



BUSINESS SA Submission

Senate Inquiry into Future of Australia's Automotive Industry

February 2015



BusinessSA

South Australia's Chamber of
Commerce and Industry

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Introduction

Business SA, as the peak Chamber of Commerce and Industry in South Australia, represents thousands of businesses across all industry sectors. These member businesses range from micro businesses through to multinational companies. Business SA plays a lead role in advocating on key issues affecting our members and South Australia's economic future.

Business SA has played an active role in recent Government inquiries into the auto-manufacturing sector, including the Productivity Commission Review of Australia's Automotive Industry and the Federal Government Review of the Victorian and South Australian economies which inform its assistance package. Our primary aim has been to ensure that both levels of Government collaborate and target limited assistance to ensure the best chance of South Australian component manufacturers remaining viable in some form beyond local auto-production.

We are pleased to respond to the Senate's inquiry into the future of Australia's automotive industry and provide feedback gathered in consultation with our members. Should you require any further information or have any questions, please contact Rick Cairney, Director of Policy, Business SA on [REDACTED].

Executive Summary

The first hurdle to providing a foundation for the future of Australia's automotive industry and related advanced manufacturing is for Governments to facilitate a competitive cost base. Business SA commends the South Australian Government on opening the debate on State Taxes with its recent discussion paper and calls on the Federal Government to follow suit with its Tax White Paper. However, both levels of Government must be genuine in their attempts to overhaul the tax system and no tax should be 'off the table' simply for political reasons. Notwithstanding the tax system is only one lever to assist component suppliers and other advanced manufacturers compete in world markets, it is the area most ripe for reform. Enabling growth through economic infrastructure is also required and both the State and Federal Governments need to work to find ways of delivering projects such as the Northern Connector freight link to Port Adelaide.

Business SA has received feedback from a number of component manufacturers on their success or otherwise in applying for both State and Federal grants to transition away from supplying local auto-producers. Where grants have been made, the projects have been worthy endeavours by businesses to diversify their operations and we are pleased resources are beginning to flow to those most impacted. However, there needs to be a more appropriate focus on assisting businesses which may be working to diversify but have issues with leveraging off redundant plant and equipment. In such cases, appropriate support to facilitate merger activity may be warranted, particularly as a means to save multiple businesses 'folding' where at least some operations can be salvaged through company consolidations. This approach recognises that because of the timeframe required to completely diversify most traditional component manufacturing businesses will not neatly fit into the local auto-production cycle.

The future of advanced manufacturing will also rely heavily on Australia's ability to increase the commercialisation of research for industrial purposes and the Federal Government must prioritise reforms to research funding models. Enabling the auto-component supply chain to better leverage university resources to diversify will also help provide a future beyond auto related manufacturing.

Part of the Government's role in assisting the future of advanced manufacturing is to ensure there is a skilled workforce available as businesses develop new opportunities. One of the most significant threats facing South Australia's skilled workforce will be the lack of immediate jobs post auto-manufacturing, particularly considering the reduced number of manufacturing businesses and the timeframe for remaining businesses to realise diversification opportunities. The Government can play a role here by ensuring that where practicable, any work related to the future submarine project which can be undertaken in Australia is prioritised for areas most impacted by the closure of auto-production. The Government can also ensure it does not exacerbate job losses in the auto-sector through any premature scaling back of the Automotive Transformation Scheme (ATS).

Background

1. Diversifying Australia's economic base

Business SA acknowledges the Senate Committee is interested to explore how Australia can reduce its dependency on commodity exports and leverage from the auto-manufacturing industry and other advanced manufacturing to assist with this transition. While it is crucial that Australia continues to focus on how it can grow advanced manufacturing and other higher value add industries, first and foremost Governments must ensure that all industries enjoy a competitive cost base.

South Australia has a significant auto-component manufacturing sector but also faces one of the highest cost bases in the country. Our water and electricity prices are the highest in the country and even after welcome reforms to WorkCover are delivered from 1 July 2015, we will still face the highest average workcover premiums in the nation at 2%. State taxes, particularly land tax, impose a much higher burden on local businesses than their interstate counterparts and while our payroll tax rate is competitive, the threshold at which it applies is one of the lowest in Australia. Combined, all of the above factors make it very difficult for businesses such as component manufacturers to diversify and penetrate interstate & overseas markets.

