PRODUCTIVITY COMMISSION INQUIRY

INTO

POST 2005 TCFL INDUSTRIES ASSISTANCE

AUSTRALIAN WEAVING MILLS SUBMISSION

MARCH 2003

AUSTRALIAN WEAVING MILLS PTY LTD

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BACKGROUND TO AUSTRALIAN WEAVING MILLS PTY LTD

The Company

Australian Weaving Mills Pty Ltd (AWM) as a company has evolved through a series of mergers which during the 80's and 90's saw four formerly independent towel manufacturers come together in one large mill. The result of that was the formation of a large manufacturing facility in Devonport where a textile plant had originally been opened just after the second world war. The Company currently supplies towels and bed linen to retail and institutional customers.

AWM's core business involves selling towels with annual sales of $37m p.a., 95% of which stems from local manufacture.

AWM also has a bed linen business, sales of which total $8 million. This is now fully imported, having gone through a natural evolution of local manufacture, to a shift offshore to Fiji with intermediate product supplied from Australia, to now being fully imported from Asia. The bed linen business is complementary to the towel business, and derives its market presence by leverage off the towel business.

Thus AWM's total business equates to sales of $45m p.a .

The company employs 275 people in total with 250 of those being based in Devonport, Tasmania. The balance of the workforce is based at the Melbourne sales/ marketing office or at interstate selling offices.

AWM's key strengths are:-

- It's high profile brands (Dri- Glo, Dickies)
- Its image of quality supported by ISO 9001 accreditation
- It's strong, financially healthy customer base
- Its ability, through its vertical structure, to provide quick response supply
- Its experienced and committed management team and a stable workforce in the Devonport mill.

The towel industry and AWM's Current and Future Strategies

In 1985 there were 9 towel mills in Australia. Following the recently announced closure of Supertex there are only 2 domestic mills of any significance left in the industry.

Import penetration in the towel business has been significant but is much lower in terms of market share than has been the case with other segments of the industry. There are four major reasons for this:-

- The importance of Brands
- The retailers' need for quick replenishment of "back wall towel programmes which is difficult to fulfil via the import route
- Investment by the industry in up to date technology

- Innovative product

AWM has pursued a course of brand development (the company's brands represent 65% of its total sales) supported by appropriate investment in technology (AWM has invested $ 8.6M in its Devonport plant. Over the last 3 years) and in product development and in the development of a smart interface between its business and the customer.

AWM foresees a viable future for the towel business in Australia subject to appropriate arrangements being put into place under the post 2005 industry plan. AWM intends to further invest in plant and equipment in order to continue to maintain its overall competitiveness, and to further strengthen its market position through product innovation and the use of its brands. Under such a scenario the Devonport plant should continue to be viable and offer long term sustainable jobs to this regionally TCF dependent area.

The Devonport community

Devonport is situated in the northern part of Tasmania where unemployment is much higher than the Australian norm and where the economic dependence on TCF activities is high. The table set out below compares unemployment rates between Devonport, Tasmania and Australia, as a whole

% Unemployment

	Devonport	Tasmania	Australia
Males	13.4	11.8	6.2
Females	11.6	8.1	6.0
Average	12.6	10.1	6.1

Devonport is a town of 23,000 people and a full time workforce of 5,200 people. AWM and the local carpet manufacturer (Ulster -Tascot) together account for 500 full time jobs (i.e. 10% of Devonport's total workforce). In AWM's case employment is evenly divided between males and females. Unemployment in Devonport is twice the national average

Both the Ulster -Tascot and the AWM businesses have a track record as profitable, viable enterprises. As such neither is a "basket case surviving on government handouts" but both of which are deserving of appropriate ongoing support for readjustment.

AWM draws on supplies and services from 110 companies within a 20 mile radius of the Devonport facility. As such it is a significant contributor to the local economy stretching well beyond the immediate employment dynamics.

FUTURE INDUSTRY ASSISTANCE – WHAT WOULD AWM BE LOOKING FOR

1) TARIFFS

a) Finished Product tariffs

Australian Weaving Mills recognises that tariffs are scheduled to be reduced on 1st January 2005 from 25%, to 17½ % for finished goods. We acknowledge that this was a decision reached, and agreed to by industry, at the time of the last review.

The subsequent reality however, is that the restructuring pressures imposed on the industry by the ongoing tariff reductions through to June 2000 were much more severe than anyone had expected. This pressure was compounded by the introduction of GST, which manufacturers were forced to absorb and which has more recently been impacted on by the strengthening $A. AWM believes therefore that the previously legislated tariff reduction should not necessarily be tacitly taken as read. Rather the Company holds the view that the commitment should be reviewed in the light of the current circumstances.

Whilst AWM has invested heavily in new capital equipment and has devoted considerable time to new product development, the Company is firmly of the view that the current operating environment in Australia is still very tenuous. This is amply demonstrated by the recent closure of Supertex's towel manufacturing operations in Goulburn, New South Wales.

AWM is confident that it is taking the necessary steps to ensure it's ongoing viability in the Australian market place. However, the Company is conscious that it cannot stand still and that it will need to continue on it's re-investment path, continually developing new products and new markets.

