



Federation of Automotive
Products Manufacturers

Productivity Commission Inquiry:
Review of the Australian Automotive
Manufacturing Industry

Supplementary Submission

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Dear Commissioners

Federation of Automotive Products Manufacturers (FAPM) Supplementary Submission to the Productivity Commission's Inquiry into the Australian Automotive Manufacturing Industry

Since FAPM lodged its initial submission, the context within which the PC is conducting its Inquiry into the Automotive Manufacturing Industry has changed dramatically.

The decision by all three Motor Vehicle Producers (MVPs) to cease manufacturing in Australia by 2017 will have a devastating impact on local automotive suppliers and will forever transform Australia's traditional manufacturing landscape.

Nevertheless, the FAPM considers that there are several vital issues that the PC can focus on that would ensure its Final Report makes a constructive contribution to economic policy in Australia.

The adoption of the approach outlined by FAPM in its supplementary submission ensures that Australian automotive manufacturing experiences an orderly structural adjustment process that seeks to secure our advanced manufacturing capabilities and maintains as many businesses as possible.

In developing this submission, FAPM has continued to consult widely with its members and encouraged them to submit their own submissions.

With Regards

Richard Reilly
Chief Executive

Jim Griffin
National President

1. Introduction

The dramatic events taking place in Australia's automotive industry requires the Productivity Commission (PC) to immediately shift the focus of its Inquiry into the Automotive Manufacturing Industry.

With all three local Motor Vehicle Producers (MVPs) having announced their intention to cease operations in Australia, there is little value in the PC proceeding to complete a report that simply contains high-level arguments that call for an end to the current support for local manufacturing.

The demise of large-scale automotive manufacturing in Australia will lead to the direct loss of 50,000 jobs (including 33,000 across component companies), the closure of most of its 150 component businesses and will create severe flow-on economic and social impacts in many parts of Victoria and South Australia.

The focus of the PC's analysis must shift towards examining practical ways to best manage this economic adversity in a way that minimises the short and long term impacts on the Australian economy and community. These issues include:

- Developing strategies for Australia to draw upon its existing capabilities to secure new global automotive opportunities, particularly in contract manufacturing and the production of niche vehicles
- Accelerating efforts to support automotive suppliers in diversifying their businesses, to ensure that Australia's automotive capability is transitioned to support other areas of advanced manufacturing
- Ensuring that an orderly and coordinated approach is taken to the wind-down of MVP and supplier production to minimise the impacts on employees, industry, regions and the taxpayer
- Re-assessing Australia's industry policy and program framework in light of a comprehensive international benchmarking of the trade and investment attraction policies of our competitors.

These matters are outlined below in more detail.

FAPM considers that there is a narrow timeframe for Australia to harness the automotive supply chain's capabilities that have been developed over six decades and transition them to emerging global opportunities.

We call upon the PC to play a constructive role in facilitating this transition by providing practical analysis and advice on key issues that would moderate the severity of the impact of structural adjustment in automotive manufacturing.

2. An emerging 'new manufacturing' model for the global automotive industry

The PC Position Paper places a strong emphasis on assessing Australia's competitiveness as a centre of automotive manufacturing against an 'old manufacturing' paradigm, where high volumes in the order of 300,000 units per annum are essential to a plant achieving economies of scale.

The PC briefly notes (p.62) that some stakeholders, including the Federation of Automotive Products Manufacturers (FAPM), have suggested that niche players be facilitated into the local market. However, it does not analyse in any depth the broader 'new manufacturing' trends in the global automotive industry and what opportunities this may create for Australia.

The nature of automotive manufacturing is changing in a manner that is leading to the emergence of a new approach to the production of motor vehicles, particularly in regard to niche models.

This 'new manufacturing' model is being driven by a range of factors, including:

- The development of new production technologies and techniques such as modular assembly systems that enable economies of scale to be achieved at a fraction of the volumes usually required under the 'old manufacturing' model
- Fragmented consumer preferences, requiring MVPs to adapt to manufacturing a more diverse range of low-volume vehicles
- Electric vehicle and other alternative fuel technologies that are generating demand for high-value low-volume vehicles
- Global model platforms, which facilitate large-scale production volumes but also provide opportunities to pursue niche markets
- The unrelenting drive by MVPs to achieve economies in their production systems and supply chain, leading to innovative business models including contract manufacturing.

