk". This notwithstanding, had the project not been successful then the piece of equipment that was modified would have to have been returned to its original condition. Indeed, it also took several iterations to make the process work successfully.

It is our view that the definitions being applied to what is "innovative" and of a research and development nature are too narrow and are more suited to industries that are science based. In relation to the TCF industries, definitions of the terms should be broad enough to capture activities that are of an incremental, developmental nature specific to the industry of the firm making the claim under Type 2.

RECOMMENDATION #6:

That the term "innovation" be more broadly defined to include claims for projects that are based on new methods and ideas in relation to the manner in which the firm has historically performed its activities. If this definition is seen as too broad then the newness of the methods and ideas should be assessed in relation to what is the norm for the industry.

RECOMMENDATION #7:

That the scope of research and development activities be broadened out to ensure that projects are not unduly rejected as a result of a narrow, scientific definition of what is considered to be a "high level of technical risk". An appropriate definition would simply be confined to the acquisition of new knowledge, the creation of new or improved materials, products, devices, processes, or services and activities associated directly or in support of this acquisition.

6. Structural Adjustment

We understand that the current Type 4 and Type 5 categories will not continue in the proposed scheme and that they will be replaced by a Structural Investment Program. It is also our understanding that a separate opportunity will be provided to make comment on the Structural Investment Program. As a result structural adjustment issues have not been addressed in this submission on the basis that an opportunity to make another submission specific to this program will be provided in the near future.

CONCLUSION

As noted in the introduction to this submission, the very willingness of the government to propose a further period of TCF industry support by extension of the SIP scheme and the announcement of other support measures demonstrates the government's continued support and recognition of the challenges faced by TCF firms of which Blundstone is one. In making this submission Blundstone does not wish to be seen as critical of the government's efforts in this area. The submission is made in the spirit of wanting to fine tune the scheme in order to maximise the benefits from the scheme in terms of further preparing Blundstone to engage in a global market environment based on a competitive, efficient, quality manufacturer of world class footwear.

The introduction of the current scheme some four years ago has allowed Blundstone to move forward with confidence in making a number of significant capital acquisitions that have enhanced the company's ability to meet competition and remain a strong Australasian manufacturing presence.

As tariffs are further reduced it is imperative that Blundstone continue to invest heavily in technology and innovative production techniques in order to ensure that global competition is met in terms of both quality of product and pricing. Blundstone has a long term strategy of obtaining growth in its domestic markets as well as expansion in its export markets around the globe.

The proposed SIP scheme provides Blundstone with the confidence and the capacity to continue its drive for productivity gains through investment in capital assets and innovation. The recommendations made in this submission are based on the need to fine tune the proposed scheme so as to maximise the opportunities to be world leaders in our industry and to ensure that Blundstone remains one of Australia's domestic and international iconic brands now and in the decades to come.

The government can facilitate this aim by adopting the recommendations made in this submission.

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