A Vision for the Entire Automotive Manufacturing Industry

Submission to the Productivity Commission
Review of the Australian Automotive Industry

Grant Thornton is one of the world's leading organisations of independent assurance, tax and advisory firms. Grant Thornton Australia has more than 1,300 people working in offices in Adelaide, Brisbane, Melbourne, Perth and Sydney. We combine service breadth, depth of expertise and industry insight with an approachable “client first” mindset and a broad commercial perspective.

Grant Thornton Australia: Thomson Reuters 2013 Advisory Team of the Year,
Grant Thornton UK: 2013 Global Firm of the Year at the British Accountancy Awards,
Grant Thornton International: Awarded 2013 Network of the Year by the International Accounting Bulletin.

Australian Automotive Aftermarket Association

The Australian Automotive Aftermarket Association Ltd (AAAA) is the national industry association representing manufacturers, distributors, wholesalers, importers, mechanical repair & modification services and retailers of automotive parts and accessories, tools and equipment in Australia.

A Vision for the Entire Automotive Manufacturing Industry

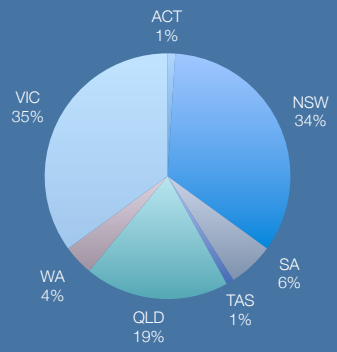
Submission to the Productivity Commission
Review of the Australian Automotive Industry

November 2013

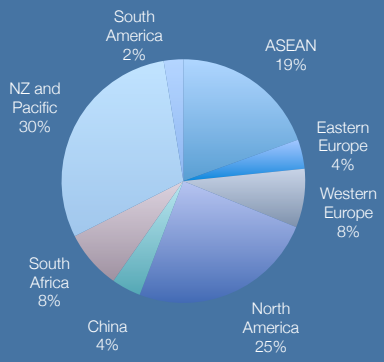
Contents

Quick Facts

Manufacturing Primary Location



Primary Export Markets



Aftermarket Manufacturing Ownership
Australian 88%
Foreign 12%

Manufacturer Supply of Products
Original Equipment and Aftermarket 61%
Aftermarket Only 39%

Aftermarket Manufacturing Industry Total

$5.2 Billion
turnover

21,000
employees

AAAA Manufacturing Members

$4 Billion
turnover

16,000
employees

Introduction

About the AAAA

The Australian Automotive Aftermarket Association Ltd (AAAA) is the national industry association representing manufacturers, distributors, wholesalers, importers, mechanical repair & modification services and retailers of automotive parts and accessories, tools and equipment in Australia.

The Association has over 1700 member companies in all categories of the Australian automotive aftermarket and includes major national and multi-national corporations as well as a large number of Australian owned small and medium size businesses. Further information on the Association can be accessed from our website: www.aaaa.com.au

Approximately 260 AAAA member companies manufacture product in Australia with around 65% of these companies (170) actively exporting. We estimate the annual value of exports by AAAA member companies to be in the vicinity of $800 million per annum.

Many AAAA member companies that manufacture in Australia also supply locally manufactured OE components to automotive manufacturers as replacement parts and accessories for fitment to locally built and imported vehicles, as well as to the independent aftermarket.

As the Terms of Reference of the Automotive Review focus predominately on local production our response will in the most part reflect the views of the 260 manufacturers that form part of the AAAA membership. However where appropriate, the views of the other segments of the AAAA membership will be incorporated into our submission.

AAAA members manufacture motor vehicle components, including:

- Products that last the life of the vehicle or are replaced irregularly during the life of the vehicle, usually as the result of a crash or a major mechanical failure –

e.g. seats, instrument panels, engines, and transmission; or

- Products that are replaced regularly throughout the life of the vehicle as a result of normal wear and tear – e.g. filters, tyres, wiper blades, batteries and brake pads; and
- Products used to modify, maintain or enhance the performance of vehicles, including modifications for rough terrain, speciality products, safety, comfort, appearance, functional performance and body components.

Executive Summary

$9.28b
Total PMV and OE Component Manufacture

$5.37b
Locally Produced PMV and PMV Derivatives

$3.91b
Automotive OE Component Manufacturing

$5.2b
Automotive Aftermarket Manufacturing

21,000
Aftermarket Manufacturing Employment

14.2%
Aftermarket Exports as a Share of Sales

1.5%
Aftermarket R&D Expenditure as a Share of Sales

2.3%
Aftermarket Capital Expenditure as a Share of Sales

A constructive discussion about the future of the Australian automotive manufacturing industry cannot be held by examining only one part of the sector, namely the original equipment (OE) supply chain for passenger motor vehicle (PMV) production.

Whether Holden and Toyota maintain PMV production in Australia or not, current and projected OE volumes simply can't support a sustainable view of the OE supply chain, acting in isolation, any longer.

While the domestic PMV volumes have declined, the far more alarming aspect is the declining value of local Australian content. Global Vehicle Platforms in tandem with Global Purchasing Policies conspire to ensure the economic benefit for local OE component producers is rapidly shrinking.

It is time to take a step back from traditional views of what is considered to be the "automotive industry" and view it in a holistic sense. It is also time to have policy settings which recognise the inherent weaknesses and strengths of all parts of the automotive industry and facilitate transition to a sustainable industry with ongoing growth prospects.

The automotive industry we had in 2008 when the $6.2 billion "A New Car Plan for A Greener Future" was announced is not the industry we have today, and certainly not the industry we will have in 10 or 20 years' time.

A sustainable future for the OE segment must inevitably involve diversification. Diversification into non-OE automotive segments such as automotive aftermarket products, or other industries such as rail, mining, defence, marine and industrial goods.

The aftermarket is a significant part of the total automotive industry.
Automotive aftermarket manufacturing represents 36% of all automotive manufacturing in Australia. What is more, the aftermarket segment continues to show strong year-on-year growth while in contrast, the OE segment is in decline.

Not only is the aftermarket segment significant in terms of its size, but it has totally different drivers and a totally different future outlook compared to the OE segment.

The aftermarket is a prime candidate to assist in the process of structural adjustment.
If the growth potential of the aftermarket segment is realised, it can absorb the excess capacity, skills and knowledge that become available as the ongoing decline of the Australian domestic OE PMV business sector plays out.

In fact, the performance of both the OE component segment and the aftermarket segment can be simultaneously enhanced through a holistic approach to policy setting which embraces both segments.

The aftermarket cannot reach its potential value without further structural adjustment. The aftermarket segment is under intense import pressure. This has forced manufacturers to move up the value chain; from service parts to high value specialty products with a technological advantage. Import competition at home has also forced companies to seek offshore manufacturing opportunities to achieve sustainable volumes and global competitiveness.

Import competition, among other forces, has created an aftermarket segment that has the right pre-conditions to be a globally competitive sector (significant investment in R&D and capital, and significant export focus), but it is actually facing an environment of disincentive under the current domestic policy settings.

Based on the analysis in this report, there are four key areas where government can intervene to assist the transition towards a new synergistic policy outcome.

1. Diversification
2. Competitiveness and Innovation
3. Export access
4. Consolidation/Rationalisation of the supply chain

Gap modelling shows the current policy settings have actually had a net negative effect. If the Government's automotive policy settings were more effectively structured around the future role this industry can play to the automotive sector's long-term future, then this industry could be worth some $6.56 billion today rather than its current estimated value at around $5.2 billion.

In fact, not only have the policy settings had a negative impact, but much more importantly, policy settings are exacerbating the structural adjustment process.

Gap modelling shows a realignment of public policy support will enable the aftermarket to achieve greater potential and be more effective at absorbing displaced OE resources.

The aftermarket segment can play a constructive role in bringing about the structural adjustment process the government is seeking for the Australian automotive industry.

A re-orientated incentive structure for the entire automotive manufacturing sector will, on the one hand, encourage diversification by the OE segment into the aftermarket, and on the other hand, position in the aftermarket for growth, so that the resources of the OE segment can flow more easily into a more sustainable and growing aftermarket segment.

Methodology

Data provided in this submission was gained and aggregated from various sources including, but not limited to ABS Data, IBISWorld, Commonwealth Department of Industry, Motor Vehicle Census, VFacts, Citibank, interviews with industry stakeholders and the AAAA Online Member Survey January 2013.

To ensure targeted intelligence was collected to address the specific questions of this Productivity Commission Review an additional survey was developed of the latest industry trends and drivers within the Australian automotive aftermarket. This survey was sent to all 260 manufacturing member companies of the AAAA, on 18th November 2013. 103 member companies responded to the survey within an extremely tight two-day timeframe, which was necessitated by the Productivity Commission submission timetable.

The survey was designed to provide the Productivity Commission with an understanding of the potential changes in the future of the Australian automotive aftermarket segment and the implication that this may have. Therefore, a central component of this Submission revolves around the use of survey-based research to provide:

- An assessment of the aftermarket segment in the current market; and
- Insights into the future role of the aftermarket segment if a fundamental shift were to occur in Passenger Motor Vehicle (PMV) production in Australia. In fact, the survey methodology was designed to also shed light on the most fundamantal change, being the absence of local PMV production in

the future, and to undertsand the potentail oppportunities and challenges which could exist in such a changed environment.

The survey-based research undertaken also underpins the sensitivity analysis included in this Submission. With such sensitivity analysis we have sought to provide the Productivity Commision some insights around how much and in what ways the Australian automotive aftermarket segment may change between the two scenarios of ongoing domestic PMV production and none.

Our modelling has sought to identify and then to quantify the extent of the gap between the potential value of the aftermarket segment and the impact of policy settings.

In order to provide the Productivity Commission with relevant and reliable insights into how much the changed automotive sector may impact on the aftermarket segment; we have initially sought to capture as much valuable intelligence as possible about the current drivers and constraints on business expansion. From this we can develop meaningful intelligence around how key partcipants in this industry are likely to respond to the future challenges in the broader automotive sector.

This methodology enables the following components to the future direction of the aftermarket segment to be followed in a logical and systematic manner:

1. The extent of potential change which current participants in the aftermarket segment are already starting to consider.
2. The readiness of existing market participants to respond to future sectoral changes.
3. The potential drivers of future change in a different market paradigm for the Australian automotive sector.
4. The role of Government in helping to facilitate the restructuring of the aftermarket segment to maximise future economic opportunities.

Defining Automotive Manufacturing

Industry Overview

The automotive industry in Australia (and globally), is much more than just the supply chain for new passenger motor vehicle production. In fact, in terms of manufacturing, there are three key segments:

- **Motor Vehicle Production – Original equipment (OE)**
  This segment comprises the Original Equipment Manufacturers (OEMs), or Motor Vehicle Producers and their supply chain of original equipment component producers and services companies.

  Throughout this document, we refer to Australian component producers who comprise the supply chain for Ford, Toyota and Holden's indigenous supply chain for passenger motor vehicle production as "OE component producers".

- **Parts and Accessories – Sold to Original Equipment Manufacturers (OEMs)**
  While also Original Equipment, this segment refers to Parts and Accessories (P&A), which are sold to OEMs, but are fitted to vehicles post production.

  We will refer to component producers who manufacture P&A for all OEM's supply chains for passenger motor vehicle production as "P&A producers" in this document.

- **Automotive Aftermarket**
  This segment is comprised of, in some cases, the same componentry produced in the P&A segment, with the differentiation being they are sold to customers other than the OEMs. Customers include wholesalers, retailers, resellers and end-users. The aftermarket also includes vehicle modification and performance enhancement products: the purpose of these components is to customise the vehicle for final intended use and road conditions.

  We will refer to automotive aftermarket component manufacturers as "aftermarket producers" in this document.

These segments are critical to the health of the automotive sector, and are highly inter-related. It is important to recognise that an automotive aftermarket manufacturer can operate in all three segments. Some companies manufacture products that are distributed and retailed under a motor vehicle manufacturers brand name, their own brand name and may also supply a major retail chain for sale under the retail group's brand name. AAAA membership demonstrates this point. All manufacturing members operate in the aftermarket segment however, 60% also produce some level of OE componentry, predominantly in P&A and predominantly for imported vehicles.

The aftermarket industry, when considered in its entirety, performs very strongly. It is highly trade exposed and comprised of a percentage of companies that achieve cost competitiveness by importing from low cost countries. Among its membership of 1700 companies, 260 manufacture aftermarket products in this highly competitive environment in Australia.

The aftermarket is predominately Australian owned and operated, with the majority of producers operating in specialist markets i.e. performance improvement, emissions control, stability, safety, replacement parts, and collision repair and 4WD component parts. See the full list of products that make up the aftermarket at Appendix 1.
These AAAA aftermarket Producers alone are significant contributors to Australia's automotive industry, representing 16,000 direct jobs, $4

billion in turnover with high levels of R&D investment, and export propensity.

Based on our database capture of non-AAAA member companies that have visited our Trade Shows in recent years, we estimate there are 1400 companies in the wider aftermarket manufacturing segment, representing 21,000 jobs and $5.2 billion turnover. Many of these additional manufacturers are downstream suppliers.

OE Manufacturing Versus Aftermarket Manufacturing

Statistics abound when it comes to measuring the size of the OE automotive sector. In most data sets used to analyse the automotive manufacturing industry the aftermarket segment is not separated from the OE supply chain. It is important that this differentiation is acknowledged.

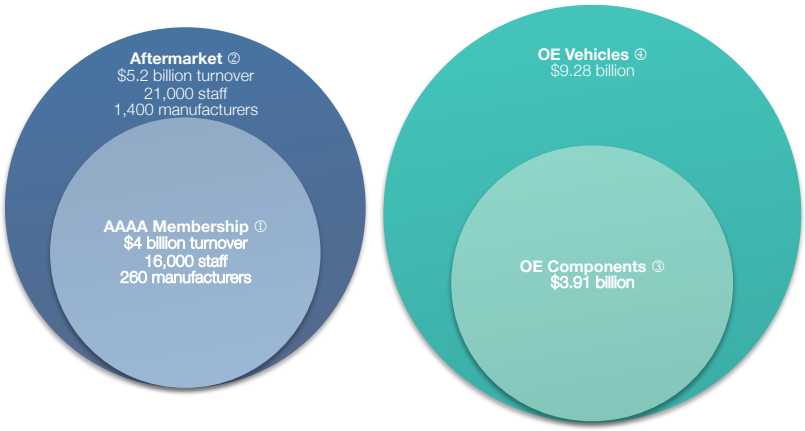
For example IBIS Industry Report C2319: "Motor Vehicle Parts and Accessories Manufacturing in Australia", a widely quoted industry source for the automotive sector, includes aftermarket production:

According to IBISWorld Industry Analysts, the OEMs and aftermarket automotive manufacturers segment revenue is be included in the total revenue figure of the industry. The products and services section of the report which provides an indication of the main services offered by the industry along with the main consumers, accounts for the original products manufactured. The product split however, is not based on original equipment versus aftermarket products. Rather, it is based on the type of product with regards to functionality or primary activities and this treatment of product segmentation is consistent across other industries IBISWorld writes on.

