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Defab Weavers Pty Ltd

TCF Industry Review Submission

Introduction

The aim of this submission is to highlight to the Productivity Commission the internal and external pressures facing Defab as it structures and positions it self within the current TCF industry. Furthermore this submission will highlight the opportunities and threats encountered by Defab and other SME companies that will allow the Commission to develop a better understanding of the TCF sector.

Defab is a family owned fabric weaving and coating business. From modest beginnings in 1974 as a commission weaver to the Australian wholesale market, Defab has evolved into a significant manufacturer of fine quality fabrics servicing distinct markets throughout Australia (e.g. apparel fabrics, and outdoor canvas fabric range) and exporting to Singapore, Fiji, New Zealand, and Hong Kong (not EOAP).

With the decision to move into the marketing of its own fabrics, Defab relocated to new, purpose built facilities in the mid 80's, boasting a fully integrated and controlled manufacturing environment. Since then it has constantly been introducing latest state of the art equipment as the need arises.

Since deciding to target customer markets directly with its own branded products, Defab has been supplying fabrics to a vast array of unique markets not adequately serviced by local competitors and imported producers. (eg. homewares, filtration, outerwear, linings etc). The company specialises in the production of heavier weight materials suitable for industrial applications and also produces materials suitable for the apparel industry (corporate wear) and contract furnishings (Sydney Superdome, Crown Casino, Oakford apartments to name a few). From an initial focus on canvas base cloth production, Defab has now also moved into fabric coating and uses external resources for dyeing and finishing. Defab has researched market trends (both local and international) and developed products to service perceived gaps in what is available from larger competitors and imports. Further opportunities have been developed as the industry has restructured (e.g. Bradmill restructure).

Defab's growth has been steady with turnover doubling over the past 2 years to current annual sales of $5.4 million. It is expected that this will grow further to around $8 - $10 million over next two years given recent product initiatives in corporate wear and school wear fabrics, and a push for further export growth. This should allow a sound base for steady growth beyond 2005.

Defab sees its competitive advantage arising from the fact that it is a smalllmedium enterprise (SME) and therefore more responsive to the changing needs of the marketplace it serves. Defab has been encouraged to continue investment in new equipment and infrastructure with the introduction of the TU SIP scheme (approx. $1.5 Million investment allocated for the next 2 years) to enable the company to maintain a flexible, efficient and cost effective production to service the growth that has occurred in the target markets.

Defab's key strengths are derived from its ability to:

- Be a niche market supplier
- Be highly flexible to changing conditions
- Provide a product which offers excellent value
- Have high customer service levels
- Operate using products which require smaller production volumes, and
- Being internationally focused and astute
- Focus on innovative products and quality

Defab's main strength as an SME, being comparatively small in relation to its major competitors, allows the company to be more dynamic, and provide the flexibility and diversity increasingly sought by the marketplace. Defab also prides it self on continually improving the quality of its product, and adding value to ensure the resultant product is clearly targeted to the high end market (e.g. outdoor fabric).

Supply Chain

Figure 1 depicts Defab's current supply chain management (i.e. raw materials, manufacturing, warehousing and distribution). Due to the uncertainty relating to the changing industry structure and to ensure Defab maintains its price competitiveness Defab has undertaken offshore sourcing of yarn. If cost competitive yarn was available then Defab would source locally.

Import overseas yarn
Local fabrication converters
Manufacturing External Dye Distribution
• Weaving (dobby weaving) & Finish Warehousing
• Coating (blade coating, Wholesaler
proofing) Overseas
fabrication
v converters
Local yarn

Figure 1 Defab Supply Chain

Whilst Defab is committed to local manufacturing the company has elected to also import commodity fabrics and yarn that allows it to offer a broader cost competitive product range and develop offshore sourcing skills should manufacturing in Australia become uncompetitive post 2005. However, it is through local manufacturing where Defab is able to offer customers a wide spectrum of potential fabric applications because it produces innovative and effective solutions efficiently and can respond to changing market demand quickly. Consequently the supply chain represents a dynamic, customer focused business model, that provides an extensive range of niche products complemented by the services Defab provides.

Defab has also invested significantly in new plant and equipment in its quest to become Australia's most pro active fabric producer. An example is the new coating plant that complements state of the art weaving facilities. Defab's outdoor fabrics range offers maximum performance, for domestic and commercial awnings, caravan annexes, truck tarpaulins, horse rugs and window furnishings. To ensure the customer receives the best quality possible these specialist fabrics are woven, coated and proofed completely within Defab's internationally accredited facilities.