The scheduled tariff cut in 2005 will tend to undermine the positive efforts AWM has made to date. The currently legislated reduction from 25% to 17½ % is substantial and will cause major disruption. To ensure the Company can move forward with future expenditure plans with reasonable confidence, tariffs should be held at their current rate or, in a worst case scenario at the legislated 2005 rate until at least 2015.

This is imperative to enable AWM to continue to compete in what promises to be a very disruptive global environment in the post 2005 period - when all countries will seek to reposition themselves in the wake of the myriad of bilateral quotas that have been in existence for the last 30 years between the major TCF trading countries. This is not just a matter of ensuring AWM's sustainability, but ensuring it can continue to contribute to the employment opportunities for the TCF dependent regional area of Devonport Tasmania, and continue to be a major value adder to the Tasmanian and Australian economies.

b) Greige tariffs

Unlike many segments of the industry, importation of greige in the towel sector has been limited. The reason for that is partly the fact that towel manufacturers both in Australia and overseas are vertical but also because the tariff duty applying to cotton greige towelling is the same as that applying to finished goods. Any change to that duty relativity would seriously undermine the vertical nature of domestic towel manufacturers since it would be possible for importers to import greige towelling and finish at commission dyers. Such a structure would put on going local manufacturing at considerable risk.

AWM contend therefore that duty on greige towelling should continue to remain at the same level as that applying to the importation of finished goods.

c) Raw Materials tariffs

It is important to understand that AWM's major raw material is yarn (yarn purchases represent 34% of the cost of goods) and that where we can we purchase open end yarn produced locally (from Rocklea Spinning Mills and Bradmill) . The bulk of our yarn purchases however have to be imported since 65% of our yarn requirements are for ring spun cotton, which is no longer locally produced. The mix of our yarn requirement is driven by the need to have a robust base to the towel (supported by purchasing open end yarn locally produced) with the need for softness and absorbency in the pile, which has a different technical requirement and which can only be achieved by using ring spun yarn.

Given this requirement to import yarn, the drop in tariffs on 1 January 2005 will impose significant pressures on our cost competitiveness if the duty on our key input (i.e. yarns) is not reduced at the same time. The current plan is to reduce finished goods tariffs by 7.5% whilst leaving yarn tariff at current levels, effectively exposing AWM to greater import pressure whilst not relieving it of the tariff burden on its key raw material.

Elimination of yarn tariffs should not impact adversely on local yarn producers, as they will still offer the advantage of quick response and technical superiority in the area of open end yarn which substantially remains the domain of the local industry, whilst allowing AWM to import the 65% of its needs which cannot be locally produced duty free.

To reduce tariffs on finished product imports and not on yarn would significantly weaken the competitive position of local towel manufacturers. AWM contend therefore that yarn duties should be eliminated across the board but at the very least in the area of ring spun cotton yarns.

d) Tariff Duration And Certainty

Given the lead times for capital projects to show an adequate return, for reasons of predictability the Government should be looking at a firm plan for tariffs through to 2015.

This should involve either delaying currently planned tariff reductions through to 2010 in order to recognise the changed circumstances which have unfolded since the original scheme was put in place or at the very least pausing tariffs at the legislated 2005 level until 2015. Any further tariff reductions beyond those currently envisaged in 2005 should not be legislated, rather they should be examined and their appropriateness adjudged at the time of the mid term review which should take account of action taken by other countries to reduce their trade barriers to accord with our more open market. This could be done by conducting a streamlined industry review at that time (ie focussing solely on trade barriers) to determine the nature (path/extent) of further tariff reductions if any, for the period 2010 to 2015.

2) <u>POSITIVE ASSISTANCE</u>

The positive assistance currently provided by the TCF Strategic Investment Scheme has been most beneficial to the industry.

For AWM's part, the assistance afforded the industry for capital expenditure through Type 1 funding has facilitated investment in new technology, which would otherwise have been unaffordable or would have occurred at a much slower pace.

Additionally the scheme's support of R&D through Type 2 funding has encouraged AWM to become increasingly more innovative and it has helped the company grow and develop its business. This is exemplified in the growth of the business over the term of the plan to date.

Given the foreshadowed reduction in tariff on 1 January 2005, it is even more vital that this positive form of assistance is retained beyond 2005. The increased competitiveness accorded imports through the tariff reduction will demand further and more accelerated improvements in production efficiencies on our part which will only be obtained from further capital investment and continued innovation.

<u>a) Future scheme requirements</u>

AWM acknowledges the WTO limitations imposed on the SIP scheme and its operations through the need for overall support levels to not exceed 5% of revenue.

For the bulk of the scheme the Company therefore has no intention of mounting any argument for an increase in total support levels , however under WTO rules it is understood that there are some areas where the cap could be legitimately relaxed.

For instance, AWM believes additional encouragement could and should be accorded to regionally based development and to environmentally focussed projects. Discrete funding should be made available for these purposes, or alternatively a multiplier should be applied to the SIP funding rates, in recognition of such activities. These are both areas where other major markets (ie Europe and US) provide significant support, ostensibly without breaching WTO requirements. Thus funding accorded for these purposes should not need to be captured in the capped amount.