Source: Email correspondence with IBIS November 2013

We have therefore relied on the Department of Industry's "Key Automotive Statistics 2012" report to identify the value of Passenger Motor Vehicle (PMV) and OE component manufacturing. The image below demonstrates the significance of the aftermarket manufacturing sector in its own right without the usual representation of this element of the industry as being part of the motor vehicle manufacturing supply chain, which it is not.

By separately identifying the aftermarket segment, it is possible to highlight its significant size, and note its different drivers and future outlook compared to the declining automotive OE supply chain.



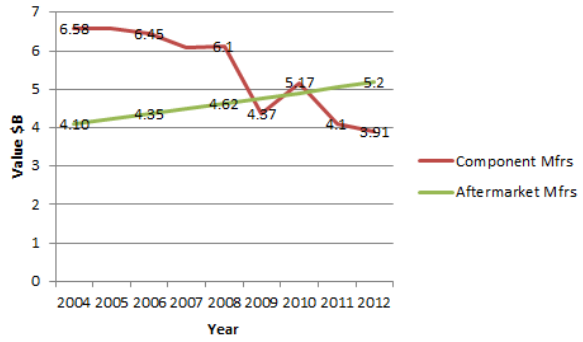
Aftermarket $5.2 billion

OE Sector $9.28 billion

① Source: AAAA database of members, and specifically the subset of members classified as manufacturers
② Source: AAAA database of Aftermarket Trade Show Visitors. 1400 companies are listed on the AAAA database of Aftermarket Trade Show Visitors, who have classified themselves (as part of the visitor registration process) as "manufacturers". The list includes AAAA members. Taking the database analysis of turnover and employment of our 260 manufacturing members as the base calculation, we have assumed a very modest 30% uplift in employment and turnover, to account for the 1140 non-member companies.
③ Source: Department of Industry "Key Automotive Statistics 2012". "OE Components"- Table 10: Value of Components Sources from Australian Suppliers, $2.34 billion; and Table 13: Value and Growth of Automotive Exports, $1.57 billion
④ Source: Department of Industry "Key Automotive Statistics 2012". "OE Vehicles" – Table 9: Value of Production of locally-made PMVs and PMV derivatives, $5.37 billion

Aftermarket Current Performance

The aftermarket segment has performed strongly, achieving year on year growth of 3%, despite the contraction of the passenger motor vehicle manufacturing supply chain.



Source: Department of Industry "Key Automotive Statistics 2012" for OE component manufacturing statistics. Aftermarket statistics based on AAAA 2012 database and trend line to show 3% year on year growth reported by member companies.

The export performance of the aftermarket segment represents 12.4% of sales and the results of the survey conducted for the purposes of this submission showed that respondents expect that exporting is a key focus for future success.

The survey also showed that R&D within the aftermarket segment represents 1.4% of sales with a weighted average expenditure of $207,000 per annum.

Finally, capital expenditure was shown to be 2% of sales with a weighted average of $318,000 per annum.

Impact of Scale

Critical mass is important for future growth, investment and marketing of Australian aftermarket components. The volume companies in the international marketplace promotes the view that this is a country that produces quality, well-designed and tested performance enhancement and safety components.

Critical mass of aftermarket producers in clusters of products can prove to be critical in export access and activities. Australia has a perceived advantage in 4WD, performance and racing components. In our international trade fair and mission events we have leveraged these 'sub-clusters' to provide a block of exhibitors in an Australian stand to further enhance a perception that Australia is the best country to produce components for rugged and difficult conditions. The depth of market participation has allowed the AAAA to develop industry councils to further leverage the critical mass for combined and shared benefit.

The investment market requires confidence that the sector is here to stay and the prospects for future growth and investment returns are inevitable. The value of a significant number of companies in a subsector enhances the confidence required for future investment opportunities for new product development, capital and labour force development.

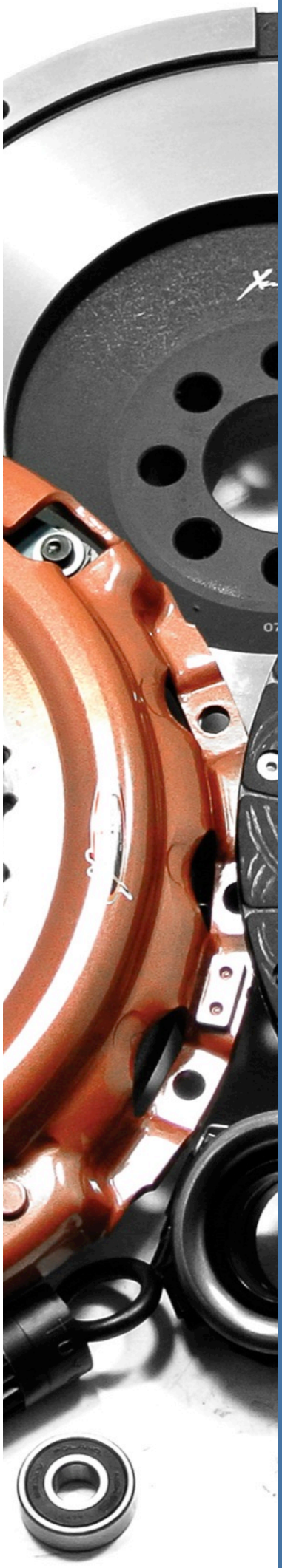
A large number of players spread through out Australia encourages labour: for example, an employee with specific skills in vehicle frontal protection systems has numerous companies to work for and hence a potential long term career in that sector due to the relatively large number of industry players.

Aftermarket Workforce

Attraction of labour to the automotive industry remains a key issue. Competition from other industries, negative perceptions of the industry and a lack of sufficient industry marketing to target groups have all contributed to this situation.

Source: Automotive Environmental Scan 2013, Auto Skills Australia

The skill base for the aftermarket is broad reflecting the wide span of the production and distribution supply chain of the sector. Aftermarket components are provided through multiple channels: car producers, vehicle service, collision repair, retail outlets and direct to car owners via the Internet and do-it-yourself (DIY) retail. As a consequence the provision of



Case Study

Business Growth Through Export

Australian Clutch Services
Wingfield, SA
www.australianclutch.com.au

Australian Clutch Services (ACS) is an Australian owned company and a major supplier of new and re-manufactured clutch components and systems. Operating since 1988 from the Adelaide suburb of Wingfield, ACS now offers direct distribution to their customers with the opening of new warehouses in Sydney, Melbourne & Perth. But ACS is not only an Australian success story; the company is also a major player in many global markets.

Seven years ago ACS decided to export Australian quality, knowledge & service to customers all over the world. Regular trips to international trade shows allowed the export team to meet new customers and improved their knowledge of the market needs and challenges.

The company efforts were rewarded and formally recognized in 2009 when ACS received an Austrade Export Award and in 2011 they were awarded a AAAA Excellence in Export Award. It was not only their presence at trade shows or the new technologies that helped ACS grow their overseas business, the key to their success in foreign markets is in their commitment to service, quality and their willingness to find new and creative ways to assist their customers.

Export sales have grown consistently over the last 5 years. In 2008, export sales represented around 10% of total sales. In 2009, the percentage of export sales boomed and achieved 16%. In 2010 and 2011, ACS export sales were around 17% and 18% respectively. In the year 2012, for the first time in the company's history export sales reached more than 20% of total sales. ACS expects growth of 20% in the European market alone for the next 3 years, thanks to the implementation of a distribution centre in Poland and targeted marketing initiatives.

ACS acknowledges the support of Export Market Development Grants in helping them launch an export strategy, however the lack of further support to expand into new markets will hinder their growth. The global clutch market is extremely competitive, however there is tremendous growth potential for ACS's innovative products.

components embraces many business processes including manufacturing and marketing and distribution of components. The skill requirements include design, R&D, manufacturing, logistics & distribution, business development, marketing and export development. Products are frequently redesigned for different platforms and the sector is particularly skilled in niche markets and in best practice time-to-market design, manufacturing and delivery. Many of our highly experienced aftermarket practitioners commenced in this industry in the engineering and manufacturing departments and are now senior sales and business development executives, many of whom spend a great deal of their working life in off shore markets.

Unlike the OE parts suppliers, the aftermarket has a particular skill in brand positioning and brand awareness. It is common to see aftermarket companies providing product training and information sessions direct to the retail and repair industry. Our employers report that there is a reasonable supply of the generic business skill areas (sales & marketing) with a mild to moderate shortage reported in the areas of research and design, manufacturing process and a severe shortage of apprenticeship trades. Anecdotal evidence from Western Australia and Queensland indicates that labour shortages are occurring due to mining industry demand for labour and perceived high wages from that sector.

The labour issues for the aftermarket are focussed on the high needs area of apprentices and the content of the apprenticeship training available. In the domestic market, some of our specialty products producers also modify vehicles and mechanics and fitters are in short supply. All of our members that have a requirement for apprentices report a severe shortage and a critical need in that area. Our members are generally satisfied with the training opportunities available and we note Auto Skills Australia report that the content of training should be continuously improved to reflect the needs of the 21st century particularly the high technical knowledge required for vehicle safety enhancements and electronic equipment.

The January 2013 AAAA survey revealed an optimistic and energetic automotive aftermarket. This sector succeeds because it continues to provide consumers with the quality goods and services they want. Moving the aftermarket forward demands increased productivity and new business models from the industry - as well as vision from Government.

Our aftermarket industry survey posed the following question:

"What is the one fundamental difference you believe your business will go through over the next 5 years?"

Four key themes strongly emerged:

1. Import competition
   "Expansion into new markets as Australian aftermarket is squeezed by cheaper imports"
   "Moving more manufacturing off shore to stay competitive on a world scale in the face of stiff competition"

2. Export growth
   "Export sales will be a much higher proportion of total sales"
   "New products and stronger export growth"

3. Diversify
   "Reduction of OEM manufacturing and need to find new products to manufacture"
   "Increased diversification into niche markets"

4. Focus on quality, innovation, productivity, technology
   "Improved productivity initiatives"
   "Significant factory & tooling investment and expansion in North America"

Challenges Facing the Automotive Industry

The automotive industry we had in 2008 when the $6.2 billion 'A New Car Plan For A Greener Future' was announced, is not the automotive industry we have today, and certainly not the industry we will have in 10 or 20 years' time.

The long-term future of passenger motor vehicle production in Australia is uncertain.

OE Component Producers
Whether Holden and Toyota retain vehicle manufacturing in Australia post 2018 or not, it is certain the economic benefit they offer the Australian OE component producers is rapidly shrinking. Declining domestic production volumes and local content percentages are central drivers.

P&A Producers
In line with Holden ending VF Commodore supply to dealerships in 2016, vehicle production is increasingly focused on global platforms. As a result, P&A supply is subject to global supply contracts and intense global competition in a shrinking market for Australian P&A producers.

Aftermarket Producers
Australian aftermarket producers are subject to market pressures on multiple fronts. On the one hand, many (60% of survey respondents) are exposed to falling volumes in P&A. On the other hand, while the aftermarket segment offers excellent growth, it is highly trade exposed, with severe competition from cheaper imported goods in every product category. Australian aftermarket producers face considerable market access barriers offshore and are under increasing pressure to move their manufacturing operations to lower cost countries. Maintaining manufacturing in Australia requires further diversification (new products, new markets, new non-automotive sector exposure); growing export sales; and continuously moving up the

value chain by investing in innovation and productivity.

The following sections discuss the key challenges facing the automotive component sector and aftermarket producers in particular.

Domestic Challenges

1. Severe Import Competition
The key domestic challenge faced by aftermarket producers is retaining (and growing) manufacturing in Australia in the face of strong import competition.

The shift to imported product has accelerated over recent years, principally because of the strength of the Australian dollar, with China and Taiwan supplying almost 40% of imported aftermarket product. There is no indication that this trend will slow, with the volume of aftermarket product imported from China, India and Thailand continuing to rise.

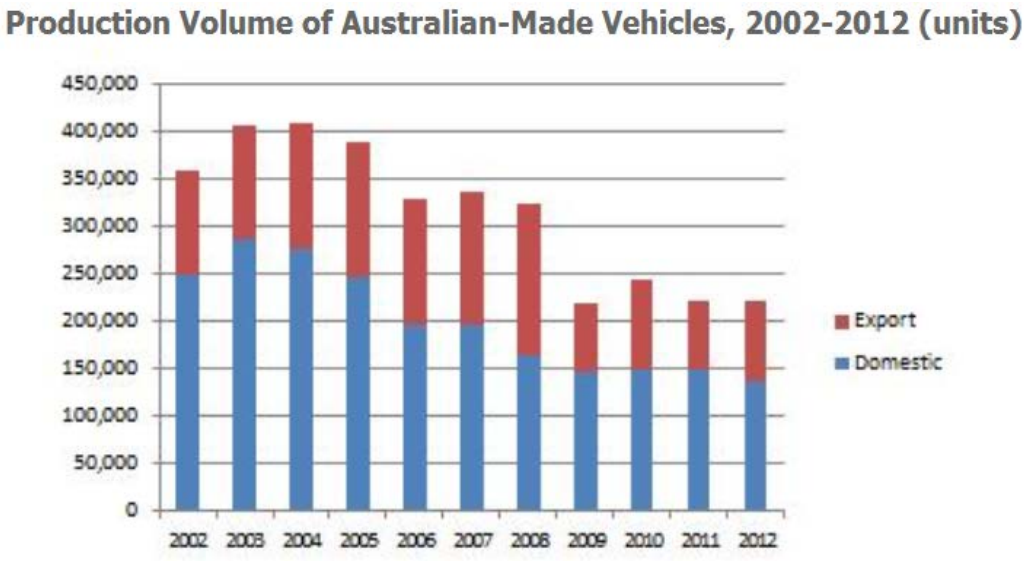
The challenge to sustain local manufacturing operations is reflected in changes to AAAA membership. Over the last 6 years manufacturing members have decreased by 13% (from 300 to 260 companies) while general membership overall (including resellers, retailer and workshop categories) increased by 50% (from 850 to 1700 companies).

The primary response of the remaining domestic aftermarket producers to date, is to shift the focus of production to higher value add products such as speciality 4WD products.

2. Declining domestic vehicle production volumes and local content
For the automotive component producers that do rely on domestic OE business, the market is a story of diminishing opportunities. The annual production volume for 2013 is currently estimated at around 200,000 vehicles, with production at 179,994 vehicles to date (January through October). (Source: FCAI). The industry estimates 2014 to be much the same as 2013, according to our discussions with members.

While the domestic vehicle production volumes have approximately halved since 2003-4, they have been relatively stable in recent years. The more alarming facts are not so much total volumes, but Australian content value.

VF Commodore new dealership sales will end in 2016 and from that point onward production will be focused on global vehicle platforms. The supply base believes local content in Holden's new (Cruze) platform, including Holden's own local content contribution, is an extremely low 20-25%.



Source: Automotive Industry Datacard, Department of Industry
http://www.industry.gov.au/industry/automotive/Statistics/Pages/automotivedatacard.aspx

Local content is guaranteed to be an eroding equation as a result of the OEM's Global Purchasing Policies implemented in tandem with the move to Global Vehicle Platforms.

Global purchasing policies will ensure future vehicle programs will have few local suppliers. Not many local suppliers have the ability to produce global volumes nor the resources to overcome the distance and timing issues. Global sourcing for new program launches are tied to their "Homeroom" timing schedules (that is the design centre for a particular vehicle, rather than a vehicle production centre). While Australia is waiting to hear whether a new vehicle will be produced here, the Homeroom design and development will have been completed and global sourcing decisions already made.