Australia enjoys one of highest standards of living in the world which has been predominantly influenced by our ability to leverage natural resources to take advantage of foreign demand for commodities. Over the past decade this demand has predominantly emanated from China but indicators now point to a maturing Chinese economy and as a consequence, declining demand for raw materials.

The reality for Australian manufacturers is that they must compete on all costs to be successful in export markets. While to date Australia's commodity export earnings have allowed us to maintain a high standard of living with the fourth highest real minimum wage in the OECD, the days of relying on commodity exports to underpin our economy are numbered. Although Business SA does not support cutting the minimum wage, further wages growth needs to be limited until Australia's non-commodity exporters are able to better position themselves to replace the growth in export earnings which has traditionally come from raw commodities. Furthermore, there needs to be a whole of economy focus on how to reduce costs for exporters, particularly through a more competitive tax system, improved economic infrastructure, reduced penalty rates and more efficiently delivered essential services.

A key plank to reducing costs for Australian exporters is through access to strategically located economic infrastructure including freeways and ports. Considering the Senate Committee is interested in how to diversify Australia's economic base, we acknowledge the Federal Government's recent commentary that improving transport infrastructure is critical to opening up opportunities for new agricultural export markets. For this reason, the Government should reconsider funding the \$1.1 billion Northern Connector project which has already been assessed by Infrastructure Australia as

being at the threshold stage; meaning it has strong strategic and economic merit. If there is a need to consider alternative forms of funding to get this project 'off the ground', then the Government must put this proposition to South Australian business and the broader community.

The Northern Connector will reduce freight costs for key growing regions of South Australia including the Adelaide Plains, Barossa Valley, Mid North and Riverland and help to increase their export competitiveness across a range of commodities and food & beverage manufactures. Reducing freight costs is a key factor in increasing competitiveness for Australian produce in world markets, particularly where Australian produce is already at a significant disadvantage from having to compete against heavily subsidised European nations and the United States.

There is no argument that increasing Australia's export competitiveness, particularly in advanced manufacturing, is not just about ensuring an efficient cost base. Increasing the innovative capability of Australian businesses is also critical to growing advanced manufacturing and more particularly, assisting auto-component manufacturers to diversify. However, there needs to be a strategic approach to ensure Australia is firstly capitalising on existing resources to achieve such change. While government programs including the R&D tax incentive are needed to directly assist businesses to innovate, the real game changer for innovation within Australian businesses will occur once we begin to adequately leverage the research capacity of our highly regarded universities to achieve better commercial outcomes for industry. Australia has world class universities with five in the top one hundred alone, and a further 14 in the top 400, but we still rank at the bottom of the OECD when it comes to university/industry collaboration.

There must be fundamental structural change in the university sector to address the poor outcomes in leveraging university research capacity for commercial outcomes. The key to this change requires the Federal Government to embark on an overhaul of the university funding model to ensure there are adequate incentives in place to promote university/ industry collaboration. This will involve allocating at least 20% of research funding to projects which partner with industry for commercial outcomes and ensuring Australia's university quality benchmarking system for research funding, ERA, is appropriately re-structured to recognise the impact of university research in industry.

At present, universities are typically focussed on research to improve their ranking in order to attract the international students vital to their funding needs. If the underlying funding drivers are fundamentally restructured, universities will be more driven to collaborate with industry. Universities also need to restructure their career progression systems to give appropriate weight to academics who have achieved success with industry in realising commercial outcomes through collaboration. The Federal Government cannot mandate how universities promote their staff, but if the underlying funding structure rewards collaboration with industry, universities will be more likely to remodel academic promotion structures to suit.

2. Difficulties for component manufacturers transitioning away from local auto-manufacturing

The primary concern of the Senate Committee should be how Governments can open up opportunities for component manufacturers to transition away from local auto-manufacturing. First and foremost, the Government creates opportunities by ensuring there is a foundation for success. Provided that foundation is a competitive cost base, the range of markets component manufacturers can access will broaden significantly.

There is no doubt that it is, and will continue to be very difficult for component manufacturers to diversify into alternative markets. The nature of component supply chains has led to many local component manufacturers having supplied auto-manufacturers for several decades. This has meant

component suppliers have been able to customise their businesses to suit the auto-manufacturers and realise all available supply chain efficiencies. However, the unintended consequence of these commercial relationships is that component suppliers have not necessarily had to market their products, nor be concerned about building relationships in alternative markets.

Notwithstanding the need to actually be 'able' to diversify a manufacturing operation, one of the biggest challenges facing component suppliers is:

- what do they diversify to? and
- how to they sell their products into new markets?