This 'new manufacturing' model is evidenced through the strategies and techniques of a number of innovative players in the global automotive industry, including:

- Mahindra Reva, an Indian-based electric vehicle manufacturer that has adopted a modular approach to production that achieves economies of scale at 30,000 units, rather than pursuing a traditional model of investing vast sums of capital expenditure in a large scale plant
- Greater utilisation of third party contract manufacturing in the automotive industry by the major global MVPs including Mercedes-Benz, Porsche and Mitsubishi. These manufacturers include Magna Steyr, Valmet, NedCar and DRB HiCom.
- The emergence of a new generation of nimble automotive manufacturers such as Yamaha, the utilisation of next generation production techniques such as the iStream manufacturing process developed by Gordon Murray Design in the UK
- Partnerships between established manufacturers and innovative start-ups, as evidenced by MTM's production of the TomCar utility vehicle.

The advent of new manufacturing in the automotive industry is being recognised by global capital markets. As one example, the market capitalisation of General Motors is around \$50 billion, and the company manufactured approximately 7 million vehicles last year (market cap per vehicle of \$7,100 per car). Tesla, the luxury electric vehicle manufacturer in the US, has a market value of around \$20 billion and manufactured 25,000 vehicles (market cap of \$800,000 per vehicle).

While this is a static example, it is highly instructive of the relative value the market is placing on next generation automotive manufacturing against traditional players.

International experience suggests that a country's competitiveness in attracting niche manufacturing is increasingly influenced by talent, technology, supply chain capability and infrastructure, rather than solely production costs such as wage rates.

FAPM considers that the Australian automotive industry is well positioned to be a global centre for automotive 'new manufacturing', given:

- The local automotive industry's demonstrated experience in manufacturing a wide range of model variations at relatively low production volumes
- An adaptable and globally connected supply chain

- The resilience in the volumes of new cars sold in Australia each year, and fragmentation of the profile of those sales
- Our proximity to emerging Asian markets
- Our technological capabilities in vehicle electrification, gaseous fuels and lightweighting, as evidenced in the Automotive Australia 2020 Roadmap
- Talent and resources that are becoming displaced as the MVPs wind down their local manufacturing operations
- Australia's capabilities in high-value low-volume manufacturing adjacent industries, including defence (military vehicles), trucks and rail rolling stock.

However, in order for Australia to engage with the new manufacturing model, urgent steps need to be taken while the local supply chain and associated infrastructure is still largely intact.

FAPM considers that this is achievable within the existing funding envelope for automotive programs.

FAPM Supplementary Recommendation 1:

FAPM recommends that the PC Inquiry Final Report should:

- **Identify emerging global developments in new manufacturing technologies and techniques in the automotive industry**
- **Analyse trends in the composition of consumer demand for motor vehicles and the implications for existing automotive production models**
- **Examine global Foreign Direct Investment (FDI) flows in the automotive industry, including the proportion of investment that is being attracted to high-wage locations**
- **Provide case studies of innovative global automotive businesses that are leaders in 'new manufacturing' techniques**
- **Outline how high cost countries (eg. United Kingdom) have transitioned their automotive industries into centres for niche production**
- **Develop strategies and programs to position Australia to pursue niche and contracting manufacturing opportunities and attract key global investors.**
- **Assess how these strategies may help facilitate the transition of the local automotive industry and reduce the adjustment costs to the community associated with the closure of the MVPs' manufacturing operations.**

3. An assessment of supply chain potential

The recent closure announcements by all of the car companies create immediate issues for each of the 150 suppliers impacted. These include:

- Assessing what changes they could make in regard to diversification or export activity to become sustainable
- Determining whether any alliances in the form of merger or acquisition activity can create the required scale to drive success
- Understanding the detail of their legal and commercial obligations.