Export Challenges

For AAAA members with OE P&A business, the OEM's transition to global platforms and global purchasing practices is increasingly diminishing the supply opportunities of Australian automotive manufacturers. Unlike the lengthy and slow product cycles of the OE segment (with seven-year vehicle model cycles), the aftermarket is very fast-paced segment, driven by rapidly evolving consumer demand and market trends.

Success is this sector requires manufacturers to respond quickly to consumer demand and by extension, to remain close to the consumer.

The AAAA has worked diligently and persistently to support members' export efforts focused on North America, Europe and the Middle East. While the sector has proved itself a highly successful exporter of Australian goods, and predominantly elaborately transformed manufactured goods, the costs and barriers of export development and sustainability are high.

The sector has achieved "Brand Australia" recognition for 4WD speciality segment, but is yet to achieve the same level of recognition across all aftermarket goods. Clustering support of other speciality segments (high performance products, racing components) is required to gain sufficient critical mass for broad market recognition. There is evidence that the aftermarket requires market access information and support to understand the emerging opportunities and best market entry options in the emerging Asian markets.

Tariff Reduction and Reciprocal Market Access

While Australia currently maintains a general import tariff of 5% on automotive components and vehicles, the tariffs on these goods are eliminated (reduced to zero) in the case of originating goods exported from those countries with which we have bilateral or regional Free Trade Agreements (FTAs).

The table below includes the top 10 car producing nations as well as Indonesia (in 17th place) and Malaysia in (23rd place). This table provides these interesting facts:

- The percentage of global production volume Australia's FTAs will cover (FTAs concluded and under negotiation) is 66%;
- The only countries not covered in Australia's trade agreements in the top 10 producing nations are Germany (4th), Brazil (7th) and Canada (10th).

Rank	Country/ Region	2012 Volume	2012%	FTA Partner	
—	***World***	**84,141,209**			
1	China	19,271,808	22.90%	In negotiation	Australia-China FTA
2	USA	10,328,884	12.28%	Yes	Australia -US FTA
3	Japan	9,942,711	11.82%	In negotiation	Australia-Japan FTA
4	Germany	5,649,269	6.71%	No	
5	S Korea	4,557,738	5.42%	In negotiation	Australia-Korea FTA
6	India	4,145,194	4.93%	In negotiation	Australia-India Comprehensive Economic Cooperation Agreement
7	Brazil	3,342,617	3.97%	No	
8	Mexico	3,001,974	3.57%	In negotiation	Trans Pacific Partnership
9	Thailand	2,483,043	2.95%	Yes	Australia- Thailand FTA
10	Canada	2,463,732	2.93%	No	
17	Indonesia	1,065,557	1.27%	In negotiation	Indonesia-Australia Comprehensive Economic Partnership Agreement
23	Malaysia	572,150	0.68%	Yes	Australia-Malaysia FTA
29	Australia	209,730	0.25%		

Source: OICA (Organisation Internationale des Constructeurs d'Automobiles)

Despite the open access to the Australian market, and in particular the preferential tariff treatment accorded to our FTA partners, reciprocal access has not been forthcoming.

The following table highlights tariffs, other taxes and non-tariff barriers in relation to automobiles and automotive parts for those countries with automobile industries. The table demonstrates that there are significant market access barriers in the form of taxes (other than import tariffs) and non-tariff barriers.

Country	FTA Status	Tariff	Other taxes and non-tariff barriers
China	In negotiation	25% on vehicles 10% on parts	VAT rate of 17%, Consumption Tax rate is 25%. Subject to CCC (China Compulsory Certification) certificate. China has a volume of other non tariff barriers too many and varied to detail here.
Japan	In negotiation	0%	Onerous approval system and costly certification
S Korea	In negotiation	0% on vehicles 8% on parts	Practice of subjecting foreign car owners to tax audits. VAT rate of 10%, Education Tax rate is 30%, Special Tax For Rural Development rate is 10%, Special Consumption Tax rate is 10%
India	In negotiation	100%- 125% on vehicles 10% on components	When all duties are added the "Overall Duty" is 214%. Landing Charges rate is 1%, Countervailing Duty rate is 30%, CESS rate is 3%, Additional Countervailing Duty rate is 4%.
Mexico	Yes	20% on vehicles	VAT rate of 16%, DTA rate is 0.8%
Thailand	Yes	0%	Excise Tax: cars with an engine of more than 3,000cc pay 50%; pick up trucks (which Thailand specialise in) have 3% Excise Tax
Indonesia	In negotiation	40% on Vehicles 5-15% on parts	The luxury tax on 4,000cc sedans and 4x4 Jeeps or vans is 75%; automobiles with engine capacities of 1500cc or less are 10-30%. Passenger cars with engine displacement less than 1500cc comprise 40 per cent of the market, including a large group of vehicles predominantly produced in Indonesia that are taxed at a rate of 10%
Malaysia	Yes	0% on large cars (small cars 0% by 2016) 0% on most parts	Import permit and a government-imposed pricing system, excise duties that disproportionately affect imported vehicles, and special tax reductions for vehicles with components manufactured in Malaysia.
EU	No	10% on vehicles	Onerous approval system and costly certification

Structural Adjustment Pressure

The aftermarket has undertaken considerable structural adjustment in its efforts to become globally competitive, and this continues to be a key ongoing business driver.

As demonstrated in the survey undertaken for this submission, 41% of respondents cited import competition as a constraint on current investment activity within the industry. Clearly, the presence of substantial import competition has forced Australian aftermarket manufacturers to take action on structural change within the sector.

The survey results indicate that principal among these actions is a focus on export, producing products higher up the value chain, particularly speciality components and diversification into other industries such as rail, mining, defence and marine.

The migration into these more challenging product areas has required a higher focus on R&D investment, capital deepening and skilled labour.

Diversifications into non-automotive sectors (notably defence and mining) and replacing dependence on OE component manufacture to aftermarket manufacture have been successful strategies.

As domestic OE supply opportunities decline and import competition (in terms of cost and product sophistication) increases, the need for appropriate structural adjustment measures becomes more critical.

The aftermarket segment needs to harness the skills, know-how and workforce increasingly being shed from the OE component sector, in order to achieve its growth potential and retain sustainable manufacturing operations in Australia. Together with appropriate policy settings and program support, this will enable aftermarket manufacturers to address these objectives:

- Increase productivity of domestic manufacturing operations
- Harness technology and creative capital
- Increase export focus
- Focus on further diversification into non-automotive sectors

Effective policy settings and assistance are required to address these adjustment pressures: consolidation/right-sizing of the supply base, fostering local manufacturing volumes, diversification and accessing global supply opportunities.

Case Study

Moving up the Value Chain

Turbosmart
Croydon, NSW
www.turbosmart.com.au

Turbosmart's core range consisted of only two products when CEO Nic Cooper began manufacturing performance products in 1997, with a great amount of effort put into the product design and manufacturing process. Being more handcrafted than mass-produced, Turbosmart products quickly gained acceptance within the performance community for their quality, performance and reliability.

Over the years the company has moved considerably up the value chain through diversification and is now a market leader in boost control and fuel management with more than 600 products in the range and exports to every continent. Turbosmart blow-off valves, wastegates, boost-controllers, fuel pressure regulators and other products are still designed and manufactured in Sydney using the same tried and proven formula of innovative design, strict quality control and rigorous testing.

Turbosmart opened its California based operation, Turbosmart USA, in 2007 and with the trusted expertise from Vice President Marty Staggs they have developed a successful business model with their products now distributed by more than 200 companies in North America including Summit Racing/Atech Motorsport, Mopac, Turn14, Motovicity, Motorstate, NAPA Auto Parts and Amazon.

With this experience the management team recognised a void in the Australian industry that their experience and resources could help fill. They began offering services to other Australian aftermarket companies looking to penetrate and gain market share in North America's automotive market and their latest venture, 3pConnect, was born.

Also based in California, 3pConnect is a third-party logistics services and consulting company offering a comprehensive range of services to automotive performance product manufacturers. The outsourcing of logistics is a proven and effective method for companies looking to expand their reach and capabilities with minimal investment.
The group of companies 3pConnect currently service include Redranger, Penrite, Davies Craig and Aftermarket Industries. These companies benefit significantly because the group provides discounted and flexible marketing programs and compounded media exposure, which is extremely helpful for brand awareness, freight consolidation, sharing customers and contacts, product support and more.

Turbosmart strongly believe that should the right policy mechanisms be in place to assist greater diversification, significant growth is assured. They have a range of products with strong export potential still in concept stage, and there is significant potential for their products in the UK and Western Europe. If they were in a position to fully maximise these new opportunities, strong investment in R&D, plant and equipment and human resources would follow.

Case Study

Successful Diversification

Mackay Consolidated Industries
Moorabbin, VIC
www.mackayrubber.com.au

Founded in 1932, Mackay Consolidated was initially Mackay Spares, a supplier of automotive parts for the growing automotive repair trade in Melbourne. In the late 1930's the business evolved again to begin to manufacture automotive rubber products, which is still a significant part of their business. In 1948, Mackay began to supply Holden with original equipment components, and over the next 30 years supplied Ford, Chrysler, Nissan, Toyota and Mitsubishi.

While automotive components remain a critical part the business, Mackay realised that diversification was the key to long term sustainability. Today Mackay manufacture and distribute products to the automotive OE, automotive aftermarket, truck, rail, defence, mining, industrial, agricultural, packaging and building industries. As a result of this diversification, Mackay now generate an even spread of revenue from each of these key sectors.

A further example of their diversification was in early 1995 when Mackay, in association with the Defence Science and Technology Organization and other defence customers, continue to develop many defence rubber products for naval crafts and land vehicles. One such development are the closures of the Vertical Launch System silos used for the Evolved SeaSparrow Missile.

Mackay have also been able to develop a strong export focus with markets in North America, Asia and the Middle East growing in prominence. From an automotive aftermarket perspective, the Middle East is one of their growing export markets in recent years.

The Future of the Industry

The Future of the Australian Automotive Industry

A key contention of this submission is that a rational and constructive discussion about the future of the Australian automotive manufacturing industry cannot be held purely in the context of one part of the automotive industry; the original equipment (OE) supply chain. Current and projected OE volumes simply can't support a sustainable view of this element of the industry, acting in isolation, for any longer.

It is now time for policymakers to take a step back from traditional views of the automotive industry and to view the industry in its true and more holistic context. This is because a sustainable future for the OE segment must now inevitably involve diversification into other parts of the automotive industry, particularly the automotive aftermarket segment, and into other industries as diverse as rail, mining, defence, marine and industrial goods.

It is now clear that the future of the Australian automotive manufacturing industry must be built upon a wider and more diversified base, and policy makers must now shape their policies to facilitate this transition.

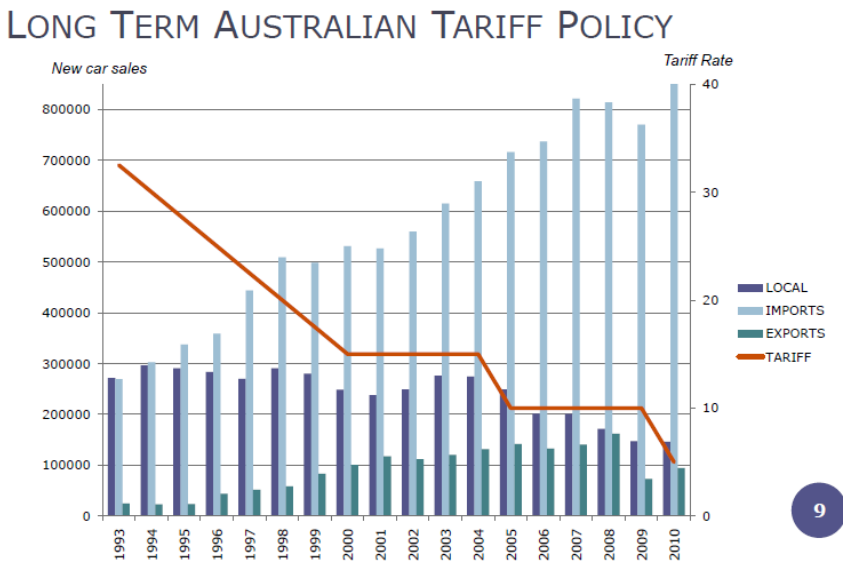
This section of the AAAA submission will develop an accurate and rational picture of the future for the Australian automotive industry, by:

a) Explaining the likely outlook for the OE industry given current market conditions and policy settings;
b) Explaining the likely outlook for the aftermarket segment given current market conditions and policy settings; and
c) Exploring how both the OE segment and the aftermarket segment can complement each other and enhance each other's future success, in the presence of a more holistic policy view of the industry.

Outlook for the Australian OE Manufacturing Sector

We are now seeing the results of tariff reform that commenced in the mid-1980s, reaching the end game. Some might say, the inevitable end game.

Since 1987, tariffs on passenger motor vehicles and automotive components have been progressively reduced from 57.5% to an average tariff of only 3.5% today (accounting for Free Trade Agreements preferences). The following graph shows the steady decline in the number of Australian produced passenger motor vehicles that has accompanied the progressive tariff reductions. When the program of tariff reductions began, the Australian passenger motor vehicle industry produced in excess of 400,000 units per annum, and this volume has now declined to only 209,730 units in 2012.



Source: GMH

The effects on the competitiveness of the Australian passenger motor vehicle manufacturing industry of the fall in tariff protection to historically (and globally) low levels, has been exacerbated in recent years by the sustained appreciation in the Australian dollar, which has made imported vehicles and components less expensive, while at the same time making Australian exports of such products less competitive overseas. Efforts to open up foreign markets to Australian automotive goods have also fallen well short of expectations, particularly due to non-tariff barriers, which have created further constraints on export growth.

As a result, the domestic vehicle market has become fragmented and dominated by imports, with the most diverse number of makes and models anywhere in the world.

Competition for the supply of OE components has also become more intense, with diminishing local content, as imported componentry becomes less expensive.

This has precipitated a sequence of closures by local OE component producers as they compete for a part of the ever-diminishing OE components pie.

This fall in the volume of Australian manufactured vehicles has seen the exit of Nissan and Mitsubishi from domestic vehicle production, and in 2016, Ford. The exit of vehicle manufacturers is perhaps the most stark evidence of the extent of the structural adjustment occurring in the Australian vehicle manufacturing industry, a trend that locks-in the industry's structural decline.

Further exacerbating this decline is the ever-increasing trend towards the use of global platforms by vehicle producers, including those located in Australia. Should GM Holden continue production in Australia beyond 2017, it will be predominantly on global platforms. Globally designed parts sourced through Global Purchasing processes will replace Australian-designed parts for Australian vehicles.

In order to win contracts suppliers must be global (in their own right, or 'via association' – part of a 'network of suppliers'); local suppliers will only be required for goods that do not ship well. The former category of global suppliers will either be considered "strategic suppliers" by virtue of their investment in the design and development phase alongside the OEM's global design centre, or "non-strategic suppliers" who win purely on global supply volume and cost competitiveness.

