

Austanners (Vic) Pty Ltd

Submission to the Productivity
Commission Inquiry Into the
Textiles, Clothing, Footwear &
Leather Industries

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Austanners (Vic) Pty Ltd (referred to in this submission as Austanners) welcomes this opportunity to present its views and experiences to the Productivity Commissions inquiry on the textile, clothing, footwear and leather industries.

This submission provides an overview of:

- the industry
- the company
- recent international developments
- the Strategic Investment Program
- future strategies
- conclusions

Overall, Austanners suggests:

- SIP should be retained beyond 2005. However, some modifications need to be made to strengthen the future effectiveness of the scheme.
- An industry targeted trade strategy including the selective negotiation of free trade agreements and instruments should be adopted
- The post 2005 environment should look to encourage a viable local footwear industry in some form. Providing an overseas assembly provision for footwear assembled from Australian sourced and cut leather could do this. This would encourage the local development of a technical capability and provide this technical capability with access to low cost offshore assembly labour with which to manufacture footwear that would be more competitive with fully-made up imports.

THE INDUSTRY

The Australian leather industry produces over \$730 million of leather per year and generates nearly \$190 million of value added, which is about the manufacturing average. This activity is undertaken in some 180 establishments located throughout Australia, frequently in regional or remote locations and employs over 3000 people.

The industry is highly focussed on exports, with nearly 78% of sales being exported in 2000-01. This export orientation compares to the manufacturing average of about 30% in that year.

Austanners currently accounts for some 5% of total industry sales and about 60% of finished consumer apparel leather exports. The company currently employs about 80 people.

The industry is part of a global supply chain that stretches from Australian cattle farms to the sale of premium quality footwear and furniture in the salons of Europe and America. The industry predominantly processes bovine hides and sheepskins (in wool-on and wool-off states) through various stages into finished leathers and skins. Specialist leathers, derived from kangaroo skins, goat, pig, calf, emu, crocodile, snake, and fish skins are also produced in small quantities. Major end users include the footwear, apparel, upholstery and leather goods industries.

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The industry is dominated by a few major companies which undertake fleshing, de-hairing, fellmongering, skin pickling, wet blueing, sammying, splitting and shaving hides and skins in order to produce wet blue hides. Two firms, including Austanners, perform these wet blueing activities prior to undertaking re-tanning, dyeing and embossing to produce premium quality finished leather. Two other companies purchase wet-blue hides in order to finished leather.

The tanning process involves two main stages of processing, wet and dry.

In the wet process, large volumes of raw materials are batch processed employing considerable quantities of chemicals and dyes in liquor solutions. Tanning in drums usually takes around 48-60 hours to achieve the desired penetration of hides/skins with tanning agents. In dry processing, materials continue through various sequences of batch processing in order to impart the required attributes of the particular leather for its intended end use. This may involve drying, printing, buffing and finishing. Typically these processes are labour intensive and highly dependent upon the individual skills and craft of the tanner.

Significant capital improvements incorporating advanced technologies to improve the control and speed of processing, including the operating speed of some processing machinery, better functional control of equipment and operating variables and the development and application of sensor technology have and are being made.

Whilst leather production involves a capital intensive production method, mastery of this is not sufficient to produce a high quality product. Whilst technological and capital factors influence the degree of competitiveness they are unable to replace the skill, judgement and innovative problem solving skills of the tanner.

World market capacity, prices and trading rules, increasingly stringent environmental standards and regulations (particularly in the European countries to which Australia exports) and the exchange rate also have impacts on this commodity based supply chain.

THE COMPANY

Austanners is the only vertically integrated manufacturer of finished apparel and furniture leather in Australia.

The company is the result of a significant restructuring of the Australian leather industry in 1998 that consolidated the skills, expertise and craft of Dixon/Spectrum Leather, Courtnay Leather, Austanners Wet Blue and Austanners Pty Ltd.

This rationalization included the establishment of a new world-class greenfields site in Lara Victoria, incorporating the most up to date equipment available. Due to a change from what we had been led to expect as to the interpretation of the SIP arrangements this world scale investment was not treated as eligible for assistance under the regional components of the scheme. As such the complicated nature of the SIP scheme has resulted in the facility operating with a larger financing cost than originally envisaged.