AWM also offers the following general suggestions for how any continuance of the current SIP scheme might be more appropriately tailored to suit the needs of the industry.

b) Structural Parameters for the Scheme

- The Company questions the need for maintaining a cap on the value added component. We understand the need for the overall sales cap, given WTO considerations, but surely this is the only cap that is required. It would make the scheme much simpler administratively, and more predictable if we did not have to also calculate the value added cap. This is significant given that the extent of value added, under the definition applied, varies considerably between sectors. The capital intensive segments of the TCFL sector, which arguably comprise the more internationally competitive companies within the sector, are disadvantaged under the current treatments (which favours the labour intensive industries).

- AWM also believes some realignment of the support package in terms of mix would be appropriate to the future needs of its business and those of the industry. Given the current prospect of a further round of tariff reductions in 2005 and the inevitable further competitive pressures which would be brought to bear coupled with a strengthening A$, manufacturers will need to satisfy themselves as to the merits of capital investment over even shorter payback periods. Thus AWM contends that consideration should be given to increasing the level of grant given to capital expenditure as a proportion of the total industry support package.
  A package might be considered which still offered grants under Types 1&2 but rather than have a differential claims rate of 20% and 45% respectively perhaps a common rate of say 35% might be examined.

- Under the current scheme a company can roll forward funding generated if a company exceeds its 5% sales cap but any under claiming against the cap is lost. Given that capital spending is often cyclical there should also be a provision to roll back a claim if a company is under the cap in a previous year.

- Consideration also needs to be given to the timing of SIP payments. Currently companies receive the rebate on eligible expenditure often 15 – 18 months in arrears. The scheme should allow for interim (say quarterly) payments on R&D/Product Development expenditure where the company has a track record of such activity and can readily demonstrate that this has been ongoing. In the case of major capital projects likewise there should be a facility to make a claim on a quarterly basis. Cash flow funding of large scale capital projects is a major issue for the industry and an ability to make claims and have them paid within the year of expenditure would enable companies to make major investments earlier and with greater regularity rather than do nothing in the nine months of the year and cram expenditure into the last quarter. This is a major issue in terms of cash flow funding for the industry.

- The Type 4/5 components of the scheme have clearly been poorly crafted. The existing arrangements have played no part in encouraging proactive industry rationalisation/ restructuring. In that context it is a loss to the domestic towel industry that Supertex has closed its plant in order to move production offshore when under the original vision for the industry scheme, funding would have been available for industry players to seriously look at consolidating those activities into regionally dependent areas. The lack of utilisation of grant funding offered under Types 4&5 of the scheme clearly demonstrates the failure of those two parts of the Scheme to offer appropriate incentives for the industry to rationalise. The reality is that the industry will continue to need to rationalise, and measures that could facilitate such restructuring would provide a major benefit, not just to the participants, but to the industry generally and the economy overall. Types 4/5 grants need to be completely revisited and they should be restructured to match the original intent of the draft scheme which was to facilitate industry rationalisation with an emphasis on encouraging the industry to migrate form unsustainable major city locations to regional TCF dependent locations.

c) Capital and Infrastructure Expenditure Support

There are two parts to the industry – volume commodity product, and the more fashion oriented sector that relies on quick response. The latter is the sustainable sector in Australia, but we need to continually access state of the art equipment to take full advantage of the opportunities generated. As tariffs come down, industry will need to be even more at the forefront of new technology.

In the case of investments already made, payback periods have not yet have been reached for this capital expenditure. Given the prospective further tariff reductions, the hurdle rate for capital investment will rise whilst at the same time the need for such investment will also further intensify. Therefore in order to encourage the accelerated investment necessary it will mean that the support provided under SIP for Type 1 will not only need to continue but will need to be increased.

Warehousing is also an important component of future expenditure to ensure we can best service our market and thus pull through locally produced product. One of AWM's biggest costs is the interface with its customers and the ultimate consumer. Supply chain management is vital and this will require ongoing and intensive focus and investment in order to ensure the Company's future sustainability.

We are already, and will continue to need to spend significant money on systems management, warehousing, distribution systems, etc. This is an integral component of ensuring we can maintain effective and competitive manufacturing operations in Australia, and all such expenditure should be eligible under SIP.

d) R&D and Product Development Support

Turning to the Type 2 element of the Scheme, given AWM's experiences to date, we are comfortable with the definitions of R&D as they currently stand. The onus is on us to be able to demonstrate that the expenditures undertaken are innovative, and we believe this is a fair and reasonable requirement.

However we also believe there are other expenditures, vital to ensure our ongoing competitiveness and sustainability that should also be eligible for Type 2 funding under SIP – notably market development and skills development and training. It is incongruous for the scheme to support expenditure on the latest capital technologies, but not in training the workforce to understand and make best use of these technologies. AWM therefore suggests that consideration be given to incorporating funding for those activities within any post 2005 industry plan.