With the above said, it must be remembered that the picture of progressive rationalisation of the Australian vehicle manufacturing supply chain, is exactly what was envisioned by the designers of successive car plans. The OE manufacturing industry should not be criticised simply because it has gone through a process

of transitional change, brought on by the policy action of successive governments. Nor should the support that has been provided with the intent of aiding a smooth and orderly transition by the industry be criticised, as the assistance has to date played the predetermined role that was intended in this process of change over three decades.

What is clear now, however, is that the task of transitioning the OE component manufacturing sector into a sustainable future must be seen in the context of the wider automotive manufacturing sector, as the OE volumes alone will no longer be sufficient to sustain this element of the supply chain in a viable form.

Outlook for the Australian Aftermarket Manufacturing Sector

Automotive aftermarket manufacturing represents 36% of all automotive manufacturing in Australia.

What's more, the size of this sector has been growing over time, rather than declining as is the case for OE component manufacture.

Aftermarket
3% year on year growth 

Most importantly, while the structural factors which are driving the decline of the vehicle manufacturing supply chain look set to continue (high exchange resulting in cheaper imports; phased tariff reductions; the trend towards global platforms), by contrast, there are structural factors facing the aftermarket segment that have the potential to support continuing and significant future growth. In particular:

- The demand for specialty components, in which Australian aftermarket manufacturers are very competitive, is growing in line with higher SUV sales (a vehicle segment which generates high demand for specialty components;

4WD speciality components
8% year on year growth 

- The ageing of the population is supporting demand for specialised vehicle retrofit components (e.g. suspension components), which are needed for towing caravans used by retirees for vacations;

- The rise of the global platform, while representing a threat to local OE component producers by reducing opportunities for OE contracts globally, is generating opportunities for the development of accessories and modifications to global vehicle platforms, first developed for local use and then exported;

- Overseas trends point to emerging consumer preferences in terms of the modification of new vehicles. For example, in the USA, SEMA (Specialty Equipment Manufacturers Association) figures show that sales of post assembly fitment parts for off-road vehicles are 5.2%. If these kinds of trends take hold locally, this will further support growth in demand for aftermarket parts and accessories.

  In this regard the Australian market tends to mirror trends in the US market and as such, if this trend alone is replicated in Australia, this could see the Australian aftermarket grow by as much as 4% over the next decade;

- The Australian aftermarket has been effective in exporting product around the world, developing innovative components for use in the modification of vehicles and using overseas trade shows and trade missions as an avenue to securing foreign sales opportunities; and

- The Australian aftermarket has also been successful in branching out into non-automotive industry sectors, such as rail, defence, mining, marine and industrial, creating further opportunities for volume growth through diversification.

Hence, a contrast between the outlook for the OE and aftermarket segments makes for stark comparison – structural decline in volumes in one sector, versus structural growth through diversification and niche market trends on the other.

What is also apparent, however, is that the performance of both the OE component sector and the aftermarket component sector, can be simultaneously enhanced through a holistic approach to policy setting for the entire automotive sector, not just for OE.

Outlook for a Complementary OE and Aftermarket Sector

It is clear that the transitional path for the OE component-manufacturing segment requires a realistic and achievable avenue to diversification and higher volumes. In short, the OE component sector needs to embark on a process of structural change to achieve a sustainable future.

The question is, what could this structural change look like and how can government policy assist this transition?

From both a product synergy and policy point of view, the easiest and most logical transitional path for the OE segment is to diversify into aftermarket component production.

Further, the forecast demand trends for the automotive aftermarket indicate that the aftermarket segment has the potential to draw on the OE supply chain's resources, to help it to grow and achieve full potential. For example, the aftermarket segment can enhance productivity and capability by retaining and leveraging the OE supply chain's:

a) Workforce and skills;
b) R&D capability;
c) Intellectual Property;
d) Quality systems
e) Knowledge of OEM product development and validation processes for parts and accessories;
f) Tier 2 and tier 3 suppliers, by maintaining and growing the volumes fulfilled by this element of the supply chain.

Hence, a key consideration for policy makers is to re-orient the incentive structure for the entire automotive manufacturing sector, so that on the one hand, it encourages diversification by the OE segment into the aftermarket and on the other hand, positions the aftermarket for growth, so that the resources of the OE segment can flow more easily into a more sustainable and growing aftermarket segment.

If this approach is taken, policy makers will be successful in fostering the structural adjustment needed, to transition the OE segment into a more sustainable future.

Further, by fostering greater integration between the aftermarket segment and the OE segment, the resources of the OE segment can play an important role in further enhancing the diversification lead already being taken by the aftermarket segment, into industries such as rail, defence, marine and mining.

The key policy point here is that the transitional role of automotive industry assistance is not complete simply because the tariff reform process is now complete. Policy makers must distinguish between inputs to structural adjustment (e.g. tariff reductions), and the outputs of structural adjustment, namely the orderly transition of resources into more sustainable and higher-value uses.

The question of how government policy could be re-designed to foster structural adjustment to the benefit of the entire automotive manufacturing supply chain, is discussed in more detail below. However, the fundamental policy principle is that if the necessary structural adjustment is to be achieved, policy settings must be designed and based on the entire automotive manufacturing supply chain in mind and not just the OE supply chain.

Summary of Findings: Trends and Opportunities

The survey of AAAA manufacturing members provides support for the proposition that the aftermarket and OE segments can play a complementary role in the structural adjustment process and provided some important insights in terms of policy support that might be beneficially applied by government to assist this structural adjustment process. See Appendix 2 for full survey findings.

High Quality, High Technology Products

In terms of current determinants of investment in the aftermarket-manufacturing sector (i.e. in the presence of vehicle manufacturing), the

importance of high quality products (82%) and technology (68%) rated highly.

Further, 41% of respondents cited import competition as a key constraint on current investment activity within the industry. These results are indicative of the movement of Australian manufactured aftermarket products up the value chain into highly engineered speciality products, as distinct from commoditised replacement parts.

Labour Costs & Productivity
The survey results had 59% of respondents viewing labour costs as a key constraint on investment. Further, skilled and flexible labour was seen as a net constraint on capital investment plans, as evidenced by 43% citing this to be a negative constraint on investment and 37% stating that skilled and flexible labour is currently conducive to investment.

This realisation of opportunities to improve the productivity of the aftermarket segment was also evident in the survey through the profitability results. This is particularly clear in the results which found that the weighted average profit margin, measured at the EBIT level, for the aftermarket was a healthy 15.4% on average, (which compares favourably to far lower profitability levels for OE manufacturers). Yet despite this result, the aftermarket manufacturers were still conscious of the need to reduce costs, particularly labour costs, pointing to the belief amongst survey respondents that productivity and cost competitiveness could still be further enhanced.

A healthy 24% of aftermarket manufacturers saw the key impact of their capital investments as relating to capital deepening, which drives output efficiency, as opposed to capital broadening (34%) and capital acquisitions relating to new product lines (34%). This result is indicative of an industry sector that is aware of the need to improve productivity to enhance competitiveness through the adoption of leading-edge technology.

Scope to Absorb Displaced OE Resources
Capacity utilisation was cited by some 35% of survey respondents as a positive force for additional investment. This is an important outcome of the survey findings from a structural adjustment point of view, as it indicates that the overcapacity issues that plague the OE segment are not as prevalent in the more buoyant aftermarket segment. It can be concluded therefore, that the aftermarket segment is well placed to absorb surplus capital from the OE segment and if incentivised to invest, innovate, diversify and export, will generate further sustainable business opportunities to assist the structural adjustment process for the declining OE segment.

A further survey finding which is relevant to interpreting the capacity of the aftermarket to invest to create the opportunities for the structural adjustment of the automotive sector is the reporting of the cost of capital as a key constraint on investment intentions. Some 46% of all survey respondents said that the cost of capital was a constraint on their investment plans. Hence, incentives to assist the aftermarket to make capital investments and overcome this constraint are a key to unlocking its potential to play a constructive role in the structural adjustment process. Widening access to ATS could be a useful initiative in this regard.

Impact of the Absence of Locally Manufactured Vehicles
A key outcome of the survey was that the aftermarket segment was confident that it could build a sustainable future for itself in the absence of a local vehicle manufacturing industry. In particular, when the survey asked the direct question of aftermarket producers of what the impact of the absence of locally manufactured vehicles would have on their investment plans, 51% of respondents said that this eventuality was unlikely to have any effect on their investment plans.

The role of export demand as a driver of future investment outperformed the role of the domestic market in the two scenarios.

While there was a slight decline in the perceived importance of non-automotive diversification in the event of the cessation of local vehicle manufacturing, there was still a healthy 22% of respondents who said that this would be an inducement for investment.

Global Pressures and Consumer Demand

The Australian automotive aftermarket is a growth sector, and can be an engine for growth of advanced manufacturing capability in Australia. Government policy and programs should support the potential of this industry to play a constructive role in structural adjustment. However, in order to harness this potential for economic growth, it is very important that policy makers not only embrace a wider definition of the automotive industry and look to not only what Australia can excel at, but look to where global forces are dictating future direction.

Changes in Global Automotive Retailing and Implications for the Aftermarket

The global automotive industry is in a period of rapid change, from design and manufacturing, through to modification, customisation and retail delivery, and then into the post sale service and maintenance market. This has clear implications, challenges as well as opportunities, for the aftermarket, which is now becoming an integral part of the manufacture and supply of individual private motor transport.

It is now well understood that the Internet has caused radical changes to retailing in general, with small consumer items such as books, music, food and clothing increasingly being sold online, and in some cases downloaded online. This trend is now increasingly moving into larger consumer goods such as furniture, whitegoods and audio-visual entertainment units. Up until now, however, motor vehicles were thought to be immune from these developments, as it was considered that prospective purchasers wanted to see and touch the actual motor vehicle, test drive it, and yes, 'smell the leather'.

This is now changing, for several reasons. There are many more variants and models of all cars now available, many more than can be displayed in a conventional showroom. Online technologies can now display more effectively the huge range of options available to a purchaser, who can choose online, at home or via a terminal in the showroom, and feed those customisation requests directly back into the manufacturing and aftermarket supply chain. Combined with this development of technology is a basic economic change of increasing rents for the space in central business districts required for showrooms, leading to a change to smaller, more luxuriously appointed premises, with only one or two display vehicles, and perhaps located in a retail precinct or department store – another aspect of their changing role in the online environment.

While there is, on the one hand, a greater range of options and models of cars available, on the other hand the global motor vehicle industry is becoming more standardised with fewer basic platforms, designed in the USA, Japan, or Germany. The days of a six cylinder family car designed in Australia for Australian conditions have gone. The basic platform will have the most common model variants but increasingly this modification will occur with components and specialty equipment produced by the aftermarket.

This has clear implications, challenges and opportunities for the aftermarket segment, which in the American market is now an integral part of the manufacture and supply of individual private motor transport. In the USA, customers select their requirements on line and these customisation requests are subsequently fed directly back into the manufacturing and aftermarket supply chain. In the North American market, aftermarket producers work actively at product development through vehicle sales as an integrated market offering. The relationship between the vehicle producer and the aftermarket is seen to be mutually beneficial in meeting the many variations that a customer may require. The USA marketing of vehicles clearly demonstrates a collaborative relationship based on OEMs embracing aftermarket input.

Economic Value

An examination of the current structure of the Australian automotive aftermarket manufacturing industry points to an industry with a value of some $5.2 billion.

Key Metrics for Aftermarket Producers

$5.2b
Automotive Aftermarket Manufacturing

21,000
Aftermarket Manufacturing Employment

14.2%
Aftermarket Exports as a Share of Sales

1.5%
Aftermarket R&D Expenditure as a Share of Sales

2.3%
Aftermarket Capital Expenditure as a Share of Sales

While this is an accurate assessment as to the economic value in terms of this industry's actual value, it is not an appropriate statement as to its true potential value.

The latter part of this submission includes a detailed explanation of a methodology for modelling the gap between current and future performance of the aftermarket segment and the role and impact of Government Policy as a driver for achieving structural adjustment.

The model identifies a clear disconnect (or gap) between the direction of economic benefits that are and will be derived from the aftermarket segment and the impact of government support.

If the Federal Government's current automotive policy settings involved greater synchronicity with the role this industry will play in the future of the Australian automotive industry, then its current value today to the Australian economy (from its own direct contributions) could be closer to $6.56 billion; a more accurate measurement of the industry's potential value to the Australian economy.

Case Study

Industry Innovation Centre

Specialty Equipment Market Association (SEMA)
Los Angeles, USA
www.sema.org

Located at the Specialty Equipment Market Association (SEMA) headquarters near Los Angeles, SEMA Garage gives members from across the USA access to high-tech tools and equipment they need to take their products from initial concept through to product launch.

The 15,000-sq.-ft. facility houses nearly $2 million of equipment, including two vehicle lifts, a portable coordinate measuring machine (CMM) for 3D scanning, a 3D printer for fast prototyping, digital race car scales for the vehicle weight measurements and a dynamometer for power output measurements. The facility also features a fully certified Executive Order (EO) aftermarket-part certification lab to provide the required certification for any company planning to sell aftermarket powertrain parts in the California market. The temperature-controlled test cell can simulate weather conditions ranging from winter in the mountains, summer in the desert. Testing meets all US federal Environmental Protection Agency and California Air Resources Boards (CARB) standards with capabilities that include emissions, fuel economy, acceleration, brake stopping distance, interior/exterior noise levels and handling, SEMA said.

SEMA is now in a position to provide members with a reliable and affordable way to develop and test their products, thereby helping them get their products to market quicker.

The SEMA Garage originally opened May 9 2013 when the aftermarket-part certification lab was first made available to members. A suite of marketing support tools will be added in the next several months to complete the three-phase opening, in the form of a media centre with a photo cove, photography centre and media coordination services.

Case Study

Contrasting Aftermarket / MVP Collaboration USA and Australia

Pedders Suspension
Keysborough, VIC
www.pedders.com.au

Pedders Suspension is a third generation family company that commenced in 1950 when owner Roy Pedder, opened Pedders Die-Cast Welding Service in Carnegie. Roy was an ex-RAAF plane welder and found his niche in the repair and reconditioning of shock absorbers and the business grew rapidly.

In 1972, Roy's eldest son Ron took over the company and made the next significant step of utilising what the company had learnt from reconditioning other brands of shocks to begin designing their own. To support this strategy, Ron took the view that the only way to ensure good distribution of his product was to open Pedders branded stores.

Today, Pedders is headed up by Ron’s eldest son Mark and has 116 locations Australia wide as well as distributors in Korea, Mauritius, Thailand, Indonesia, Kenya, South Africa, Malaysia, Cyprus & the U.S.A. Pedders employs over 330 people in Australia and has suspension products for the majority of vehicles on our roads today.

Hampering their Australian expansion are the constant challenges when trying to engage with the local vehicle manufacturers, despite the strong potential for collaboration with sales advantages for both parties. In North America, Pedders Suspension has worked very closely with General Motors (GM) to offer ‘approved’ Pedders branded products for post sale through official GM dealerships. The advantages for Pedders are clear, access to 2500 more businesses, and for the dealership, they know they will sell more cars if they can offer a full modification service onsite, and they make greater margins on the sales of the parts. This is a growing trend in North America, and already Pedders are engaging with other vehicle manufacturers to mirror the GM offer.