Utilising the TCF SIP scheme Defab is developing new products and making further improvements in the production process to achieve greater efficiencies and to reduce waste in time and materials. Defab is also contemplating adding to the current weaving and coating capabilities, with a dyeing and finishing plant to achieve even further cost reductions. Such facilities will support Defab's niche marketing policy and allow better control over the manufacturing process to meet Defab's customer needs in the context of quick response and high quality.

Recent Performance and Future Prospects In the TCF Industry

The profitability and rate of return on investment in the TCF industry has declined in recent years. This decline is due to many internal and external factors that include the higher cost of maintaining a manufacturing facility (e.g. taxation, insurance, labour cost), further consolidation within the TCF industry, fabric converters sourcing offshore and the growing shortage of trained staff within the TCF, sector that increases labour costs above award rates or in line with jobs in the services sector.

Contrary to this negative trend Defab has grown significantly over the pass few years and emerged as a company that is well positioned to capitalise on the opportunities created by the industry restructuring that has been facilitated by the current assistance package. As outlined in the introduction these opportunities are in areas where there is a high value added content (e.g. outdoor fabric, fabric with custom design). This success can be attributed to Defab's focus on servicing niche markets, developing new products that required higher value added components (ie Defab has kept away from commodity product with little value added requirements), and taking advantage of the positive assistance available under SIP eg reinvestment. Defab is also undertaking exporting initiatives with market research into the European and Asian markets and brand development.

Continuous improvement of manufacturing productivity and return on investment has been achieved through benchmarking against international best practice, and developing a vertically integrated manufacturing plant, and utilising the latest and best technologies available. Defab has also addressed the industry uncertainty created by the ongoing restructuring and rationalisation, by investing in world class, purpose built facilities and equipment with the assistance of the TCF SIP scheme. This has allowed Defab to put in place a strong manufacturing base that is characterised by flexible manufacturing methods, high quality, and quick response systems.

Defab has also undertaken its own internal training program to ensure its staff are well trained. The limited availability of skilled labour in the TCF industry and a lack of strategic training available to the industry in conjunction with the poor coordination between education providers and Australian TCF industry is one of the most important areas that requires government guidance and assistance.

The difficulties facing TCF companies adjusting to the changes in the sector include the downsizing of a skilled labour force within the TCF industry (ie shortage of skilled labour entering the TCF industry and the lack of educational institutions offering textile related courses). Consequently, wages have steadily increased (e.g. skilled weavers) whilst the average age for TCF worker has also increased as younger people are choosing not to enter the TCF industry due to its relatively negative image. Whilst labour costs through awards have kept within the CPI, TCF companies, in reality, have to pay a premium for skilled labour well above award. (e.g. dyers, technicians and administration).

The cost of doing business in Australia has continued to increase outside of the normal manufacturing and administration charges. For example:

(a) In Victoria work cover and payroll tax are a major cost that has increased by 8% over the past decade
(b) Insurance costs are spiralling (FY-2002 $23000 cf FY 2003 $49000)
(c) Power costs are increasing each year that is taking away the energy advantage we have enjoyed over the major textile nations (China and Pakistan). Privatisation has not given real long term benefits
(d) Banking costs (LC services have increased in the past 18 months by 500%),and
(e) Freight costs - our geography is a constant burden that seems to impose an impost on business. (importing air freight from India costs $1.15/kg whereas exporting from Australia to Singapore is $2.901kg-NZ is $4.201kg)

To operate successfully and profitably within the current TCF environment and post 2005 companies will display certain similar attributes. Most of these companies will be SME (i.e. turnover between $5 - $10 million), have a good understanding of the changing market dynamics, market focus and service focus, have access to a broader product range, and provide flexible service (e.g. available same day/special design and a smaller flexible production volume). Other characteristic will be:

- A focus on niche product for. local manufacturing (e.g. canvas with anti bacteria antimould or fire retardant properties, point of difference)
- Initiating, through overseas market research the development of new product and processes
- Offer different unique design
- Implement international best practices to reduce production cost.
- Clear strategic marketing objectives for short and long term

The external forces that will influence future performance and prospects for the industry include:

- Exchange rate (primary driver for imports and exports)
- Trade barriers and non trade barriers e.g. tariff, product and country standards and labelling requirements, international trading agreements (e.g FTA), logistics (freight costs), and quotas.
- Influence of various trading block and trading agreements (e.g EU market and a common currency, and NAFTA)
- Overseas Government intervening into their respective TCF industry to ensure the longevity of the sector. For example the India TCF companies receive approx. 15% - 33% Government subsidies for export sales)

Defab believes changes to the domestic policy setting (e.g. taxation, worker compensation etc) can significantly increase the sector's competitiveness. Whilst these areas may be outside the Commission's terms of reference they are real factors that have a major impact on any TCF company and its ability to compete with imported goods.