In total over \$12 million has now been spent on the development of this new greenfield plant and its associated equipment and processing techniques to ensure that it is at the leading edge of the industry's technological development.

It is also developing and applying world-class effluent treatment systems to ensure that the most efficient

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utilisation of available water is made in an environmentally sympathetic manner, including recycling where possible.

The company is committed to enhancing the competitiveness of the entire leather supply chain through the development and application of innovative management systems. For example, Austanners was a prime participant in the Hide Improvement Program, which developed computerized information and management systems to improve the information flowing to all stages in the supply chain. By encouraging the development of a system that recognizes variable hide quality and value, growers, processors and consumers were encouraged to take more informed decisions.

The pressure to increase the degree of innovative capabilities and products is particularly strong for a relatively small-scale producer of leather. To succeed without the benefits of large scale production economies requires the development of other areas of competitive advantage - i.e. high level production competence and flexibility (allowing rapid responsiveness to opportunities) and product innovation (leading to world class products tailored to specific market requirements)

The company has therefore concentrated on developing new products and production processes, utilising its skills and the advantages of having one of the worlds most advanced facilities of its size.

INTERNATIONAL DEVELOPMENTS

Leather is not generally subject to substantial tariffs in its own right. Instead intermittent export restrictions on raw material hides and skins are more commonplace as countries look to ensure the survival of their processing industries in periods of shortage. In addition support is often provided by local government instrumentalities to individual firms. Identifying and quantifying such arrangements is difficult as they are often subject to commercial confidences.

Other leather producing nations in Asia, India and South America impose significantly lower requirements for treating and disposing of waste than is required in Australia. This results in a substantial indirect financial subsidy to Austanners overseas competitors.

Looking forward, it is possible that there will be reductions in tariffs as a result of the Doha Round. However the policy of the worlds leading players such as the United States of America to make any reductions conditional on being linked and reciprocated means that unilateral unconditional reductions of benefit to the leather industry are unlikely to occur.

In addition any reductions are likely to be phased in. As such significant progress in lowering tariff barriers is unlikely to eventuate until 2010-2015.

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There is therefore little to suggest the Australian industry will receive significant benefit in the next five to ten years from reductions in General System of Preferences (GSP) tariffs.

In addition it should be noted that Australia's past policy of unilateral and unconditional reductions is at odds with international practice and stated policy for these negotiations. This could result in any reductions made by Australia prior to the negotiations not being reciprocated.

Regional trade blocs such as NAFTA, the EU and, in time, AFTA have and will open up increased trade opportunities for their members. (APEC may also offer some trade advantages in the future but these are speculative at the moment.) At the moment at least, Australia is not a member of any of these regional agreements, and it runs the real risk of being effectively locked out of any of the major trading blocs. If Australia unilaterally reduces its tariffs further it will have given away any capacity it may have had to negotiate reasonable access to these blocs.

STRATEGIC INVESTMENT PROGRAM

The company has received support under the Commonwealth Governments Strategic Investment Program. Details are available on a confidential basis if required.

The SIP Scheme evolved from the strategy adopted by government over the 1990's, firstly to encourage export growth through the 1991-2000 Import Credit Scheme, and improving TCF&L business practices through the 1996-2000 Future Strategies program. An Overseas Assembly Provision encouraged increased internationalization of locally controlled supply chains. The company, and its predecessors, was an active participant in these arrangements.

The Strategic Investment Program was to encourage those activities determined as drivers of improving business capabilities - investment and innovation.

Overall the SIP should be retained beyond 2005. However, some modifications need to be made to strengthen the future effectiveness of the scheme. In particular, consideration should be given to ways of improving the level of certainty participants have about the value of projects undertaken under the auspices of the program.

In particular, the scheme:

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- has not provided the predictability and certainty of outcomes that would enable the company to implement a more strategic approach to product and market development
- has involved distinguishing innovations that occur as a result of normal business practice from those that result from some other source. This is a source of considerable uncertainty.
- has involved distinguishing normal product development from innovative product development. In a working tannery such distinctions are subjective.
- treats plant and equipment differently depending upon whether it is new or used rather than whether it is state of the art or not.
- imposes significant administrative costs

Future Strategies

Australia's hide and skin resources are not an advantage in them unless the leather industry is able to apply the marketing, technical and financial expertise needed to produce efficiently for the global market. It is also necessary to be able to obtain in those markets a reasonable price that reflects those costs.