Government Policy and Role

Background

The setting of industry policy for the automotive industry is one of the few areas of public policy which has had a consistent theme sustained by successive governments, over a period of decades.

In the mid-1980s tariffs on imported vehicles and OE components were set at 57.5%. Over the ensuing decades, tariffs have been gradually reduced to a point where the average tariff now rests at 3.5% on average for these products.

As a quid-pro-quo for opening up Australia's borders to ever increasing import competition, the Australian passenger motor vehicle manufacturers, and the OE components supply chain, have been receiving various kinds of "transitional assistance" over this time period. The more notable forms of assistance include the Duty Free By-law (DFA); the Export Facilitation Scheme (EFS); the Automotive Competitiveness and Investment Scheme (ACIS) and since 2011, the Automotive Transformation Scheme (ATS).

The hope and intent of policy makers over this period was that the Australian vehicle manufacturing industry would eventually reshape to a more sustainable level, with perhaps 2 car manufacturers, export programs and a sustainable supply chain for OE components.

What is now clear is that trends towards global platforms, global engineering homerooms and regional purchasing, the most open automotive marketplace in the world and a lack of reciprocal market access, has meant that an Australian vehicle market with sufficient room for 2 Australian vehicle producers is now in serious doubt. Further, access to foreign markets has not been achieved due in large part to the failure of governments to secure reciprocal market access, exacerbating the lack of opportunity to build sustainable OE volumes in the domestic supply chain.

Hence, a central premise about the intended end-point for this 3 decade-long policy process is now in serious doubt and it is now time for current policy makers to break with the past and re-define the intended transitional end game for the Australian OE supply chain.

The New Policy End Game

Now that policy makers can clearly see that the expected and intended end-point for the industry will most likely not be reached (i.e. an automotive supply chain that can be sustained by domestic and export OE volumes), it is incumbent upon them to look at the automotive supply chain in a far broader sense than has traditionally been the case, to pave the way for a transition by the industry into other automotive (and non-automotive) markets, which can realistically deliver a sustainable future for the sector.

As discussed in some detail in "The Future" section of this submission, a logical step for policy makers is to consider the role that the Australian automotive aftermarket can play in providing a realistic and achievable pathway of transition for the OE supply chain away from OE dependency and into the wider automotive space.

In short, the aftermarket and OE sectors, if considered together in the policy making process, can leverage-up their respective capabilities and performance potential.

On the one hand, the aftermarket has made progress in accessing growing speciality component markets, both domestically and globally, as well as being successful in accessing new non-automotive markets such as rail, mining, defence and marine. It is poised to act as a catalyst for diversification for the wider automotive industry, but will need to grow

and improve its efficiency and levels of innovation to realise full potential, as has been shown by the survey results discussed above. While on the other hand, the OE segment, which needs urgent access to diversification opportunities, can provide the much needed workforce skills, R&D capability, intellectual property, quality systems and knowledge of OEM product development and validation processes, to help the aftermarket segment to overcome supply side constraints to its further diversification and growth.

Clearly then, policy settings which seek to maximise these synergies between the two sectors will produce win-win outcomes for the sustainability of the industry as a whole, and minimise the displacement of the workforce and other resources within the industry.

Overview of Programs and Effectiveness

Based on the analysis in this report, there are four key areas where government can intervene to assist the transition towards this new synergistic policy end game.

1. Diversification
2. Competitiveness and Innovation
3. Export access
4. Consolidation/Rationalisation of the supply chain

Diversification

The survey results and industry trends reported in this submission have shown the importance of diversification to the future success and sustainability of the automotive industry. These results have also shown the success that the aftermarket segment has achieved in this area.

The Automotive New Markets Initiative (ANMI) is the key instrument for Government support of diversification. This $47 million 4-year program, through all three of its program elements, is exclusively available to suppliers to an OE manufacturer for new passenger motor vehicles. Aftermarket manufacturers are explicitly excluded.

Policy Objective:

The ANMI policy objective of encouraging firms to remain in the automotive industry by achieving critical mass through product and market diversification is highly worthy, as this preserves advanced manufacturing capability in Australia along with the associated high-skilled jobs, intellectual capital and spill-over benefits.

Policy Failure:

By excluding the aftermarket manufacturers however, this policy has excluded those automotive companies most capable of growing and absorbing displaced resources from the declining OE segment, through the manufacture of speciality components which are not dependent upon the existence of OE customers; diversified production into other industries such as rail, defence, mining and marine; and through export.

Program	ANMI - Automotive New Markets Program (ANMP)	ANMI - Business Capability Support Program (BCSP)	ANMI - Automotive Supplier Advocate
Objective	$42 million fund for projects which develop: -new automotive products/services to domestic or offshore automotive customers, -or products/services to new non-automotive customers domestically or offshore.	$2.6 million fund for AutoCRC Limited's "Automotive Supplier Excellence Australia" (ASEA) arm to develop business capability, improve productivity and encourage diversification.	This role is designed to help OE automotive industry suppliers diversify into other automotive and non-automotive opportunities in the domestic market.

Program	ANMI - Automotive New Markets Program (ANMP)	ANMI - Business Capability Support Program (BCSP)	ANMI - Automotive Supplier Advocate
Comments	This program has been viewed as highly successful for OE component producers, however it must include the aftermarket segment to achieve structural adjustment outcomes.	While there is general consensus that the elements of this program that focus on diversification have been successful with general awareness raising, it fails on two accounts. Only Tier 1 and 2 OE component producers may apply; and efforts were regarded as too superficial rather than the desired "hands-on" sustained effort at bringing about change.	Once again, this program element is too narrowly focused as a result of focusing efforts on OE producers.
Recommendation	Future diversification programs are needed which incentivise those elements of the automotive supply chain that can deliver rapid and sustainable diversification opportunities, such as the aftermarket segment. This will create opportunities for resources to be redeployed from OE production to more sustainable markets.		

Competitiveness and Innovation

Even though the aftermarket segment has reasonable profitability, with a weighted average profitability at the EBIT level of 15.4%, the industry is still critically aware of the need to further improve productivity, to invest in capital deepening, plant and equipment and to continue to innovate and undertake research and development to push its production further up the value chain.

The centrepiece scheme to support investment and innovation in the Australian OE motor vehicle production supply chain is the Automotive Transformation Scheme (ATS). The current legislation provides for over $3 billion in assistance to the industry from 1 January 2011 to 31 December 2020.

The ATS program is currently undersubscribed relative to its annual budget, as evidenced by the modulation rates for both the vehicle producer and supply-chain funding pools being set at unity. With continuing reductions in volumes being forecast, this trend may be set to continue. Accordingly, there would appear to be scope to open up the program to other automotive component manufacturers, without necessarily disadvantaging the amount of funding available to existing program beneficiaries.

The AutoCRC Limited's "Automotive Supplier Excellence Australia" (ASEA) arm, also received funding of $2.6 million through ANMI - Business Capability Support Program (BCSP) for the purpose of improving competitiveness and innovation of the OE motor vehicle production supply chain.

Policy Objective:

ATS seeks to improve competitiveness and levels of innovation through incentives in respect of investments in new plant and equipment and research and development activities. Importantly, R&D activity directed at improving the efficiency of manufacturing processes is an eligible activity, which means that this program is an important driver of productivity in the OE supply chain.

The ASEA program delivers benchmarking and lean manufacturing / efficiency projects with the OE supplier base. The program has been somewhat effective in improving the efficiency of OE production through general awareness raising, benchmarking and encouraging follow-on lean activities.

Policy Failure:
By limiting the accessibility to ATS to producers who are predominantly OE producers, this policy setting is not fostering greater efficiency and growth in the aftermarket segment, which is the sector which has very real prospects of absorbing resources redeployed from the OE supply-chain. Hence, the current ATS policy settings are not used to generate absorptive capacity in the segment of the automotive supply chain that can play a positive and timely role in minimising displacement of resources from the declining OE supply chain.

In the case of the ASEA program, it is in the view of the AAAA that this program is no longer warranted, as both Holden and Toyota run their own comprehensive supplier development programs. Further, it is the view of AAAA that continuing to fund ASEA runs counter to what must be the key automotive industry priority, of facilitating structural adjustment in the industry.

The wider automotive sector would see more benefit in redeploying the ASCDP funding into initiatives such as a better targeted diversification program, which facilitates the urgent structural adjustment needed by the industry.

Program	Automotive Transformation Scheme (ATS)	ANMI - Business Capability Support Program (BCSP)
Objective	Encourage investment and innovation in the automotive industry. Assistance in the form of cash payments in respect of eligible P&E and R&D to registered automotive participants (OEMs, component producers, machine tool and tooling producers and service providers).	$2.6 million fund for AutoCRC Limited's "Automotive Supplier Excellence Australia" (ASEA) arm to develop business capability and improve productivity.
Comments	This program has been viewed as highly successful for OE component producers, however it must include the aftermarket segment to achieve structural adjustment outcomes.	The industry has sufficient general knowledge of the benefits of improving competitiveness and innovation; the need for this program has passed.
Recommendation	That as an aid to the structural adjustment imperative facing the industry, the ATS program be extended to include aftermarket component producers, to assist this sector to grow and innovate at a more rapid pace, thereby improving its capacity to absorb displaced resources from the OE supply chain.	That the ASCDP program is discontinued and its funds are redeployed into a better targeted diversification program.

Export Access
The survey conducted as part of this submission identified 87% of survey respondents as exporters and identified export growth as a key determinant of future investment in the aftermarket segment.

As a highly trade-exposed market segment, export market access is a key to the future success of the automotive industry in Australia. The reality is that the Australian market can only sustain a given level of automotive production and further volumes must come from abroad.

Policy Objective:
The Export Market Development Grant (EMDG) program has been a useful program for AAAA members. It provides an opportunity to recover up to 50% of the cost of export promotional costs, which provides a critical offset to the cost of establishing new offshore markets.

The ANMI program provides funding for a special automotive envoy, whose mission has been to find OE export opportunities for the OE supply chain.

Policy Failure:
The limit of seven EMDG claims over the life of a business is restrictive. Given the fundamental importance of export growth to the future sustainability of all elements of the automotive supply chain, the EMDG program could be reformed with a few simple rule changes to greatly enhance its effectiveness.

The effectiveness of the Automotive special envoy initiative is somewhat blunted by the OE focus, as this is unlikely to deliver the scale and speed of opportunities required to build a sustainable future for the OE supply chain. Accordingly, these funds would be far better deployed within a diversification program as discussed above.

The other key issue facing the aftermarket segment is the lack of progress on reciprocal access to export markets. Despite Australia entering into numerous Free Trade Agreements and unilaterally reducing its own tariffs, market access remains a significant impediment to market growth and structural adjustment. The presence of Non-Tariff Barriers is particularly acute in this regard.

As discussed above, the survey undertaken by the AAAA in support of this submission identifies a number of key markets to which the aftermarket is looking to help facilitate market growth, such as ASEAN, New Zealand and the Pacific Islands, North America, Eastern Europe and China. Any actions which can be taken by government to improve market access into these markets would be beneficial to strengthening the aftermarket and making it more able to play a role in absorbing displaced capital and workforces from the OE manufacturing sector.

Further urgent work by the Federal Government in securing access to key markets is a key to facilitating a sustainable future for the Australian automotive industry.

Program	Export Market Development Program (EMDG)	The Asian Century Business Engagement (ACBE)	ANMI - Automotive Envoy
Objective	Support investment by companies with turnover under $50 million in export promotion costs, for the purposes of penetrating new export markets.	Assist member-based business organisations harness commercial opportunities in Asia for their members.	This role was designed to help promote Australian automotive industry capabilities in the international automotive industry.
Comments	This scheme has been enormously beneficial to the automotive industry that is fundamentally export orientated. The limitation of up to 7 grants however is highly restrictive.	This newly established 4-year program is to be commended. AAAA achieved outstanding results with the former Global Opportunities (GO) program and looks forward to implementing a program with ACBE support.	Once again, this program element is too narrowly focused as a result of focusing efforts on OE producers. A wider missive that leverages aftermarket as a key theme to "Brand Australia" will deliver more powerful outcomes.
Recommendation	That the EMDG program be modified by removing the upper limit of 7 claims over the life of a business. That the funding for the Automotive Envoy be redeployed into a diversification program as discussed above. That the Federal Government redouble its efforts to achieve access to key export target markets such as ASEAN, New Zealand and the Pacific Islands, North America, Eastern Europe and China. That funding for ACBE be increased to facilitate greater results.		

Consolidation/Rationalisation
The aftermarket segment has generally handled the issue of rationalisation in two ways. It has either exited local manufacturing and imported those components that cannot be manufactured competitively, or moved operations offshore to produce at a more competitive cost.

The OE supply chain has seen a similar trend, however in some instances, the Australian vehicle manufacturers have brought global producers into the country to achieve certainty and quality of supply, where they prefer the presence of a local supplier.

Traditional policy responses to date have once again focussed on the OE supply chain, most notably through the Automotive Industry Structural Adjustment Program (AISAP).

Policy Objective:
AISAP was designed to assist the OE automotive component producers to consolidate for the purpose of achieving greater scale and retaining core capabilities. AISAP funding supported legal, relocation and other merger costs.

Policy Failure:
AISAP required the "resultant entity", the product of the consolidation of two automotive component-producing businesses, to be ATS eligible (i.e. that the consolidated entity was a predominantly OE producing entity). Further, the Australian vehicle manufacturers had an informal role in providing "letters of support" for a proposed consolidation as part of the AISAP application process, providing further impediments to structural adjustment proposals which made sense for the overall automotive supply chain, but didn't fit with the OE supply plans of the vehicle manufacturers. Clearly the wrong incentive was provided by AISAP, given that the OE supply chain is the element of the industry that is in structural decline.

Given the analysis in this submission, a far better policy outcome could be that the resultant entity become a pure aftermarket entity and lose the OE part of its business in the process. The same could even be achieved through an "internal consolidation", whereby the business might lose its OE manufacturing in an orderly way and focus on growing a more sustainable aftermarket or otherwise diversified business.

Other key limitations of the former AISAP program related to the lack of eligibility for redundancy costs that are inevitably part and parcel of a supply chain consolidation proposal.

The other issue facing the industry from a consolidation point of view is the effectiveness of the Fair Entitlement Guarantee (FEG) process. The FEG only comes into operation when a company has gone into liquidation, meaning that worker entitlements are only protected when the business is coming to a close. Clearly, a process to protect worker entitlements in the event of a re-organisation of a business, without the need to go into liquidation, would be preferable and would provide an important aid to structural adjustment proposals.

Program	Automotive Industry Structural Adjustment Program (AISAP)
Objective	Assist OE automotive component producers to consolidate by providing funding to support legal, relocation and other merger costs.
Comments	On-going consolidation of the supply chain is an inevitable process and requires support to ensure it happens in an orderly manner which brings about structural adjustment outcomes which serve a holistic view of the future of automotive manufacturing in Australia.
Recommendation	That an AISAP style program be considered as part of the new policy settings for the automotive industry, but its parameters are far broader, and not focus on the outcome of the consolidation activity delivering an OE focussed (or ATS eligible) resultant entity. That a process be developed whereby a company can borrow to cover worker entitlements in the event of corporate re-organisation, but the company cannot pay dividends until the loan has been repaid. That a "Chapter 11" style business re-organisation style approach be considered for application in Australia to help companies trade through corporate re-organisations, without going into formal liquidation.

