

SUBMISSION BY



GODFREY HIRST AUSTRALIA PTY LTD

**TO THE
PRODUCTIVITY COMMISSION**

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**INQUIRY INTO THE POST 2005 ASSISTANCE
ARRANGEMENTS FOR THE TEXTILE, CLOTHING AND
FOOTWEAR INDUSTRIES**

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INTRODUCTION

Since the last review of the textile, clothing, footwear and leather industries in 1997, the Australian carpet manufacturing industry has undergone substantial change. That review found that in the '80's the industry had been inwardly focused, highly protected and was operating in an unsatisfactory policy and economic environment. The sector is now on a transition path, well on the way towards becoming a dynamic, globally oriented industry.

The industry has made progress in repositioning itself within the international market, but there is still a long way to go. Based on export growth in high value added products and a solid performance in the domestic market, the industry has strong prospects for the future. These efforts can be significantly enhanced with supportive and positive policy measures from the Government.

Carpets are sophisticated, elaborately transformed manufactured products. Through applying capital and technology intensive manufacturing techniques, raw materials (including wool) are transformed into high value commercial and residential floor coverings. The carpet industry is also a major manufacturer of natural and synthetic fibres and yarns including wool, nylon and polypropylene.

The carpet industry will continue to meet various challenges and change accordingly over the next decade and more. It is vital that appropriate assistance measures be implemented over the medium to long term, i.e. five to ten years, that best enable the industry to meet these challenges head on, and ensure its ongoing sustainability. To this end, the basic SIP principles should be extended beyond 2005, to provide the necessary support to accelerate the fundamental industry drivers of product development, capital investment, technology uptake and market growth and development.

GODFREY HIRST IN BRIEF

Godfrey Hirst is Australia's leading carpet manufacturer and employs over 1000 people at its manufacturing facilities in Geelong, Bayswater and Benalla, its distribution centre at Laverton and at overseas offices including, Canada, Singapore, Hong Kong, the United Kingdom and the United States of America with related company activities in New Zealand.

The company is vertically integrated in both natural and synthetic fibres. This includes extrusion of both Nylon and Polypropylene yarns, wool spinning facilities, yarn texturing and tufting and carpet finishing.

The company also undertakes a significant research and development program. Research into fibres at the various stages of transformation are complemented by an extensive process improvement program into the mechanical processes of transformation. An extensive design program is also conducted to identify and develop new products and features.

The company ranks as one of the top 30 carpet manufacturers in the world rated on sales revenue. Most global companies specialise in synthetic carpets which due to their use of filament yarns and scale of operations provide opportunities for manufacturing efficiencies greater than in similar sized companies in Australia. The technical and financial challenge associated with our requirement for flexibility is highlighted by the fact that comparable sized facilities in the United States and Europe manufacture only 10-15% of Godfrey Hirst's product range.

The company is a significant catalyst for new and improved services to complement the carpet development process. These services include the treatment and disposal of waste products in an environmentally sustainable fashion, the testing and analysis of fibres and the performance and health implications of finished carpets.

As an extension of its own value adding activities, the company is a major customer for a wide variety of trade, professional and technical services. In addition to the direct employment and income effects generated, the company also acts as a test and trialling bed for the development and evaluation of new technologies and business techniques by these suppliers.

Godfrey Hirst is Australia's leading user of coarse wools. The company purchases some 80% of all Australian coarse wools and transforms this into wool carpet yarn, and subsequently into finished carpets. The company produces more than half the total wool yarn produced in Australia each year. As such the company is a major contributor to the further processing of Australian raw materials into higher value products.

Godfrey Hirst is the only company in the carpet industry that has extrusion capacity for both bulk continuous filament Nylon and polypropylene, reflecting the strategy to maintain a strong focus on import replacement to capture value-add throughout the manufacturing processes.

Godfrey Hirst is an integral component of the Geelong, Victorian and Australian industrial, economic and social structure. It:

- adds value to and thereby generates greater economic benefit from Australia's wool supplies.
- builds on IT and e-commerce applications in facilitating the introduction and extension of information and communication technologies.
- develops, designs, creates and adapts new products and technologies: As an example, this includes original research in fibre development to create a bulked continuous filament yarn system to emulate the characteristics contained in natural fibre constructions.
- identifies, analyses and develops manufacturing processes to adapt new and existing technologies to the demands of a lean flexible manufacturing environment.