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The international leather market is adversely affected by the practices of Asian and Indian producers to obtain raw materials at less than the international price (which is the price that Australian tanneries have to pay to local suppliers) and then process that material into finished leather which can be sold at a significant discount to the worlds best practice, competitive cost achieved by producers such as Austanners.

Proximity to suppliers can in some instances result in cost savings by reducing the need to salt the hides and skins. However since Australia's herd is so disparate these savings are in reality only realisable by small-scale specialist tanners.

As noted above the leather industry is part of a large international supply chain. Similar linkages also occur in Australia where the industry is a major customer for the livestock and chemical industries as well as providers of transport, information technology, computers and technical research services.

The importance of these linkages has been highlighted in recent years with significant work and expenditure going into branding, yarding, and slaughtering practices, as well as methods for controlling and minimising tick damage. Improvements in these areas have involved the active co-operation of farmers/feedlots, saleyards, abattoirs, state and federal governments and the CSIRO.

Linkages forward from the tanning sector extend most importantly into the footwear and furniture industries.

These linkages have led to the development, amongst others, of technologies and systems to digitise and automate the assessment of leathers in order to maximise cutting yields. This is an area of research that is at the forefront of global industry practice.

Work such as this is an example of the advanced technical, scientific and manufacturing skills associated with the operations of the leather industry. These capabilities then of course extend out into the broader economy as well.

However the concentration of the Australian footwear industry has led to a significant decline in the local market for finished leather. As well as the immediate loss of scale economies, this development resulted in the technology not being fully commercialised, developed and extended due to the smaller leather cutting requirements of the manufacturers.

Generally the reduction in the number and scale of Australian leading edge customers has increased the cost of investigating and developing new methods and products. While such programs can be undertaken in the context of strategic partnerships and facilitated by proximity and personal contact such investigations are immeasurably more difficult when trying to deal with distance and time zone differences.

CONCLUSION

The industries are an integral component of the Australian industrial, economic and social structure. They:

- add value to and thereby generate greater economic benefit from Australia's abundant supplies of hides
- build on IT and e-commerce applications such as bar-coding and scanning technologies in facilitating the introduction, extension and mastery of information and communication technologies
- develop, design, create and adapt new products for consumers, industries and technologies
- identify, analyse and develop new and different manufacturing processes to adapt new and existing technologies to the demands of a lean flexible manufacturing environment that operates without the benefits of scale production

While the Australian leather industries are small by global standards they make a significant contribution to the Australian economy and are well placed to continue playing a leading role in driving evolution in the knowledge and service economy. This arises from their being a high value producer, driven by innovation and the ability to identify, supply and capitalize on ongoing global leading edge demands.

These gains will and are being realized through the direct and indirect efforts of the industries as engines of change, development and growth. These benefits are realized in the tangible value of value-adding intellectual, creative, and physical activities, their associated employment and income and the implicit costs associated with the absence of these activities.

To succeed without the benefits of large scale production economies requires the development of other areas of competitive advantage - i.e. high level production competence and flexibility (allowing rapid responsive to opportunities) and product innovation (leading to world class products tailored to specific market requirements).

The absence of fair competition in export markets and amongst global exporters combined with the deleterious effects of the diminishing local customer base means that it is very difficult to forecast developments beyond 2005. It is therefore essential that any changes considered for 2005 and beyond should be aimed at facilitating adjustment to domestic and international pressures rather than causing additional pressure to be applied.

In recognition of this Austanners suggests:

- SIP should be retained beyond 2005. However, some modifications need to be made to strengthen the future effectiveness of the scheme.

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- An industry targeted trade strategy including the selective negotiation of free trade agreements and instruments should be adopted
- The post 2005 environment should look to encourage a viable local footwear industry in some form. Providing an overseas assembly provision for footwear assembled from Australian sourced and cut leather could do this. This would encourage the local development of a technical capability and provide this technical capability with access to low cost offshore assembly labour with which to manufacture footwear that would be more competitive with fully-made up imports.