TCF activities in regional areas are no more vulnerable than they are in the capital cities. That is both regional and capital city companies are faced with the same pressures and market drivers. Defab is in favour of any scheme that may assist regional areas to adjust to the changing TCF industry as it would consequently benefit the industry. However, any future or current assistance packages should not exclude TCF companies operating in capital cities as all TCF companies are facing the same or similar pressures even if it means reversing previous policy towards regional areas.

Impact of Current Assistance Arranqements

The current assistance programs have lead to structural change within the TCFL sector. The Victorian State Government has provided assistance for business planning and export development in conjunction with EMDG. By far the most important program is SIP. SIP has provided effective assistance for:

(a) Capital investment, and
(b) Research and development (including product development and process improvement)

Other programs for offshore expansion are SPARTECA and EOAP. Defab believe SPARTECA works well, as does the new S-TCF scheme, as long as it is structured so as to not have a negative impact on Australian industry (eg simply not replace cotton for wool at expense of Australian industry). Furthermore, Defab believe EOAP is a vehicle that encourages companies to relocate all their activity offshore without having to try and improve their domestic operations. Defab does not believe EOAP has any value to TU industry going forward.

The SIP program has been most effective for Capital Investment but Defab feel the 5% Total Eligible Revenue (TER) ceiling has provided an unfair bias to larger companies when the industry is restructuring into SME (ie it is the SME's that are proving most flexible and most responsive to changing market conditions). The most efficient companies are now the TCF SME's and the failure of larger companies has lead to a waste of SIP funding.

SIP has had some success in directing funding into R&D but the process is laborious and bureaucratic and involves circular debates over the definition of innovation. SIP has not been effective in addressing market access in the context of skills required, market knowledge, and export marketing assistance.

Defab believe the SIP program would be improved if the following changes were made:

(a) Separate the funding into three distinctive areas. Capital programs, Market Access, and Research and Development
(b) Capital investment should have a higher ceiling to allow a TCF SME to participate without handing over a windfall gain to large companies. The TCF structure post 2005 will be primarily SME

(c) Funding should be in place for market access. The EM13G scheme works well, is easily understood, and would be an excellent model for TCF under SIP. There is a need to better understand market opportunities and how to access offshore markets.
(d) Research and development needs to be clarified so that the scheme is easier to manage. The scheme should have an R&D focus or simply day to day development rather than the fashionable yet vague definition-innovation. Collaborative research programs designed to assist clusters to work together needs to be encouraged so that skills can be pooled, and
(e) Consideration should be given to the marketing demands upon TCF companies where they are trying to establish an identity for their product to service a niche market domestically or establish a presence overseas. This work would include brand awareness for Australian products.

In addition to the above the SIP should class "new" plant and equipment as that which is up to 5 years old. There is now an abundance of surplus plant available globally whereby the current SIP definition disadvantages Australian manufacturers. Purchasing brand new plant is forcing Australian manufacturers to pay exorbitant premiums. Finally SIP funding should be conditional on the money being reinvested back into the business and retained profitability should be a primary criterion for any SIP grants. SIP should not be a prop for poor margins in an unsound business.

Workplace Issue

Workplace industrial dispute is not a significant issue. Defab's enterprise arrangement with individual employees has work effectively in establishing a flexible working environment. Although we have a strong relationship with union representatives their role at Defab has been minimal.

Efforts have also been undertaken to develop a positive working environment (e.g. implementing training program) and encouraging employees to pursue a career in the TCF industry. However, recent company -closures has tarnished the image of the industry to some degree.

The major issue is the deskilling of the industry and the poorly coordinated training of skilled workers as outline in the submission. As outlined earlier in this submission the increasing cost of labour is a concern as it is not being driven by wage demands but a shortfall in skilled personnel and competition for labour from unskilled service industry positions that offer a higher wage. Despite the success of MF SME companies the industry is not able to fill its TCF training institutions with people who want to become knitters, weavers, and textile mechanics. The average age of Defab's workforce is high with consequent pressure on OH&S injuries and productivity targets.