THE AUSTRALIAN CONTEXT

The Australian carpet industry has undergone significant structural change over the last five years, investing in new plant and equipment to upgrade production facilities and introduce the latest technological innovations. To facilitate greater production efficiencies significant investments have also been made in integrating yarn spinning and extrusion facilities with carpet manufacturing.

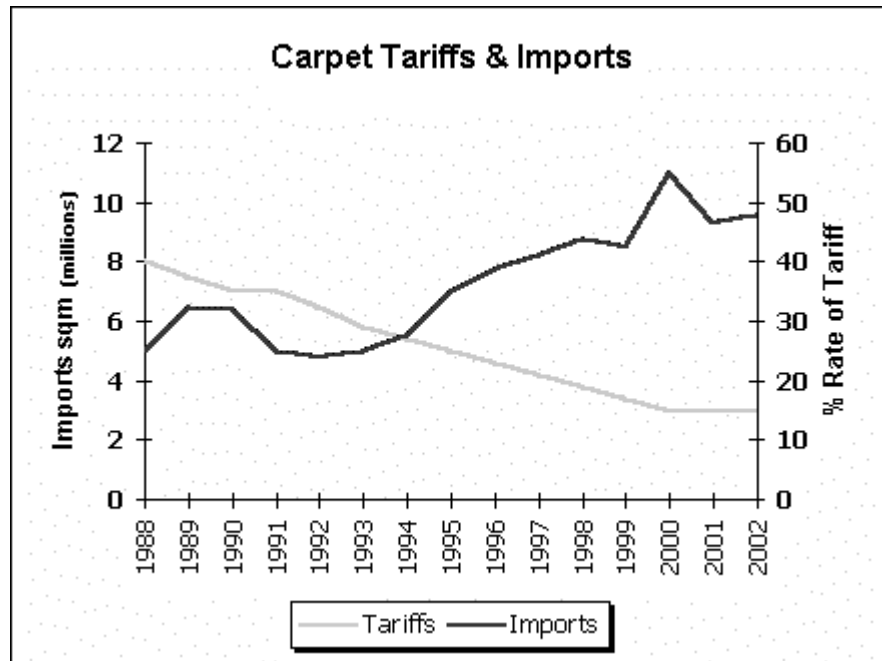
The Australian carpet market, comprising tufted, woven and modular carpets for the residential, commercial and contract market segments is relatively mature. Since 1980/81 the total Australian carpet market has grown by less than 1% p.a. in volume terms. The outlook for both the medium and long term is for a continuation of this slow incremental growth.

Total market supplies for 2001/02 were some 49 million square metres worth approx. \$750 million at the wholesale level, or some \$1.5 billion at retail. Around 40 million square metres of tufted carpet were supplied by Australian manufacturers. This represents some 80% of the local market by volume and around 85% by value.

Carpet manufacturing is a relatively concentrated industry with 65-70% of output coming from two manufacturers (Godfrey Hirst and Feltex Carpets) while 30% of output comes from another 10 firms who operate in smaller specific niches.

Imports currently represent 20% of the Australian market and are trending upwards. The total value of imports in 2001/02 was \$122 million.