PRODUCTIVITY COMMISSION ISSUES & QUESTIONS

How have the TCF industries and individual firms been performing in terms, for example, of profitability, return on investment, market share, exports, improvements in productivity and product quality?

Confidential data on these indicators are available if requested

What has been the contribution to performance outcomes of industry restructuring, investment in plant and equipment and R&D, emphasis on skilling, training and management performance and supply chain management?

Austanners is a direct result of industry restructuring to invest in a new technologically advanced world-class facility.

Investment, product development and process improvement are critical to the successful operation of the plant. Skill is the key pre-requisite for a quality tanning operation. There is at the moment no alternative to on the job training and experience complemented by purchased expertise

What adjustment pressures are acting on the TCF sector (eg. technological change, increased competition from low wage or more efficient production centres overseas, changing patterns of consumer demand)?

Leather is subject to the emergence of low cost producers in Asia, the use of materials supplies as a local production subsidy by other global exporters and the concentration of the local footwear industry

What difficulties have occurred in adjustment to changes in the sector's operating environment in recent years? What factors have facilitated or impeded adjustment to increased international market competition? What are the characteristics of those firms that have either succeeded or failed (eg. are brand recognition, marketing, design and/or product differentiation or some minimum scale important)?

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Internationally, the most successful leather firms are those with a strategic local customer base involved in the development of leading edge products and processes (i.e. Italy). The concentration in the Australian footwear industry has therefore been a major problem during a period of re-investment and revitalisation by the leather industry.

Which industries in the TCF sector in Australia are most competitive (eg. in which specific products or production processes) and why? How might this change in the future? What capacity do TCF firms have to improve their productivity/cost base towards international best practice?

Leather is potentially competitive in the long term depending upon its access to uncorrupted markets. To succeed without the benefits of large scale production economies requires the development of other areas of competitive advantage - i.e. high level production competence and flexibility (allowing rapid responsive to opportunities) and product innovation (leading to world class products tailored to specific market requirements)

What external forces will influence future performance and prospects (eg. exchange rates, microeconomic reform, trade barriers and overseas assistance measures)? Would changes in domestic policy settings (eg. to taxation, workers' compensation arrangements, etc) help the TCF sector to increase its competitiveness?

All external forces impact the international leather market - the ability to accommodate the shifts is a characteristic of a successful industry. However for this to occur the overall context and environment must be conducive to ensure ongoing confidence during periods of change.

Labour related taxation measures are inequitable and a major disincentive to local operations. Whilst the responsibility of State governments, the Federal Government should work with the States to abolish payroll tax, excessive workers compensation payments etc.

In the immediate future to directly and significantly enhance the competitiveness of the industry, these expenditures should be recognised as eligible expenditures under the type 2 element of SIP

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Is TCF activity in regional areas particularly vulnerable to changes in the sector's operating environment?

The leather industry is predominantly located in regional areas.

Impact of current assistance arrangements

The TCF sector receives government assistance through a range of measures including tariffs on competing imports, grants delivered through the Strategic Investment Program (SIP), the Expanded Overseas Assembly Program (EOAP), policy by-laws and access to generally available government programs. Analysis of the impacts of the current assistance regime will provide an important guide to the level and form of assistance that should apply to the sector after 2005.

How effective and efficient are current assistance measures in promoting desirable structural change and establishing an internationally competitive TCF sector? Which measures are the most effective?

SIP is the most important instrument. EOAP should be of relevance to the leather industry should be but isn't because of inadequacies for the direct users.

Generally available programs are of little relevance - company expenditures eligible under EMDG are relatively low while the tax concession schemes do not recognise the applied nature of Austanners development programs.

Have the impacts of assistance measures varied significantly across different industries in the TCF sector? What aspects of the current package have most helped desirable change? Have there been any unintended or undesirable side effects?

How effective has the SIP been in encouraging additional or earlier investment in process or product development and new capital equipment? Are there any deficiencies in the SIP criteria or their application?

SIP was directly responsible for the restructuring of the industry in 1997/98 and Austanners relocation program was accelerated as a result. It was therefore a major concern

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to learn that the implementation of the scheme was different to our expectations.

SIP could be improved by delivering greater certainty as to eligibility of different sorts of expenditures and reducing the timelines.