Role of Aftermarket Segment in Structural Adjustment

The OE Producers

For those automotive component producers that cannot solely depend on domestic supply volumes (in the context of rapidly shrinking OE market and increased import competition), diversification is key to their business sustainability. Importantly, diversification ensures the advanced manufacturing skill base is not only retained, but leveraged when applied to diversified manufacturing sectors.

The necessary skills sets required to undertake diversification however are on the whole, lacking among OE component producers.

Unlike their aftermarket producer counterparts who have had to become expert at selling, branding, marketing, catalogue management, distribution, logistics, price-setting and so on, the OE Producers have all but lost these skills. The OE Producers, in their efforts to deliver annual cost-down targets driven by the OEMs, have effectively allowed these aspects of their business to atrophy, while dedicated their resources to highly efficient, mass production of quality precision parts. OE Producers effectively lack the necessary skills in relation to identifying, entering and managing new non-OE markets.

Given that OE component producers must diversify at a very fast rate if they are to survive the Ford plant close-down, reducing local volumes, impact of global purchasing policies and global platforms etc., diversification into the automotive aftermarket should be a high priority sector. That is, the products are highly aligned, while the automotive aftermarket brings the skills that can compensate for the inherent weaknesses of the OE segment.

Same automotive products, different skill set:

OE producer	Aftermarket producer
Strength in mass commoditisation - most efficient at high repetition	Strength is being brand-driven - efficient at small volumes; job-shopping capability
Design & engineering skills focused on delivering to OEM drawings	Design & engineering skills focussed on market demand and innovative solutions
7-year model vehicle model cycle	Fast to market: ability to commercialise R&D quickly
Distribution arranged by OEM who picks up from plant on Just In Time basis	National and international distribution and logistics know-how
Packaging under OEM direction	Packaging design and development expertise
Activity directed by OEM	Entrepreneurial
Many multinationals, directed by offshore parent	Majority are 100% Australian owned
Low margins	Sustainable margins
Single customer type (OEM)	Customers are OEMs, AA Wholesalers, Resellers, Retailers, Consumers

The Aftermarket Producers

While aftermarket Producers can assist the OE Producers to transition into non-OE segments, a process of structural adjustment would be mutually beneficial. The aftermarket segment can enhance its productivity and capability by retaining and leveraging the OE supply chain's:

- Workforce and skills;
- R&D capability;
- Intellectual property;
- Quality systems;
- Knowledge of OEM product development and validation processes for parts and accessories; and
- Tier 2 and tier 3 suppliers, by maintaining and growing the volumes going to this element of the supply chain.

In summary, diversification is a critical imperative of the OE segment and the aftermarket segment provides the most logical and simple transition alternative.

The aftermarket is a prime candidate industry to play a leading role in assisting the process of structural adjustment in the vehicle manufacturing supply chain, by absorbing displaced capital and workforces. Aftermarket companies have provided intelligence on a number of means by which the government could foster the structural adjustment process:

- Encourage investment in technology and research and development by the aftermarket segment to encourage moving production up the value-chain and to improve cost competitiveness;
- Encourage investment in new plant and equipment, particularly capital deepening investments, to improve innovation and cost competitiveness;
- Introduce a diversification program that is open to aftermarket producers to grow and strengthen the aftermarket to allow it to play a catalytic role; and
- Enhanced export development and market access support.

Modelling the Gap

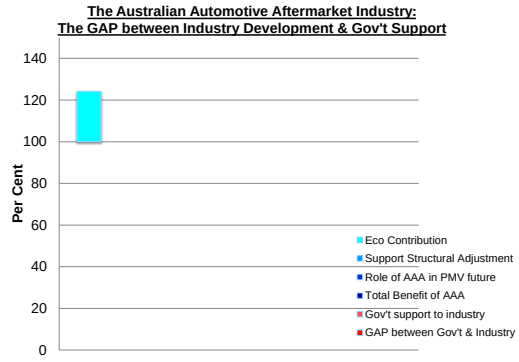
This section evaluates the gap, or extent of disconnect, between current Government policy settings and the future of the Australian automotive aftermarket (AAA) sector. A step by step description follows to substantiate the methodology applied.

Step One

The first step in building a model of this gap is to consider the contribution of the aftermarket segment to the entire Australian automotive sector. This is done by calculating the percentage points contribution of this industry to the whole automotive sector.

It has been estimated that the total benefit to the Australian economy from the Australian automotive manufacturing sector is in the order of $21.5 billion[1]. This includes all the relevant multiplier impacts across the Australian economy, including the so-called welfare loss elements, which would materialise across the entire economy if automotive manufacturing were to totally cease.

Based on this estimate of the value of the Australian automotive aftermarket segment and our estimate (based on our membership database) of the aftermarket segment at $5.2 Billion, this indicates that this industry represents some 24.2 per cent of the entire industry. Developing an Indexed value for the aftermarket manufacturing industry (as a share of the total) implies an index value of 124.2, as represented in the following chart.



Step Two

The second step is to measure the required elements of structural adjustment in the Australian automotive sector. We have given priority to the following metrics which were derived from our survey of the aftermarket manufacturing sector:

- Exports as a share of sales = 14.2%.
- Research & development as a share of sales = 1.5%.
- Capital expenditure as a share of sales = 2.3%.

The metrics were used to construct a measurable and comparable index value around the extent to which the aftermarket segment possesses the structural characteristics which indicate a truly globally competitive industry.

It is worth noting that that ratios derived from the survey results have been adjusted for the purposes of calculating the Index value for this section, for two reasons:

1. The survey respondents are skewed towards the lower-sized market participants; analysis shows a large proportion of our larger members companies could not respond within the two-day timeframe. Larger manufacturers demonstrate different industry metrics from smaller businesses. For example, the average R&D expenditure trends, as a share of sales, for surveyed businesses with turnovers of $1M or more averages around 5.0 per cent. The adjusted R&D ratio, taking this into account, is estimated at around 3.75 per cent.

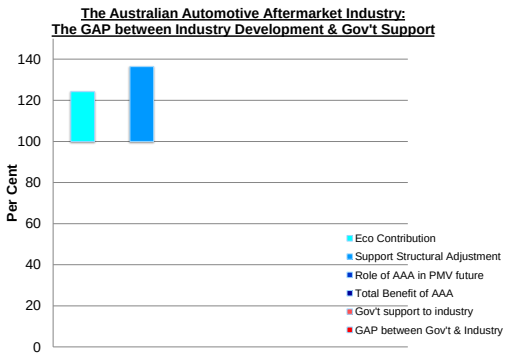
   In considering the relevant exports-to-sales ratio the survey analysis points to an average result of 14.2 per cent. However, once again due to the lack of the largest aftermarket manufacturers amongst the survey respondents, this estimate has been re-weighted against the current market structure. Based on export trends amongst the largest businesses points towards an average exports-to-sales ratio of 29.9 per cent.

- The likelihood that the aftermarket segment evolves without the presence of a local PMV manufacturing sector also need to be accounted for. In this scenario, the market structure will

[1] The Allen Consulting Group, *The Strategic role of the Australian Automotive Manufacturing Industry, 2013.*

involve increased concentration, as businesses seek to achieve greater economies of scale to compete on a more global basis.

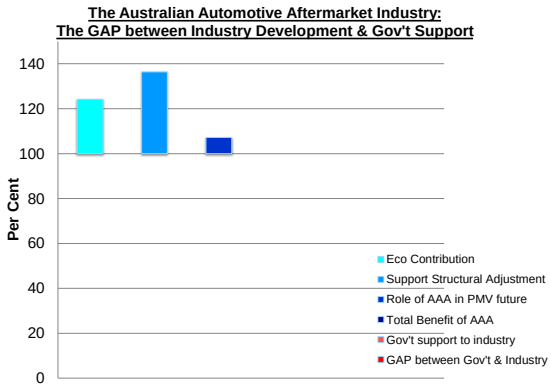
The above weighted industry metrics have been compared with the overall average metrics for the entire Australian automotive sector. From such a comparison comes an indexed measure which not only shows how the aftermarket segment is currently performing but just how much it reflects the necessary pre-conditions required in the Australian automotive sector to meet the future requirements of new automotive sectoral model, assuming a paradigm shift in the future structure of the Australian market. The Index value around the role of the aftermarket segment of 136.4 represents a 36.4 percentage points improvement relative to the entire automotive industry in terms of its current status in the development towards a globally competitive industry. The aftermarket segment therefore, is in a stronger than average position relative to the rest of the industry, in terms of developing a capability to deliver to the Federal Government the type of vision it currently holds for the future of the Australian automotive sector.



Step Three

In the third step we sought to address the likely evolution of the Australian automotive sector over the next 20 years, with local PMV manufacturing having ceased. In this scenario we believe the role and structure of what we refer to today as the Australian automotive aftermarket segment, will be fundamentally different.

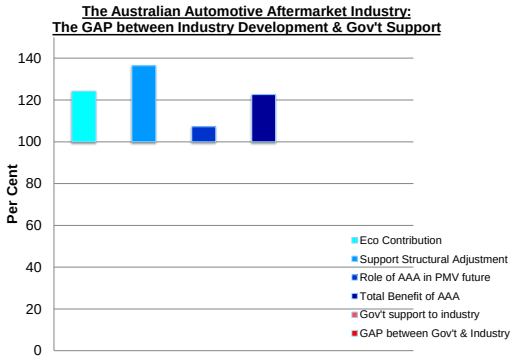
The rationale employed was to examine the market in the United States, as this is the model and structure we believe Australia is following. Current growth estimates for the automotive aftermarket segment in the US is an annualised 3.4 per cent. Given that the Australian passenger motor vehicle manufacturing market has been declining at an annualised rate of some -3.8 per cent in recent years, this implies an Index value for this step at around 107.2.



Step Four

The fourth step of the analysis is an addition of all the previous three Index values to illustrate just how much a positive force for future industry growth and capability the aftermarket segment represents going forwards.

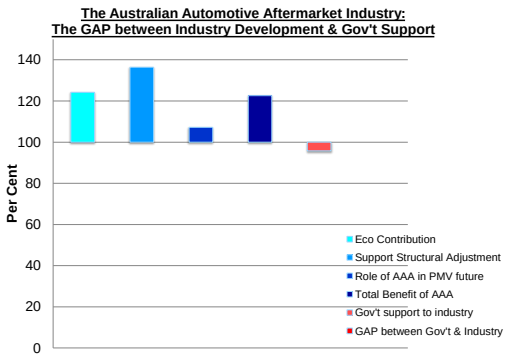
Based on the three different dimensions modelled in steps 1-3, around the current and future value of the AA manufacturing sector to the entire Australian automotive sector, an Index value of an average 122.6 was calculated.



Step Five

Step five shows a constructed index value around the relative impact of current Federal Government policy support to the Australian automotive sector and the role it plays in the future development of the aftermarket segment component. For the purposes of quantifying the impact of current arrangements that support the OE manufacturers at the (potential) expense of the aftermarket manufacturers we assessed the aftermarket survey responses. Specifically, the net weighted response by survey respondents

to the question around the impact of Government policy arrangements on the current AA manufacturing was a net negative -4.2 per cent. This implies an Index value of 95.8 index points.



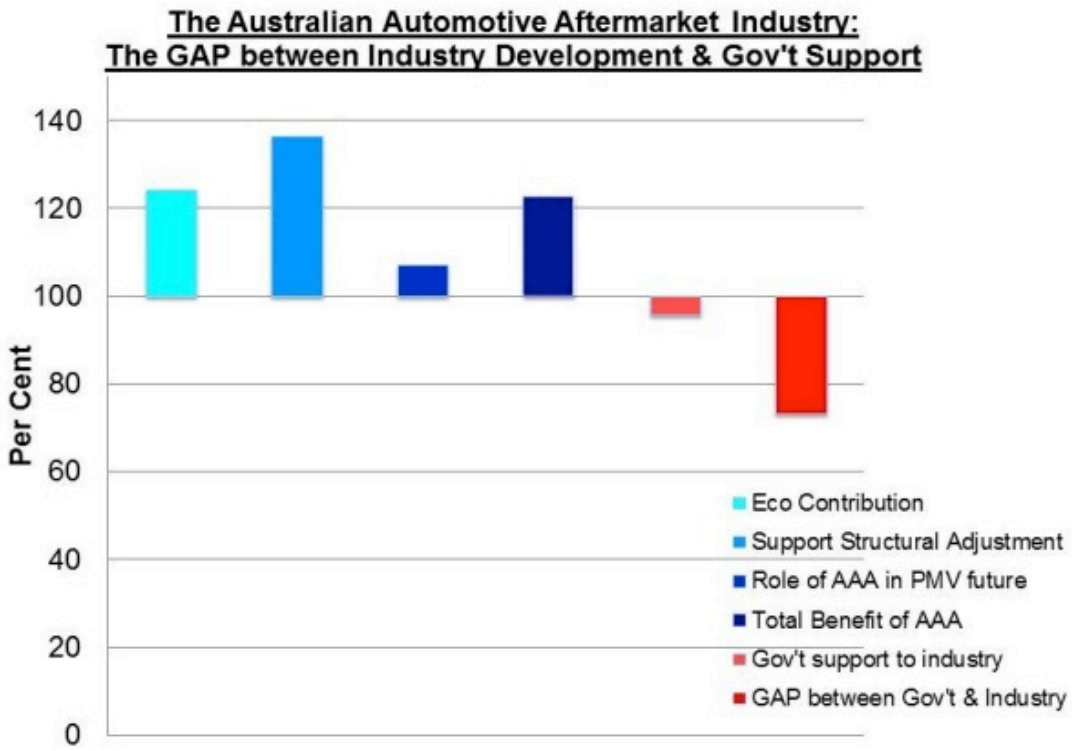
Step Six

This final step in the gap model is a simple comparison between the Indexed values contained in Step 4 and Step 5, providing an Index value of 73.8.

This demonstrates the gap between the current and future role of the AA manufacturing sector to the Australian economy, and the impact of current Government Policy settings. This implies that the degree of disconnect between the industry and its future growth potential and current Government policy settings, can be valued at around -26.2 per cent.

If we were to assume the final Index value of 73.8 was applied to the current value of the Australian automotive aftermarket, then this implies the negative impact of the Gap can be estimated at around $1.36 Billion.* Or in other words, if the current Government's automotive policy settings were more effectively structured around the future role this industry can play to the automotive sector's long-term future, then this industry could be worth some $6.56 billion today (rather than its current estimated value at around $5.2 billion).

**It should be noted, given the statistical technique employed, that the purpose of this analysis is to demonstrate the relative magnitude of the current Gap (rather than the absolute value) between the current and future performance of this industry vis-à-vis current Government automotive policy settings.*



Regulatory Barriers

The terms of reference for the Review include an examination of the barriers to improving the productivity and competitiveness of the Australian automotive manufacturing industry, including any regulatory barriers.

The previous section, *Government Policy and Role*, discusses improvements to industry policy that will deliver a structural adjustment process including improvements to productivity and competitiveness. This section raises matters of transport policy and vehicle regulations within the unique Australian regulatory framework that also affect the aftermarket segment's productivity and competitiveness.