Tariffs and Imports



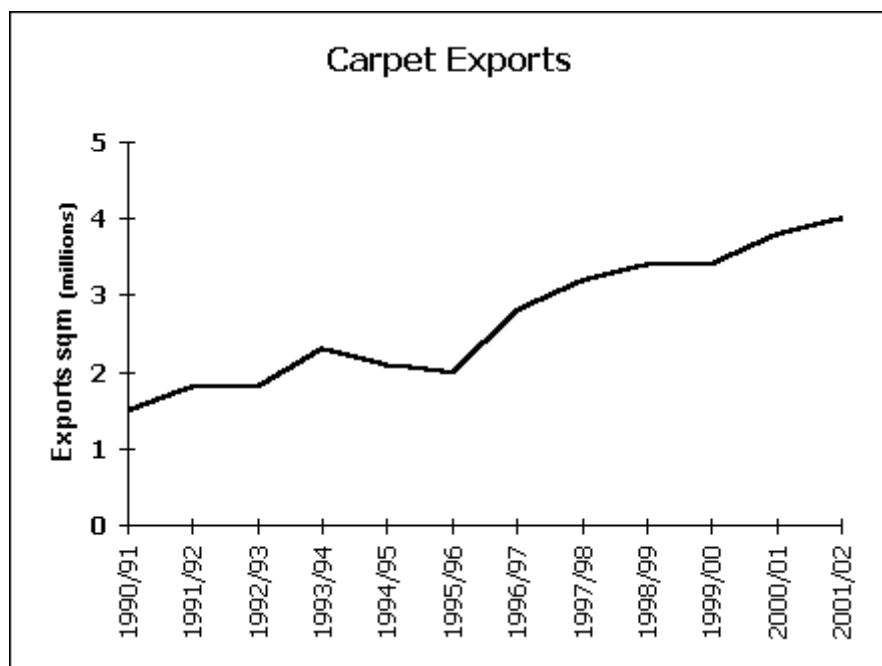
Source ABS

Australia's carpet tariffs have been reduced dramatically over the last decade. At the same time, imports have increased at an inversely proportional rate.

If the import growth to date is extrapolated through to 2005, the consequential displacement of local production would be significant. In the absence of growth in the domestic market and/or a surge in exports, the projected level of imports will increase adjustment pressures in the industry and prompt further rationalisation activity.

Exports

Exports in 2001/02 totalled four million square metres – representing 10% of industry production. Carpet exports have shown significant growth and have nearly trebled since 1990.



Source ABS

The opening of the Australian market has created increased pressure to tap into world markets. The Australian industry is seeking to penetrate northern hemisphere residential carpet markets with wool and wool rich products. The commercial carpet market in Asia also presents significant opportunities for high value products.

The industry has made steady progress in repositioning itself within the global market, but there is still a long way to go. Based on export growth in high value added products and a solid performance in the domestic market, the industry has strong prospects for the future. These efforts can be significantly enhanced with supportive and positive policy measures from the Government.

THE INTERNATIONAL CONTEXT

The major international trends in the industry include consolidation of manufacturers into larger groups, greater vertical integration of yarn and carpet manufacturing operations, retail consolidation, and the emergence of Asian suppliers as potentially significant players in the global market.

International investment in Australia has been extensive with various facilities being acquired, and disposed of, by American, European and New Zealand interests. These arrangements have not always contributed to steady improvements in performance.

Capacity is also being established in emerging economies such as Malaysia, India and especially China. These countries enjoy advantages over Australia as a manufacturing location: under-regulated labour conditions, weaker environmental standards (textile and yarn production are large users of water resources), protected home markets which discriminate against imports and the provision of incentives and supportive policies to manufacturers.

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 Australian carpet industry are unlikely to occur.

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

NON INDUSTRY SPECIFIC FACTORS

In addition to carpet specific factors it is important to be cognizant of other factors that are of significant importance to the industry's and specifically Godfrey Hirst's long-term viability.

Exchange Rates

Australian manufacturers vulnerability to fluctuations in exchange rates remains a significant issue. Australia's main role in international trade is as a supplier of commodity items such as mining and agricultural products. The result is that in the medium term the exchange rate is primarily determined by the state of world commodity and financial markets. The exchange rate therefore does not appropriately reflect the competitiveness of local manufacturing.

Taxation

Payroll tax is inappropriate as a tax measure, particularly when imposed on the manufacture of internationally traded goods. The tax only affects local production. It therefore works as a negative import tariff, offsetting the actual tariff applied to imported goods such as carpets. The tax expense is not reimbursed when the product is exported. This means that unlike the GST payroll tax increases the cost of exports and lowers their competitiveness. Finally the tax increases the cost of labour relative to capital. This means that the use of incremental labour is discouraged.