Market Access and Post 2005

Defab will adjust to the market needs within the market access parameters that are in place within Australia and overseas. Current strategic thinking within Defab is that local manufacturing will be an important part of the business and a source of competitive advantage going forward.

Clearly dumping is now part of the TCF market in Australia and is a feature of other countries strategies where Australia's open market has seen commodity TCIF imports capture large sections of the market with low price, poor quality goods that cannot be related to any Western cost accounting system. However this is an accepted part of the open market we now enjoy. The recent policy whereby up to 50 "poorer nations" can now import freely into Australia will see some market impact although it will probably impact imported commodity product from China as it competes with Bangladeshi products rather than the niche products produced locally.

A large part of Defab's business and indeed the Australian textile industry is that of specified garments for the Commonwealth or State authorities that are purchased by tenders. If it were at all possible to encourage Commonwealth or State buyers to "Buy Australian" or even specify the product as being "substantially converted from Australian made fabrics" there would be an enormous benefit for the local industry.

There is no real debate on the impact of a further reduction in tariffs. It will lead to a further reduction in manufacturing, reduced employment and a further increase in imports. It will also reduce the industry critical mass and exacerbate the labour skills problem highlighted in this submission and the consumer benefit will be minimal as retail will simply try and improve margins. The tariff pause has allowed poorer performing companies to exit, usually at a great cost, that has lead to the SME restructuring alluded to earlier in this submission. Significant capital investment has been undertaken throughout the industry during the pause. However, the transition to value added niche marketing has not been a focus of the SIP and manufacturing industry has only slowly been making this transition-in reality 5 years, given a lead time of 18 months for new plant and equipment, is not all that long a period for change.

Logistic costs are now a major market access issue for Australian manufacturers as Australian freight rates are simply not competitive into major markets such as Europe and USA (especially air freight with Qantas/NZ in a strong position). Some non trade barriers can be overcome by dual nationality whereby a EU passport holder can easily establish a trading office in Europe (only Chinese citizens can hold an import licence for China)

The export assistance provided through Austrade (e.g. market analysis), EFIC and the DFAT market access initiatives has not been that helpful to Defab. Austrade is in place to assist all manufacturing and service industries and at times it lacks the understanding and unique requirements of the TCF industry (i.e. networks, potential trading partners). Whilst the EFIC is good for companies seeking an open trading term Defab trading is primarily on an L/C basis or TT site.

Summary

The key points that Defab would like to highlight to the Commissioners are:

- Defab are a successful TCF manufacturer that has made use of the current arrangements to invest in new plant and equipment and capitalise on market opportunities.

- A further reduction in tariffs will see a reduction in manufacturing and an increase in imported goods across all segments. Defab believe that any tariff reduction should be made in gradual steps and combined with positive assistance measures aimed at assisting the development of competitive advantage in the context of modern plant, training for skills, and market access for value add manufacturers who can demonstrate a successful business enterprise.

- Continuation of positive assistance through an SIP type of scheme that:

  (a) separates the funding into three distinctive areas. Capital programs, Market access, and Research and development
  (b) defines new plant and equipment as that which is up to 5 years old
  (c) has a higher ceiling for capital investment to allow TCF SME to participate without handing over a windfall gain to large companies. The TCF structure post 2005 will be primarily SME
  (d) Allocates funding for market access. The EMIDG scheme works well, is easily understood, and would be an excellent model for TCF under SIP. There is a need to better understand market opportunities and how to access offshore markets.
  (e) Clarifies research and development so that the scheme is easier to manage. The scheme should have an R&D focus or simply day to day development rather than the fashionable yet vague definition-innovation. Collaborative research programs designed to assist clusters to work together needs to be encouraged so that skills can be pooled, and
  (f) Gives consideration to the marketing demands of TCIF companies where they are trying to establish an identity for their product to service a niche market domestically or establish a presence overseas. This work would include brand awareness for Australian products.

- Positive assistance is provided to facilitate specific training programs to increase the number of skilled textile people available to the industry and retain these people within the industry. Training assistance should be separate from any type of SIP scheme

- Measures aimed at assisting companies with market access are of immense importance to TCF companies eg

  (a) management of non tariff barriers when exporting
  (b) the cost of freight out of Australia into world markets
  (c) ongoing development of overseas market knowledge and support for product presentations overseas eg trade shows

defab