As part of the industry restructuring assistance that Government is currently considering, FAPM is urgently seeking access to a fund of \$15 million over three years to undertake specific assessments of each supplier against this framework.

The outcomes of this work would be invaluable to assist suppliers in trying to optimise their position over coming months and years.

FAPM's role in administering this program would be to:

- Appoint a panel of industry specialists to deliver the initial assessments
- Act as a single point of referral for suppliers to other sources of assistance, whether this be to diversify, access export markets, work with training and skills providers
- Assist suppliers in accessing other restructuring assistance depending on the outcomes of their individual assessments
- Co-ordinating access to the proposed AISAP Mark II outlined below
- Liaise closely with State and Federal Governments on the overall findings of these activities to assist in the management of the economic consequences of the demise of local vehicle manufacturing
- Managing inbound and outbound trade events.

FAPM believes this type of approach is the lynchpin to ensuring a 'soft landing' for many of the 150 businesses impacted by recent decisions, preserving as many positions in the supply chain as possible.

It will also mitigate the potential impact on the Federal Government's FECS program, and minimise the number of potential voluntary administration events in the industry.

FAPM Supplementary Recommendation 2:

FAPM recommends that the Federal Government establish a new \$15m supplier assessment program over three years that is administered by FAPM, with the objective of providing practical company-specific information and advice to automotive suppliers on managing their businesses during the structural adjustment period.

4. Diversification of supply chain businesses

FAPM strongly recommends that government support for diversification activities by automotive suppliers should continue as a key industry strategy.

The benefits of automotive suppliers diversifying into new markets or non-automotive products include:

- Minimising the adverse impacts of adjustment on the community, particularly the loss of high-value jobs
- Retaining key automotive capabilities in Australia
- Disseminating automotive industry technologies and expertise into other advanced manufacturing and service industries.

The decisions by the MVPs to cease manufacturing by 2017 make it even more imperative that the Government accelerate its support for automotive suppliers to diversify their activities into new markets and innovative products.

4.1 Automotive Transformation Scheme (ATS)

FAPM re-affirms the recommendations it made in its initial submission to the PC Inquiry in relation to ATS, including that the program be reformed to support diversification activities by the automotive supply chain (Initial Submission Recommendation 13).

FAPM believes that the ATS program must continue through to 2020 as planned. This will assist those suppliers who have managed to diversify their businesses or enter export markets. If retaining the ATS program beyond 2017 is not considered feasible, then the Automotive New Markets Program (ANMP) must be utilised as a primary means of supporting supplier diversification.

The PC Position Paper included Department of Industry estimates that the funding profile of ATS may lead to program participants receiving lower benefits between 2015 and 2017, even though they may have already factored in this funding into their commercial arrangements. FAPM considers that the funding profile of ATS must be re-phased to better reflect the anticipated industry activity during this critical wind-down phase.

Further, the access arrangements for the ATS program needs to be amended to reflect new supply chain requirements in response to the Holden and Toyota announcements. Specifically, the benefit cap of 5% of automotive sales needs to be adjusted to ensure consistent access to remaining ATS assistance:

- A schedule to increase this threshold as local production winds back
- Removal of the cap towards the final stages of the program.

This would ensure stability for suppliers seeking to transition their businesses over the longer term.

Under current arrangements, suppliers get paid their ATS claim for any given quarter year over the following 11 quarters. As a result, when MVP manufacturing ceases in December 2017 the supplier ATS payments will continue for approximately the next 3 years, slowly reducing to zero.

In order to assist supplier companies with their significant restructuring or closure costs, FAPM recommends that suppliers be able to receive their outstanding ATS receivable in the quarter following the quarterly claim submission. This change would significantly assist the suppliers with cash flow in order to meet restructuring and closure costs.

FAPM notes that the Department of Industry has provided advice to the PC that the MVPs' design activities will be ineligible for ATS after they cease manufacturing. FAPM considers that the retention of these local design capabilities would support local component manufacturer access to global supply chains and assist in the attraction of niche players. However, allowing this expenditure to become eligible under the program's guidelines may have a significant impact on ATS program funding available to suppliers. Therefore, FAPM believes that further industry consultation is required on this matter before such a change is considered.