Workers' Compensation

The State Government run workers compensation systems have provided, in some instances, overly generous payments. This has in turn led to substantial premium increases that are not justified and are increasingly inhibiting the expansion and even maintenance of existing employment levels.

Industrial Relations

Industrial relations reform is critical to ensure the ongoing competitiveness and viability of the Godfrey Hirst Group. With respect to the critical area of workplace flexibility, there is still a considerable way to go in ensuring that workplace practices are internationally competitive.

GODFREY HIRST'S POSITIVE PERFORMANCE

Godfrey Hirst is on the brink of a shift in its fundamental posture. In the past the main driver of success was domestic competition. The danger now is lack of adequate production volume, as it has always been, but the solution is different. The impact of import penetration must be offset by entering new market segments in Australia, and even more importantly, exports must be greatly expanded by producing relevant, innovative products for sophisticated export markets.

1990-2005

Godfrey Hirst developed from the highly fragmented and inefficient industry structure that existed in Australia in the early 1990's. The company has:

- vertically integrated from the raw fibre state to the finished product
- been an early adaptor and developer of new technologies
- continually reinvested in plant and equipment
- focussed on product innovation and export markets
- focussed on quality accreditation and highly skilled staff
- had a strong market focus

The company is now a modern, efficient and technologically advanced manufacturer of recognised world standing. For example the company's exports have more than doubled over the last five years to represent more than 12% of sales.

The Australian carpet market has exhibited little growth over the last decade. Increasing levels of imports have also tended to fragment, and constrain, the market.

To offset this the company has worked closely with major retailers and distributors to implement world class supply chain management, stock control and ordering systems. This has involved the development and application of information and communication technologies such as e-commerce and the establishment of state of the art logistic and

distribution facilities. This responsiveness is an essential characteristic in the company's strategy to drive and adapt to market trends.

The increasing fragmentation of the carpet market has resulted in the need to undertake greater product differentiation of high value product, in order to successfully service the market. This product differentiation while creating a range of new and innovative products has reduced economies of scale.

In addition to these domestic developments accessing overseas markets has proved extremely difficult due to:

- the advantages our competitors located in the USA and EU have as a result of the homogenous nature of their domestic demand for synthetic carpets, the discriminatory nature of the trade bloc they operate within and their proximity to these large and lucrative markets.
- transport charges to the USA and Europe are very high due to the bulky nature of carpets and the time taken by sea freight mitigating against capitalising on periods of high demand for particular products
- the emergence of China as a major competitor in Asian markets.

The distortions present in the world's premium markets along with the low margins on export sales to Asian countries have resulted in a limited ability to offset domestic pressures with export sales.

As a result Godfrey Hirst's adaptation to the low tariff trading environment, envisioned by the Government in 1997 when the current industry strategy was announced, is still to be completed.

POST 2005

Beyond the end of the current policy environment, Godfrey Hirst's plans are focusing on engineering, manufacturing and marketing as the key drivers of business performance.

Most importantly, the plan assumes an expanded share of the Australian domestic market obtained through the continuing development of innovative products, together with expanding export volumes. This will limit the company's vulnerability to economic cycles in each market by obtaining the appropriate balance between domestic and export markets. This will also help the company maximize its manufacturing efficiency.

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

In order to offer a full range of new and exciting products the pressure to increase innovative capabilities is strong. Moreover the ability to innovate at speed has the potential to become a powerful source of competitive advantage.

It is the application of these capabilities that is driving shorter product development cycles and, through enhanced branding and distribution capabilities, more rapid responses to consumer demands.

To facilitate the further development required, Godfrey Hirst intends to:

- 1) invest in more advanced technologies –
(such as the recent acquisition of a nylon extrusion plant from Du Pont Australia)

At the time of the acquisition, the facility's capacity was only 2,000 tonnes per annum of nylon yarn and limited to a singular polymer. Significant capital expenditure has resulted in additional capacity incorporating flexibility in base raw material usage, providing the opportunity of supplying both white and coloured nylon and polypropylene yarn for use in carpet products across a broad range of end uses, including residential, contract, export and automotive. By June 2003, capacity will be 8,000 tonnes per annum

- 2) undertake process improvements to develop a more flexible and adaptable manufacturing process -
(a recent example of this strategy includes the development of an electronic system for suppressing bowing and skewing)

The demands of export, through product differentiation, combined with new capability generated by capital expenditure on new and innovative plant and machinery, necessitated a complete redesign of our process capabilities.