The key to penetrating new markets is establishing networks within the supply chain which can be extremely challenging, particularly for businesses which have been embedded in the same supply chain for several decades. And while making contact is the first hurdle, establishing the trust needed to build commercial relationships naturally takes time.

Moreover, many component manufacturers have limited experience in actually marketing their products and this is where the Government can provide assistance through either grants for specialist consultants, or even access to graduate students who can bring the latest technical knowledge to help traditional component manufacturers position themselves to diversify into alternative markets, particularly overseas. We are aware that the South Australian Government has already assisted some component suppliers to develop marketing plans for alternative business opportunities which we welcome.

Notwithstanding a desire for many component suppliers to diversify, there is also an issue of redundant plant and equipment which can make leveraging assets to diversify a manufacturing operation quite difficult, particularly in relation to procuring finance. There are also considerations of scale and instances where two businesses could merge and salvage substantial value in both companies but the costs associated with merging prohibit such activity. Business SA has previously advised both the State and Federal Governments to consider this in their assistance packages but to date it has not been allowed for. The Senate Committee should also be mindful of the additional job losses which eventuate when multiple businesses close when at least part of those operations and associated jobs could be saved through enabling appropriate merger activity.

3. Potential for early closure of local auto-manufacturing

In relation to South Australia, the potential for an early closure of Holden is still subject to debate and may still depend on sales volumes between now and 2017. For reputational reasons, Holden will be reluctant to withdraw its local manufacturing operations prematurely, but at this stage it appears the Elizabeth plant may have built enough Commodores to carry Holden through to a future model as early as the beginning of 2017. However, considering the majority of Holden's costs are sunk, there may be less immediate pressure to cease production. Notwithstanding, the transition period for the component manufacturing sector may be shorter than what was originally expected and puts real pressure on both levels of Governments to act decisively to lessen the fallout. Governments also need to be mindful that reduced orders from local auto-manufacturers to component suppliers can push up their per unit costs and further erode the ongoing viability of some businesses.

Numerous South Australian component manufacturers also supply Ford and Toyota and anecdotal evidence suggests demand for some of Ford's components is already starting to wind back quite considerably although niche aspects such as performance vehicles are partly offsetting the broader trend. On a positive note, Toyota's component requirements seem to be holding steady and we are not aware that their local auto-manufacturing will cease any sooner than expected.

The Federal Government needs to be careful not to bring on Holden's exit any earlier than what might be otherwise determined through market forces. While there are limited levers the Government has to support local auto-manufacturing, the Automotive Transformation Scheme (ATS) should not be adjusted before the last Australian auto-manufacturing plant closes. Furthermore, there is a case for a reduced version of the ATS to operate for a limited period beyond the end of local auto-manufacturing to support component manufacturers who may be able to reposition to supply global component markets.

We expect there may be as little as 10-20% of Holden era auto-component manufacturing in Adelaide post 2017. Nonetheless, it is far better to support businesses able to make the transition to global supply chains, rather than rely on diversification opportunities or expansion of companies in other industry sectors. Furthermore, there is only a limited percentage of companies who are likely to embrace diversification strategies, typically based on their ownership characteristics, and both Governments need to strategically focus on assisting small locally owned businesses.

4. Ensuring skills in the automotive sector are not lost

A major social and economic concern for South Australia is the potential loss of employment opportunities for skilled workers once local auto-manufacturing finishes in 2017. There will be a considerable number of fitters and turners, welders and associated tradesmen and tradeswomen who will find it very difficult to find alternative work which demands such skills. While in theory such workers can be retrained, the reality is that unless there is a significant expansion of South Australia's economy in the next few years, alternative job opportunities will be scarce. Furthermore, highly skilled workers from the automotive sector will also be competing with less skilled auto-workers for the same limited pool of jobs.

Although the decision to award the next submarine contract needs to be carefully considered within a competitive tender process, the Federal Government must also factor in the potential loss of skills in a city like Adelaide which have built up from decades of auto-manufacturing. Considering the desire of both the Federal and South Australian Governments to grow advanced manufacturing, the rhetoric needs to be supported by a pool of skilled workers which will diminish if the submarines are built offshore. Alternative advanced manufacturing capability will take a considerable time to develop which underlies the need for interim measures to ensure the necessary skills are available for when demand from alternative advanced manufacturers begins to materialise.