FAPM Supplementary Recommendation 3:

FAPM recommends that the ATS program be amended:

- **to support diversification activities by the automotive supply chain (as detailed in Recommendation 13 of the FAPM initial submission)**
- **to ensure that the funding profile better reflects expected industry activity**
- **to adjust and ultimately remove the benefit cap of 5% of automotive sales to ensure consistent access to remaining ATS assistance during the wind-down period**
- **so suppliers can receive their outstanding ATS receivable in the quarter following the quarterly claim submission.**

4.2 Automotive New Markets Program

As outlined in FAPM's initial submission, ANMP has been an important initiative in supporting the automotive supply chain, with 23 suppliers to date undertaking projects to diversify their businesses. The program is regarded by the industry as successful in achieving its key objectives.

The PC Position Paper notes that the ANMP is scheduled to lapse in 2015-16 and proposes (Draft Proposal 3.1) that the initiative should not be extended or replaced after its scheduled closure.

However, in making this proposal, the PC has not assessed in any detail the efficacy of the program, the outcomes it has achieved to date or the need to maintain this program in the future.

FAPM considers that, given the major challenges facing automotive suppliers, the ANMP represents a relatively modest investment by government in facilitating a transition to more viable business models and, in turn, increases the likelihood that automotive suppliers will be able to transform themselves.

The 2015-16 scheduled cessation of the program coincides with the period that the automotive suppliers will have their greatest need for assistance, with the MVPs reducing their production levels as they wind down their local operations.

FAPM considers that the ANMP should continue even after the scheduled closure of the MVPs, as the remaining automotive suppliers adapt their operations to a business environment that will have changed dramatically within a short timeframe. Post-2017, some automotive suppliers may potentially be providing components to local niche businesses or contract manufacturers. It is also envisaged that, with the support of ANMP and other programs, more local automotive businesses will be accessing global export markets.

FAPM Supplementary Recommendation 4:

FAPM recommends that the Federal, Victorian and South Australian Governments immediately extend the operation of the ANMP initiative from 2015-16 to 2020-21.

5. Consolidation of the supply chain

5.1 Industry consolidation

A key theme of FAPM's initial submission to the PC Inquiry was that further industry consolidation is essential to retaining an internationally competitive automotive industry in Australia.

The recent decisions by Holden and Toyota to cease manufacturing in 2017 accelerate the timing and severity of the impact of the structural adjustment on the industry and the broader community.

In response, FAPM heightens its call on government to play a constructive role in facilitating the consolidation process in order to achieve better industry outcomes and minimise the burden on the community.

5.2 Redundancy liabilities

As reported in *The Age* on 25 November 2013, estimates have been made that the end of automotive manufacturing would leave approximately \$1.3 billion in unfunded employee entitlements in the automotive supply chain that may need to be met by the Fair Entitlements Guarantee.

As outlined in FAPM's initial submission, a major obstacle to an orderly consolidation of the supply chain is the redundancy liabilities held by suppliers. The Automotive Industry Structural Adjustment Program (AISAP) that operated under the *New Car Plan for a Greener Future* package sought to facilitate industry consolidation.

The program had limited uptake because redundancy costs were not defined as 'eligible expenditure' under the program's guidelines. Several acquisitions that could have taken place in recent years that were otherwise commercially viable have not proceeded because the cost to the acquirer of taking on the target business's redundancy liabilities.

The operation of FEG and its predecessor Government Employee Entitlements and Redundancy Scheme (GEERS) means that in some circumstances it suits an acquirer to wait until the target business has gone into liquidation or bankruptcy, placing a burden on the taxpayer in regard to worker entitlements. Under this scenario where the business is not sold as a going concern, production across the whole industry can be disrupted and key capabilities are lost. Further, the redundancy costs are met by the Government under FEG/GEERS, rather than by the potential acquirer as would normally be the case.

Given the impending restructure of the automotive industry, this represents a major cost exposure for the Australian Government.