This process change had to take into consideration the unique difficulties experienced with processing a variety of fibre types, and involved the development of sophisticated alignment and focal point positioning devices, and the introduction of laser alignment at various stages along the process to inhibit the gradual accretion of distortion'.

- 3) undertake product developments to capitalise on the company's market and production strengths -

(a recent example of the new products being developed include the worlds first merino tufted carpet)

In collaboration with the Australian Wool Mark Company, Godfrey Hirst has developed the worlds first carpet product using 26 micron merino fibre.

The objective of the project was two-fold – to use Australian wool fibre in Australian made carpet yarn and to produce premium carpets to compete in the upper end niche of the residential markets in the USA and United Kingdom. This collaborative project was undertaken over two years and resulted in innovative and technical changes to a number of production processes including yarn manufacture, dyeing and finishing.

- 4) look to increase export income from premium overseas markets through developing an enhanced distribution network in these markets or alternatively locating production facilities closer to the markets within these larger trade blocs.

POST 2005 POLICY ARRANGEMENTS / GODFREY HIRST RECOMMENDATIONS

The level and form of Government support beyond 2005 is critical to the industry.

The industry remains in a transition phase. Substantial performance improvements have occurred in the industry as a whole and these are now taking shape in the form of improved export performance and productivity. At the same time, the overriding crucial requirement is for companies to carve out sustainable niches for themselves.

To achieve economies of scale the industry must achieve additional exports and continued import replacement. Enhanced support for product innovation will be a key enabler in allowing the industry to achieve this.

1) Tariffs

The tariff pause between 2000 and 2005 has given Godfrey Hirst the necessary "breather" to consolidate and reinvest, to improve performance in terms of product quality, innovation and export orientation. The increasing globalization of the industry, favorable movements in exchange rates and the Import Credit Scheme and its replacement by the SIP also made significant contributions to the achievement of these gains.

Australia's tariffs on carpets are already amongst the lowest in the world. They are broadly in line with those applying in America and Europe, and significantly below those applying in Asia.

Godfrey Hirst acknowledges the next tariff reduction of 33%. However given our concerns as to the effectiveness of unilateral tariff reductions and the strategic nature of negotiations regarding potential free trade areas, any further reductions should only be considered in the light of other countries providing effective access to their markets.

To further reduce tariffs in the absence of a clear movement to improve Australian companies access to major markets would severely undermine investor confidence in the Australian carpet industry.

We note an administrative anomaly in the tariff treatment accorded to carpets relative to other interior textiles (such as bed linen and towels), which should be rectified. We contend that there should not be further cuts in the carpet tariff until other interior textile tariffs are in line with the carpet tariff.

Godfrey Hirst submits that the tariff for carpets should be held at the 2005 level and any further changes should be the subject of an appropriate review.

2) Strategic Investment Program

The TCF Strategic Investment Program (SIP) has been vital in securing investment in the latest technologies in plant and equipment and fostering innovation in new products and processes.

It is essential that this support be maintained beyond 2005 if the industry is to build on the gains made. Godfrey Hirst has pursued significant investment in capital investment, production and process improvement and export facilitations. This process must continue to ensure its international competitiveness.

Assistance beyond 2005 should be developed within the context of the challenges and changes the industry must make to be viable in the medium to long term, i.e. five to ten years. To this end, the basic SIP principles should be supplemented to provide industry assistance across the fundamental industry drivers: product development, investment, technology and sales.

Making the best use of the period available to the industry between now and the achievement of truly free and non-discriminatory international trade rules requires maintaining the tariff, and extending the SIP beyond 2005, maintaining its aims and general structure. If this support is not provided at the crucial stage of company transformation, it is necessary to recognize the risk that the changes will be incomplete or less than successful.