Transport regulation and legislation is often formulated in isolation from any consideration of Australian's manufacturing industry. A good example of this point is the Federal Regulatory Impact Statement (RIS) into Vehicle Frontal Protection Systems (VFPS) in 2011. Australia is a world-class producer of VFPS (bull bars) and a strong case could be made that Australia is the world leader in the design and manufacture of bull bars and the safety components that are interrelated: winches, lighting, recovery straps and roll over protection. These Australian-made products are exported all over the world.

Bull bars are an Australian export success story commencing with design and development and resulting in investment, production growth, exports and job creation. Contrast this outstanding industry performance with a recommendation from the Department of Transport that we adopt a European-developed standard that would make it impossible to manufacture a fit-for-purpose bull bar to comply with the standard – the practical effect of which would be that that bull bars would be banned on Australian roads. It is an interesting case study – one part of Government investing significantly in the future of the automotive industry, whilst another Government department provides advice to the Federal Government that would effectively close down one of our best manufacturing and export industries.

The bull bars manufactured and supplied by AAAA members are Australian Standards compliant and are legal fitments in all Australian states and territories, and are recognised as the best frontal vehicle protection in the world. AAAA and its members in the 4WD industry are committed to national design standards and their enforcement. Following significant representation to the then Parliamentary Secretary for Road Safety the RIS was withdrawn. But the story doesn't end there.

Approximately 41% of bull bar sales in Australia are to business customers – fleets, mining, emergency service, tourism operators, construction and trades. In 2012 the BHP/BMA mining consortium, the largest in Australia, initiated a new light vehicle policy. The policy required that all BHP/BMA fleet and contractor vehicles be ANCAP five star-rated, effective 2013. This requirement effectively ensured that all vehicles fitted with aftermarket bull bars, suspension upgrades and rollover protection would be prohibited. Estimates suggest that BHP/BMA operates approximately 3,000 vehicles in Australia with its contractors operating some 45,000 vehicles. The BHP decision effectively removes 48,000 sales from the Australian aftermarket.

Australian domestic consumption underpins investment and export growth. The point that is not generally understood is that the compliant automotive components that Australia designs, produces and exports are effectively increasingly subject to regulatory threats and bans. The components that are highly sought after throughout global markets are progressively being deemed to be unsafe for Australian conditions.

Imported vehicle numbers will continue to increase. These vehicles are produced on a global platform and are not produced for Australian conditions. The global trend is for the local market to adapt global platform vehicles to suit local conditions. AAAA companies excel in these areas to the extent that local modifications in offshore markets are undertaken with Australian components, but **our regulatory environment is hostile to our own producers.**

In relation to suspension modifications, professional aftermarket installation by qualified technicians and using quality parts, enhances the performance and safety of vehicles produced for a global market, and better equips them for operation in the harsh conditions of rural Australia. This is particularly important for additional load bearing capacity and ground clearance. Similar to the installation of bull bars, at present, such suspension upgrades would disqualify a vehicle's ANCAP five star rating. To maintain a 5-star rating, the vehicle would require a physical crash test (64 km frontal offset) for each brand of bull bar or suspension modification on each and every model of vehicle, at the approximate cost of $100,000 for each test. This is clearly not commercially viable. Industry policy is to support Australia's manufacturing industry – transport policy is progressively undermining industry policy. A solution to the ongoing negative sum gain is to develop **independent safety testing of automotive aftermarket products** and aftermarket modified vehicles.

National Harmonisation

A major issue impeding the productivity and competiveness of the automotive component industry is the lack of consistency among the States on regulation governing in-service vehicles. AAAA's analysis of the regulatory environment covering automotive products identifies over 50 relevant organisations or groups across product standards, transport, environment and consumer affairs, which leads to confusion and a lack of compliance by industry and consumers. AAAA and our member companies strongly support greater consistency and harmonisation in regulation affecting the production, sale and final use of aftermarket components, workshop tools and equipment.

Product Standards

There are 24 standards committees relating to products relevant to our members and the AAAA has a seat on each of these. Standards Australia is the governing body and convenes committees to review all standards on average every four years. The AAAA co-opts relevant member companies to provide technical input as required. The majority of the standards are voluntary rather than mandatory, which is a contentious issue with some members who ask why they should go to the trouble and expense of developing and adhering to a product standard when their competitor is not required to do so.

Transport

Every state and territory has the legislative authority to regulate the sale and final use of aftermarket components. Relevant stakeholders covering transport regulation include the eight state and territory transport departments, the Federal Department of Infrastructure and Regional Development and the National Transport Commission. Australia is a world-class producer of suspension components and suspension height regulations are an issue of state jurisdiction. Our estimation is that once every 12 -24 months, an Australian state or territory seeks to regulate suspension height allowances without any regard for national harmonisation. Export activity is dependent upon a strong domestic base and producing components that are required to comply with state variations affects competitiveness and economies of scale.

Call to Action

Policy for the Future, Not the Past

The results of the modelling contained in this submission showed that if the government's policy settings were more effectively structured around the future role the aftermarket segment can play in the Automotive industry's long term future, then the value of the aftermarket segment could be substantially enhanced, positioning the aftermarket to play an even more effective role in absorbing displaced resources from the declining OE sector.

Recommendations

Competitiveness and Innovation

The survey results clearly show that the aftermarket places a high priority on capital broadening and deepening investment, as well as technology and research and development, as part of its strategy in moving into the manufacture of higher value speciality products.

1. The ATS program should be broadened to include the aftermarket sector, so that incentives for capital investment and research and development can help boost investment and technology development in this sector. This will enhance the aftermarket sector's growth and its ability to play a role in transitioning the automotive sector.

2. The Business Capability Support Program element of the Automotive New Markets Initiative should be discontinued and the funds directed to a better targeted diversification program.

3. Transport Regulation – National Harmonisation: Variations between Australian state and territory transport regulations affect aftermarket competiveness and reduce the opportunities to achieve economies of scale. Variations in regulations such as noise emissions and suspension height affect the aftermarket export effort because they deny a strong domestic base. The relationship between industry and transport policy should be strengthened to eliminate the requirement for the industry to comply with often inconsistent and conflicting requirements, with clearly deleterious effects on the efficiency, productivity and competitiveness of the industry.

4. Industry Innovation Centre: An aftermarket specific facility such as the SEMA Garage would give the Australian aftermarket access to high-tech tools and equipment needed to take products from initial concept through to product launch. The innovation centre could contain equipment specific to the aftermarket including testing facilities to meet all Australian and export specific market regulations and standards including emissions, fuel economy, acceleration, brake stopping distance, interior/exterior noise levels and handling. The facility should provide the aftermarket with a reliable and affordable way to develop and test their products, thereby helping them get their products to market quicker.

Diversification Programs

The survey results showed that in both the current market environment and in a market without vehicle manufacturing, that diversification into non-automotive industries will be an important driver of investment for the aftermarket segment.

The case studies included in this submission also highlighted the many successes on the diversification front that have been achieved so far by the aftermarket segment.

Our research supports the notion that government support which encourages even

greater diversification in the aftermarket segment will generate further opportunities for growth in this sector and further enhance its role in the future automotive industry. Three existing programs ANMP, BCSP and the Automotive Supplier Advocate, have been too narrowly focussed on the OE supply chain which has severely inhibited their effectiveness.

Accordingly, we recommend that future diversification programs are needed which incentivise those elements of the automotive supply chain that can deliver rapid and sustainable diversification opportunities, such as the aftermarket sector.

Industry Consolidation / Rationalisation Programs

The government's recent industry consolidation program, AISAP, was limited in its effectiveness because it required that the resultant entity which arose from an industry consolidation transaction was an "OE rich" ATS eligible enterprise.

Clearly, the analysis in this report shows that a program that encourages the creation of OE focussed enterprises is not incentivising the creation of a sustainable supply chain. A supply chain that is more diversified and less reliant on OE would be a more appropriate policy outcome given the structural adjustment that needs to be managed within the OE supply chain.

Accordingly, any future industry consolidation programs should allow for aftermarket participation and not require the creation of OE rich resultant entities.

Any such programs should also allow the costs of redundancies to be eligible costs for the purposes of the program, as these costs represent a significant impediment to industry restructuring.

In a similar vein, we recommend that a process be developed whereby a company can borrow to cover worker entitlements in the event of corporate re-organisation, but the company cannot pay dividends until the loan has been repaid.

Finally, a "Chapter 11" style business re-organisation approach should be considered for application in Australia to help companies trade through corporate re-organisations, without going into formal liquidation.

Export Promotion

Exports are critical to the sector both in the current market, and in the future scenario analysis of a cessation of vehicle manufacture in this country.

Programs that promote export activity, therefore, are an important element of the industry's future development and structural adjustment. We therefore recommend that:

- The EMDG program be modified by removing the upper limit of 7 claims over the life of a business;
- The funding for the Automotive Envoy be redeployed into a diversification program as discussed above;
- The Federal Government redouble its efforts to achieve access to key export target markets such as ASEAN, New Zealand and the Pacific Islands, North America, Eastern Europe and China;
- The Federal Government take urgent action to remove non-tariff barriers which inhibit access to key export markets, as spelt out in detail within this submission; and
- Funding for ACBE is increased to facilitate greater results.

Concluding Comments

It is highly doubtful that the current approach to automotive industry policy will deliver two vehicle manufacturers producing sustainable volumes to support a domestic OE supply chain. A new approach to the transition of this industry is urgently needed.

A sustainable future for the Australian automotive industry must now be built on a wider view of the automotive industry, with structural adjustment providing opportunities for capital and workforce resources from the OE

sector to be redeployed into the aftermarket segment and from there, into other industries.

The industry now urgently needs a visionary structural adjustment package, which builds a future for the sector that leverages the inherent strengths of the wider automotive sector.

A failure to mobilise the wider automotive industry, including the aftermarket segment, in this structural adjustment process, will inevitably lead to widespread loss of businesses and employment, along with the associated social dislocation and wasted economic resources, which could otherwise be redeployed in productive, profitable and sustainable endeavours.

The recommendations set out above, in the opinion of the AAAA, would form the basis of a sustainable and productive future automotive industry.

Appendix 1

List of Automotive Aftermarket Products in the Australian Market

4WD accessories, replacement parts, off road performance parts, suspension kits and recovery gear.
ABS controllers
Adhesives
Adjustment push rods
Air compressors
Air conditioning (HVAC) parts and consumables
Air flow sensors
Air intake systems
Air jacks
Air mass meters
Air snorkels
Alignment parts
Axle and differential parts
Battery chargers, accessories and booster causes.
Bearing kits
Blind spot detection
Body kits
Body repair consumables, panels and parts
Bonnet protectors
Boost controllers
Brake consumables including brake fluids and coolants
Brake fluid testers
Brakes, brake hardware and brake accessories including hydraulics,rotors, hoses, cylinders, calipers, meters, pads and shoes.
Bushes and shackles
Cables
Canopies
Car care products, including environmentally friendly products
Cargo barriers
Charge air coolers
Chemicals, coolants, fuel additives, cleaning agents and abrasive products, oils and lubricants.
Child safety harnesses
Climate controllers
Close ratio gear sets
Clutch parts and tools, including brakes, buttons, covers, diaphragms, discs, facings, forks, kits, levers, adjustment and alignment tools and grease.
Compressors
Concentric Slave Cylinders
Cooling and radiator system parts and consumables
Covers
Crown Wheel & Pinion Sets
Cruise controllers
devices, enclosures, circuit protection, tools, sprays, relays,
Diagnostic and dynamometer equipment
Diesel conditioner
Differential and gearbox components
Distributors, crank angle sensors, modules, coils, pick up
Dowel pins and pullers
Drainers and extractors
Driveline products
Driveshaft components
DTS 4WD diesel turbo kits
Electric fans
Electric water pumps
Electrical alternators, consumables and accessories
Electrical hardware
Electronic Rust Proofing Systems.
Electronics including entertainment systems, GPS, parking sensors, reverse cameras and alarms.
Engine management
Engine parts, reconditioning, cooling hoses, ECM, ECU, bearings, gaskets and management.
Exhaust filters, performance and replacement parts
Exterior accessories including window visors
Filters, gauges and other instruments
Fluid Power Flush, Brake Bleeders, Drum Trolleys, Drum
Flywheels and flywheel retaining bolts
Fuel caps, cans and funnels
Fuel injection, system valves, gauges and cooling.
Fuel pressure regulators
Fuel pumps
Gear hobbing, gear generating, shot peening
Hard Parts, Restoration Parts, Rubber Products, Steering
Hard tops
Headlight Guards
Heat Exchangers
Hose clamps
Hose reels
Hose-engine/cooling
Idle speed motors
In-vehicle safety products
Injector cleaner
Instrument clusters
Intercoolers
Interior accessories including dash mats, seat covers, sun screens.
Jacks, trolley jacks, ramps and stands
Kits and ancillary equipment

Lamps and lighting, including warning lighting, lamps, accessories and parts
Level Meters, Oil Cans, Jugs & Bottles, Auto Transmission
Load restraints
Machinery Fan Drives & Engine Drive Couplings.
Manual Oil Dispensing Nozzles, Oil Storage Tanks
Manuals and instructional DVDs
Mass air flow sensors
Mobile Oil Distribution Kits
Mobile phone hands free (Bluetooth)
Modified paints
Modules/chips, thermal heat blanketing, petrol performance
Motorsport components including gearboxes and differentials for rally, transmissions and race fuel
Mounted transfer kits
Oils and lubricants, oil coolers, pumps, seal and stabliser.
Operated grease guns, grease nipples and grease
Paint and refinish products
Panhard rods
Performance parts, accessories and other products including brakes, steering, motor sport components, turbo and blow-off valves.
Pilot bearings and bushes
Pivot balls
Pneumatic oil dispensers
Polyurethane bushes
Portable battery systems
Power inverters
Power sockets
Power-train control modules
Primers
Protection bars including bullbars (Vehicle Frontal Protection Systems) arc bars, nudge bars and winchbars
Race harnesses
Racks
Radiators and radiator parts
Ramps and stands
Recovery equipment
Remanufactured parts
Restoration parts
Ring gears
Roof racks
Rubber products
Rust treatments and sealants
Safety apparel
Seats, seat covers, seat belts and occupant restraint systems
Shackles
Shock absorbers
Side steps
Spill containment pallets
Sports bars
Springs
Starter motors and alternators
Steering dampers
Steering parts including steering wheels
Steering rack boots
Struts coil, spring leaf springs
Suspension enhancement and replacement parts, including shocks and springs
Swaybars
Switches
Telematics and vehicle tracking
Test and repair equipment and processes
Thrust Bearings
Tie-downs
Tools
Torsion bars
Towing equipment and trailer parts including safety nets, trade racks, towbars
Trailer parts
Trailer parts
Transfer case
Transmission parts, controllers and consumables including oil coolers and magnetic filters.
Trim
Trolley jacks
TTY head bolts
Turbocharger systems, including diesel and cooler/radiator systems
Tyres and tyre accessories and equipment, including inflators, gauges, repair kits and sealant.
Universal joints
Vacuum units
Vehicle lights, lamps, fuses and beams
Vehicle safety flags
Wastegates
Water pumps
Wheel accessories
Wheel parts
Wheels
Window visors
Wiper blades, arms and refills
Wiring harnesses
Wiring protection and plugs
Workshop diagnostic equipment
Workshop equipment and tools
Workshop lights and lamps

Appendix 2

Survey Findings

In total, some 103 businesses from across the entire Australian automotive aftermarket segment participated in the AAAA/GT Aftermarket Manufacturing Survey.