In contrast, FAPM considers that a more orderly consolidation process would minimise industry disruption and reduce the cost to the taxpayer. It would also increase the likelihood that the MVPs will actually continue their manufacturing operations until their scheduled closure dates.

In its initial submission to the PC Inquiry, FAPM recommended (Recommendation 8) that a specific program be established to encourage automotive supply chain consolidation. This program would be based on the previous AISAP model, but its treatment of redundancy costs and other issues under the original program would need to be addressed.

FAPM Supplementary Recommendation 5:

FAPM recommends that the PC Inquiry Final Report assesses the benefits of a more co-ordinated approach to the restructure of the automotive supply chain. This analysis should examine:

- **The potential benefits of a more structured approach to industry consolidation**
- **The benefits to taxpayers if supply chain businesses are in a position to meet their employee entitlements**
- **Specific initiatives that could promote a more orderly consolidation of the supply chain, such as an AISAP-type program.**

5.3 Information and co-ordination

A key challenge to an orderly wind-down of the MVPs' manufacturing operations will be how best to co-ordinate MVP production requirements with the supply chain, particularly as volume trends for each MVP will be different and inherently difficult to forecast. An industry-driven co-ordinated approach to managing week-to-week production requirements will minimise the cost of industry disruption caused by MVP down-days and the number of suppliers going into administration.

Further, it is critical during this structural adjustment period that the automotive supply chain businesses have access to practical, tailored information and advice to assist in managing their businesses. For instance, careful attention needs to be given to the obligations of office-holders of businesses to ensure that they continue to meet their legal duties, particularly in relation to not trading whilst insolvent.

FAPM considers that government should give consideration to funding such an industry-driven information and co-ordination activity.

6. International investment and trade policy benchmarking

The automotive industry and the PC are in agreement that Australia has one of the most open and transparent automotive markets in the world. In contrast, our local manufacturers face significant trade and non-tariff barriers when seeking to enter export markets.

The FAPM submission detailed the trade and investment regimes of a wide range of automotive manufacturing countries to demonstrate that Australia is not operating on a 'level playing field', either in attracting investment to this country or in accessing global markets.

Recognising these global realities is critical to setting the context for considering the Australian policy and program framework for the automotive industry. This point is reflected in the Terms of Reference to this Inquiry, which specifically requires the PC to take account of international automotive industry assistance arrangements when examining the Australian automotive manufacturing industry.

In response, the PC has concluded (Draft Finding 2.2) that an accurate comparison of the levels of assistance across countries is extremely difficult to do and "is not feasible for this inquiry."

FAPM considers that, regrettably, the Position Paper has not met its obligations in regard to this critical aspect of the Terms of Reference. As a result, at this stage the PC's analysis is incomplete and its findings inadequate. FAPM believes there is sufficient information available to draw conclusions about the relative openness of the Australian market. This aspect of the analysis is even more critical for Australian component suppliers seeking new export markets to support their sustainability given the recent closure announcements.

FAPM Supplementary Recommendation 6:

FAPM recommends that the PC Inquiry Final Report undertakes a thorough international comparison of assistance to the automotive industry and re-considers its recommendations in light of those findings.

7. Importation of second-hand vehicles

The PC Position Paper briefly examined the current policy settings regarding the large-scale importation of second-hand vehicles and concluded that the policy rationale for prohibiting such vehicles is weak.

However, as acknowledged in Draft Finding 3.2 and Information Request 3.2 in the Position Paper, the PC's assessment is based on limited information and further information is required to undertake a cost-benefit assessment that takes into consideration consumer protection, community safety and environmental performance issues.

FAPM opposes changes to policy settings that would allow the large-scale importation of second-hand vehicles. In addition to issues relating to vehicle safety, regulatory standards and an appropriate enforcement regime, such changes may make Australia a less attractive location to niche manufacturers and would also impact on aftermarket manufacturers and service businesses.

FAPM Supplementary Recommendation 7:

FAPM recommends that existing policy settings in regard to the large-scale importation of second-hand vehicles into Australia be retained.