Godfrey Hirst submits that SIP should be extended to 2015

However some modifications need to be made to improve the effectiveness of the scheme. In particular, consideration should be given to:

- ***increasing capital expenditure rebates from 20% to at least 30%***
- ***including repairs and maintenance in the value added calculation***
- ***developing guidelines on demand driven activities such as expenditures relating to offshore warehousing and distribution facilities for Australian-made products.***

3) Market Access

While Australia has made strong commitments and initiated progressive change towards developing an open market, Australia's regional trading partners have not made the same concessions.

The global market still contains a broad range of tariff and non-tariff barriers restricting free and open trade. The carpet industry is not competing on a level playing field against a significant number of its major trading partners. This is a major issue for industry, as the Australian domestic market does not show any significant growth potential. The only opportunities for sales expansion are therefore primarily in additional export markets and to a lesser extent in import replacement through penetration into additional market segments

A key concern is whether actual or potential trading partners will strike trade agreements with other countries and thus exclude Australia. As an example of this, Godfrey Hirst's strategic aims could be advanced by a Free Trade Agreement (FTA) between Australia and ASEAN. In recent times this concept has been rejected by ASEAN, which has since then initiated trade talks with China.

The position with trade alliances tends to be that they are good for those on the inside and bad for those on the outside. Hence it appears the best outcome for Australia would be to obtain preferential agreements with strategically selected partners while the second best option would be generalized trade liberalization.

Godfrey Hirst acknowledges efforts by the Australian Government to identify potential bilateral free trade agreements with a number of countries. The development of these agreements will raise a number of issues of relevance to the carpet industry and it is important that a close dialogue is maintained between Government and industry on these issues (especially with the US/Australia FTA negotiations).

These issues will include –

- ***Defining Rules of Origin***
- ***The need for effective safeguards to protect against a surge of imports and/or extended phase in arrangements.***

4) Regional Issues

The carpet industry makes a significant contribution to various regional economies in Australia through the direct provision of employment and the flow through effect of demand for products and services within those regional economies.

Godfrey Hirst is the third largest employer in Geelong and the second largest employer in Benalla, employing 800 and 140 respectively. There are significant disadvantages in relation to community infrastructure when compared to metropolitan communities. This, combined with cost of transport, additional fire services levy etc., provides for disincentive for regional businesses.

Godfrey Hirst contends that special consideration needs to be given to address the unique circumstances of regionally based employers.

5) Non Industry Specific Disincentives

Payroll tax and workers compensation insurance premiums continue to be a major concern for the industry, act as a disincentive to employment and increase the cost of manufacturing in Australia for no return.

Godfrey Hirst urges State and Federal Governments to abolish payroll tax and review and overhaul their policies in relation to workers compensation.

6) Industrial Relations

The ability to tailor work practices to support flexible manufacturing systems is crucial to the competitiveness and viability of the Australian carpet industry. With respect to the crucial area of workplace flexibility there is still some way to go to bring Australian workplace practices up to the levels that apply in similar modern economies.

Godfrey Hirst supports the thrust of the Australian Industry Group's recommendations on workplace reform, in its Submission to the Productivity Commission on this Inquiry, specifically in their key recommendations of:

Rec 8 Suitable training programs dealing with effective grievance resolution and employee relations be developed and overseen by a genuinely independent body.

Rec 9 Additional powers be available to the AIRC to suspend or terminate a bargaining period. The additional powers would relate to situations where protected action is:

- Causing significant damage to an enterprise***
- Significantly endangering the welfare of employees in an enterprise***

Rec 10 Protected action be outlawed for the purposes of pattern bargaining.

Rec 11 The AIRC be given the power to establish a cooling off period in appropriate circumstances.

Rec 12 Secret ballots be mandatory before protected action can be taken.

Rec 13 The Workplace Relations Act be amended to clarify that protected action cannot be taken prior to the expiry date of a certified agreement.

Rec 14 An industry representative body including representation from the AI Group and the ACTU and TCFUA be set up to explore various industry-level matters of mutual interest and endeavour to develop worthwhile initiatives of benefit to the industry.