Are there any particular problems or anomalies in other assistance arrangements (eg. the EOAP and policy by-laws)? How might they be avoided/alleviated?

EOAP could provide for the full remission of duty when Australian leather is used as the upper in finished footwear

To what extent are TCF firms taking advantage of the current tariff pause to prepare for the legislated tariff reductions in 2005?

Not relevant as leather receives minimal tariff support.

How significant are the costs imposed on consumers, taxpayers and other industries by the assistance package for the TCF sector? To what extent have these imposts hindered the performance of local downstream industries such as furniture manufacturing?

In our experience, SIP has acted to reduce local costs by improving availability of product and skills. Other costs faced by the industry are determined in the international marketplace or by local institutions (water, rates, taxes, wage rates etc)

Workplace issues

Is workplace inflexibility and/or industrial disputation a significant problem for the TCF sector? What are the key concerns in these areas (eg. shift restrictions, demarcation, disputes associated with the protection of employee entitlements)?

Reforms to the industrial relations system in recent years have strengthened the ability to implement workplace arrangements better suited to the needs and circumstances of the individual workplace.

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What gains have been achieved in labour productivity and value added per employee over the past few years? What has happened to rates of pay in the sector over the same period?

Confidential company data is available if required

What are the main impediments to better workplace outcomes (eg. deficiencies in management or workforce skills, workplace culture, an inappropriate industrial relations framework, inadequate training infrastructure)?

Lack of scale results in constant changes which are difficult for workforce to adapt to.
No significant training infrastructure for operators due to the experiential nature of the production process or recognition of on-the-job training.

Do the characteristics of the TCF workforce (eg. skill levels, age profile, ethnicity, gender) hinder labour mobility within the sector and between it and other sectors? What consequences might this have for the long term viability of the sector and to its ability to adjust?

Educational levels are generally low - cost constraints and world prices put limits on the ability to raise the pay profile to attract more flexible workers.

Mobility is itself not an issue as the workforce is largely itinerant.

What issues and concerns are raised by the use of outworkers (eg. an inadequate information base, exploitation, working conditions)?

What impact have legislative (eg. the Ethical Clothing Trades Act in NSW) and voluntary (eg. the Homeworkers Code of Practice) initiatives had on outworkers and TCF firms? Are other approaches required?

Not relevant to the leather industry.

Market access issues

In what ways, and to what extent, do overseas tariffs and non-tariff barriers restrict access to markets? Are there

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examples of current barriers creating, rather than hindering, opportunities for Australian firms?

India and Asian producers can gain access to locally supplied hides at less than world prices during times of shortage.

Have local TCF firms been able to circumvent the trade barriers of other countries (eg. by establishing production facilities in other countries/regions, through brand recognition, concentrating on high value niche products etc)?

No

What new opportunities or threats are likely to arise from current efforts to liberalise TCF trade through the Doha round of WTO negotiations and the APEC commitment to free and open trade in the region by 2010 for developed countries and 2020 for developing countries? What will be the impact of developed countries removing their quotas on imports from developing countries under the WTO Agreement on Textiles and Clothing?

Minimal

Are imports from least developed countries (eg. Bangladesh) likely to increase significantly as a result of the recently announced removal of Australian tariffs on products from these countries?

Little demand for finished leather in Australia therefore unlikely to have much direct effect

How helpful has export assistance provided through Austrade (eg. export market development grants), EFIC (eg. export finance guarantees) and the DFAT market access initiative been in assisting TCF exporters?

Minimal

Is dumping in the Australian market a significant problem? Are current anti-dumping measures effective?

Not relevant

Post 2005 assistance arrangements

What rationale, if any, is there for maintaining tariff assistance to the TCF sector indefinitely? If not, over what time frame would it be reasonable to remove the sector's preferential tariff treatment? What are the key considerations in determining that time path?

See comments above

What, if any, of the other components of the sector's current assistance package should be retained? What modifications to programs such as SIP and the EOAP should be made if they were extended? What role would they play in facilitating structural change in the TCF sector?

See comments above

Would further reductions in assistance post 2005 be likely to cause significant economic or social disruption? If so, how could the sector be best helped (eg. special adjustment or regional assistance)? Are there any case studies of previous adjustment experience (both positive and negative) which the Commission should consider?

See comments above