The key findings from the AAAA/GT Survey are broken down in the order in which the questions were asked of the survey respondents. (Note: the first two questions simply involved company and survey respondent details, collected on a confidential basis).

Q3. Where is your business primarily located?
In regard to the primary location of the surveyed businesses, the three most frequent responses, in order, were as follows: New South Wales – 33 per cent, Queensland – 29 per cent and Victoria – 28 per cent. This result shows the concentration that exists within the Australian automotive aftermarket manufacturing sector, with some 90 per cent of all respondents located in just those three states of Australia.

Q4. How many staff do you employ?
The most frequent response in relation to the number of staff employed by surveyed businesses, involved employees with a range of between six to nineteen employees, with some 41 per cent of all businesses nominating this range.

The second most frequent range involved employee numbers of between 20 and 49 employees, with 24 per cent of all businesses identifying this range. The third most frequent response involved the range of between 50 and 99 employees, with 14 per cent of all businesses nominating this employment range.

The weighted average employment size for all the businesses that participated in this survey was some 78 employees.

Q5. What is the approximate size of your business by turnover?
The most frequent response by surveyed businesses concerning the approximate size of their business by turnover involved the range of between $1M to $3M. With some 27 per cent of all surveyed businesses citing this range as the approximate size of their annual turnovers.

The second most frequent response involved the range of between $3M to $5M, identified by some 15 per cent of surveyed businesses. The next most frequent response was the range of between $5M and $10M, with 13 per cent of all businesses nominating this range to signify their business turnover performance.

The weighted average annual turnover for businesses covered by this survey was approximately $13.7 Million. Given that only 39 per cent of survey respondents identified turnovers of $10M or more, shows how the average weighted average is skewed by the largest businesses covered by this survey. Which is also reflective of the structure of the Australian automotive aftermarket manufacturing industry within Australia.

Q6. Is your business majority Australian owned?
The overwhelming majority of surveyed businesses stated that their businesses had a majority of Australian ownership of their businesses, with some 88 per cent of respondents, identifying this form of majority ownership. With the residual of 12 per cent stating that they did not have a majority of Australian ownership.

Q7. Do you supply both Original Equipment and Aftermarket products or services?
Of all businesses surveyed, some 61 per cent of respondents said that they supply to both the Original Equipment and aftermarket products markets. With the residual, some 39 per cent of all surveyed businesses stating that they did not supply both markets.

Q8. Considering you manufacture for both the OE and Aftermarket, what percentage of your manufacturing is Aftermarket only?
Amongst the business respondents which manufactured for both the OE and AA markets, the average response to the question on the how much of their manufacturing was AA specific, the average percentage was 74.0 per cent.

Now given that 61 per cent of respondents that manufacture for both markets, undertook an average level of AA manufacturing of some 74 per cent, implies that the survey respondents which manufacture for both markets, represented some 45.14 per cent of the total value of manufactured products. That percentage combined with the 39 per cent of respondents which only supplied the AA market, implies that approximately 85.1 per cent of total manufacturing undertaken by the survey respondents was AA specific manufacturing. while the residual number of 14.9 per cent, was OE manufacturing.

Q9. Over the past 12 months, what was your overall profit margin across your business (EBIT)?
The most frequent response by respondents to the question concerning their overall profit margins involved the range between 6 and 10 per cent, with some 31 per cent of all respondents answering this way. The second most frequent response was the range of between 11 and 15 per cent, identified by 16 per cent of all surveyed businesses. While, the third most response (15 per cent) involved the range of between 16 and 20 per cent.

The weighted average profit margin, as measured by EBIT, was approximately 15.4 per cent of all surveyed respondents for the past 12 months.

Q10. What are your exports as a share of total exports?
The most frequent response by surveyed to businesses concerning their level of exports as a share of total turnover was less than 5 per cent, identified by some 51 per cent of all businesses. The next most frequent response concerning exports as a share of their total turnover involved the range of between 6 and 20 per cent, cited by some 31 per cent of all respondents.

The next most frequent response was tied by two different ranges, an export to turnover range of between 21 to 35 per cent and the range of between 36 to 50 per cent (with 6 per cent of respondents nominating both ranges).

The weighted average export performance as a share of total turnover, for all businesses surveyed was 14.2 per cent.

Q11. What are your key future export markets?
In terms of the three key future export markets identified by the survey respondents, the three most frequent responses, in terms of businesses nominating their number one destination was New Zealand and the Pacific Islands (30 per cent), North America (25%) and the ASEAN region (19%).

While, the five top future exports markets identified by all respondents, irrespective of their ranking in their future export strategies was as follows: ASEAN, New Zealand and the Pacific Islands, North America, Eastern Europe and China.

Q12. What is your annual average Research & Development (R&D) expenditure?
The most frequent response to the average annual level of research and development expenditure undertaken by respondents involved the range of under $50,000. Some 31 per cent of all businesses identified this average amount spent on research and development by their firm.

The next most frequent range involved expenditure between $100,000 and $249,000. This was cited by some 25 per cent of all businesses. While, the third most frequent response was the range of $50,000 to $99,000, with some 21 per cent of all businesses citing this range.

The weighted average annual expenditure on research and development by the survey respondents was $207,000.

Q13. What is your annual spend on capital expenditure in the past 12 months?
The most frequent response to the level of capital expenditure undertaken over the previous year involved the range of less than $50,000, with 26 per cent of businesses responding this way. The next most frequent response involved the range of between $250,000 and $499,000, with a 20 per cent response rate to this range.

The next most frequent response was tied between $50,000 and $99,000 and the range of $100,000 and $249,000 (with response rates of 16 per cent for each range).

The weighted average capital expenditure of all the respondents that participated in this survey was $318,000 for the previous year.

Q14. As a result of the capital expenditure what impact was seen within your business?
In seeking to gain some insights around the type of capital expenditure purchases were undertaken by businesses within the industry, respondents were given choices as to the type of capital equipment purchases and the impact they made on their level of productivity.

The equal-highest result was recorded for capital equipment purchases which involved investment whereby similar productive output was achieved. This was evidenced by the 34 per cent of respondents who said their recent capital equipment purchases were of a capital broadening variety (i.e. involving a similar productive output as the capital it was to replace).
A further 34 per cent of respondents said that their recent capital equipment purchases, largely involved a completely new product-line. So, in this instance, it simply wasn't being used to replace existing capital equipment. The key rationale for capital equipment purchases in this instance was to produce new products, not previously produced by existing capital equipment.

Another 24 per cent of all respondents said that recent capital equipment purchases involved capital deepening, whereby noticeably higher productive output was associated with the additional capital equipment. This type of investment behaviour is entirely appropriate with an industry seeking to expand its productive capabilities to take advantage of future growth opportunities.

Q15. Does your business have a desired rate of return it seeks on new capital investment?
In regards to businesses within the industry having a desired rate of return it seeks on new capital investment, the majority of respondents said that they don't have a desired rate of return they benchmark capital investment purchases against. This was evidenced by the 63 per cent of respondents who responded this way. While, some 37 per cent of businesses stated that they did have a desired rate of return target for new investment purchases (while the pre-tax range can often be in the low 20's).

The fact that the majority of industry respondents do not apply a desired rate of return to their capital investment purchases means that the industry has a degree of flexibility to pursuing new investment opportunities as the market evolves and new opportunities present themselves.

Q16. Does your business have a desired payback period which it seeks to achieve on new capital investment?
In relation to companies having a desired payback period that it seeks to achieve on new capital investment, the responses received from the industry participants were virtually evenly divided. With a slight majority of businesses (52 per cent) stating that they had a desired payback period. While, some 48 per cent of respondents stated that they did not.

The point to note from this analysis is that, with just under half of all businesses not having a discrete payback period (while the normal range can often be between 2 and 5 years), provides for greater flexibility in investment decision-making and potentially an increased appetite to undertake business expansion plans when opportunities present themselves.

Q17. Do you believe your products are produced at a globally competitive standard?
As a potential sign of things to come from the Australian automotive aftermarket segment was the overwhelmingly positive response, received from the industry as to its current position in relation to global competitiveness. This is evidenced by the 87 per cent of respondents that said that they believe their current products are produced at a globally competitive standard. Only 13 per cent of respondents said that their products are not of a globally competitive standard.

Q18. What is the one fundamental difference you believe your business will go through over the next five years?
In regard to the question on the most significant difference the respondents' business was likely to experience over the next five years, the highest single response involved globalisation and increased export opportunities. This was cited by some 21.8 per cent of businesses that

responded to this question. The need to find new overseas global market opportunities was the key driver behind this response.

The second highest response, cited by some 20.5 per cent of respondents involved issues around developing new market, marketing and more customer-centric strategies.

The third highest response was tied between two different issues, with each being identified by some 9.0 per cent of survey respondents. One of those issues involved changes in technology and associated productivity improvements. While the other concerns, expected shifts in production to off shore markets and the associated increase of imports into Australia.

Q19. The determinants of investment and business expansion within today's Automotive Sector.

The role of this question was to ascertain the views of the industry on the relative role of different investment determinants within the current structure of the Australian automotive manufacturing sector.

Overall, the five most important drivers of current investment within the industry are as follows:

1. Making quality high products (82 per cent).
2. Future profit expectations (74 per cent).
3. Future domestic demand (69 per cent).
4. Importance of technology (68 per cent).
5. Current domestic demand (65 per cent).

While the five most significant constraints on current investment activity within the industry, in order, are as follows:

1. Labour costs (59 per cent).
2. Market/competitive pressures (46 per cent).
3. Cost of capital expenditure (46 per cent).
4. Government policy arrangements (43 per cent).
5. Import competition (41 per cent).

A detailed discussion around the attitudes of the industry involving all the key potential determinants of their current investment activities are contained below.

The first investment determinant on which views were sought, involved the impact involving access to capital. Nearly half of all respondents, some 44 per cent said that in today's environment that access to capital represented an inducement to undertake further investment in their businesses. With over half of all such businesses or around 23 per cent of all businesses stating that access to capital was in fact, currently a strong inducement for further investment. While interestingly, some 26 per cent of surveyed businesses said that access to capital had no effect on their current business plans, while a further 8 per cent said they were not sure.

The second investment determinant on which views were sought from industry participants involved future profit expectations. This factor was overwhelmingly perceived as a current inducement to current investment intentions, in fact the second most positive response of any potential investment driver. This was evidenced by the 74 per cent of respondents that stated that this is currently an inducement to further investment, with some 35 per cent of all survey respondents citing this to be a strong inducement to current investment intentions.

The next investment determinant on which views were sought involved current demand performance. With some two-thirds all respondents (66 per cent) stating that current demand is currently conducive to undertaking additional investment. Within this positive response, some 27 per cent of all respondents believed current demand to be a significant incentive.

Somewhat surprisingly, given the potential cloud that is sometimes seen to be hovering over the future of the Australian automotive sector, future domestic demand was seen by industry representatives to be a greater incentive to investment than current demand conditions. This was evidenced by the 69 per cent of surveyed businesses that stated that future domestic demand was an inducement to investment. Moreover, a relatively strong one-third all businesses believed future domestic demand, was indeed, a strong inducement to investment.

In what could potentially point to the future role the Australian automotive aftermarket segment could play into the future, was the response received around the role of future export

demand in investment and business expansion plans. An impressive 61 per cent of all businesses surveyed said that future export demand was currently perceived as an inducement to undertake additional investment in their businesses. With some 24 per cent of all businesses saying that future export demand was in fact a strong driver of current investment behaviour.

Current perceptions around the impact from import competition were the first determinant upon which respondents believed that a potential determinant currently acts as a constraint on their investment plans. A net 10 per cent of respondents believed that current import competition currently acts as an overall constraint on their current investment plans. While, overall some 41 per cent of businesses think that current import competition is a constraint on their current investment intentions.

In relation to current Government policy settings and how they impact on the industry, a net 6 per cent of all respondents believe that the overall impact is negative for further investment in their industry. This reflects the 37 per cent of respondents that stated that Government policy arrangements are an inducement to further investment against some 43 per cent of all businesses that stated that they are a constraint on current investment.

Another investment determinant that was viewed by industry respondents as an overall constraint on investment was the current cost of capital expenditure. Some 46 per cent of all surveyed businesses said that the cost of capital expenditure was a constraint on their investment plans. An overall net 17 per cent of respondents said that the current cost of capital expenditure was an investment constraint.

Capacity utilisation, often viewed as one of the more pressing signals within a business for the need to undertake additional investment expenditure, was cited by some 35 per cent of all survey respondents, as a positive force for additional investment. With only 18 per cent of businesses stating that capacity utilisation within their firms was currently viewed as a constraint on investment.

Current labour costs were cited by some 59 per cent of all survey respondents as a constraint on their current investment behaviour. While one-third of all businesses believed that current labour costs were an inducement to further investment. Interestingly, only 5 per cent of all responses received indicated that labour costs had no effect on their current investment plans.

Skilled and flexible labour, a critical ingredient in gaining the maximum traction from additional capital equipment was seen to be a net constraint on current investment plans. This was evidenced by some 43 per cent of respondents citing this to be a negative on investment. While, some 37 per cent of businesses believed skilled and flexible labour is currently conducive to investment.

On the issue of current market/competitive pressures, nearly half, or 47 per cent of all respondents said this was a constraint on investment plans. While, a not insignificant 36 per cent of responses received indicated that this was currently acting as an inducement to further investment.
Interestingly, the determinant related to joint venture opportunities received the highest response of all potential factors, in terms of having no effect on future investment plans. This reflected the 56 per cent of businesses that stated that this has no effect on current investment intentions, while a net 22 per cent of respondents believed this to be a current inducement to investment.

In terms of the role of a firm's current research and development activities, some 57 per cent of businesses believe that this is currently a positive for their current investment plans. While, only 14 per cent of businesses believe their current research and development activities are a constraint on investment.

A majority of businesses stated that technology and its importance to the growth of their business was an inducement to their current investment plans. Some 69 per cent of respondents stating that technology was currently conducive to investment while only 11 per cent of businesses cited technology as a constraint to investment.

On the issue of making high quality products, this was seen as the Number One inducement to current investment plans. Some 82 per cent of businesses stated that this was an inducement to further investment. With 53 per cent of all businesses believing this to be an inducement to further investment. When considering the long-term viability of the Australian automotive aftermarket segment, it is clear that the industry itself considers the issue

of making high quality products as being critical to its future growth. The more this industry can develop its product base of a superior quality, the greater is its long-term future.

In today's market, over half of all respondents (51 per cent) said that the absence of locally manufactured vehicles in Australia, was likely to have no effect on their investment plans. This demonstrates the focus of the industry on imported vehicles and export markets. This was seen by the industry to have so little impact on their investment plans, that a net 3 per cent of all respondents said the absence of locally manufactured vehicles would, in fact, have a net positive impact on their investment plans.

The impact from previous Original Equipment manufacturers could have in competing with the automotive aftermarket manufacturers, was not an issue of concern to the Australian aftermarket segment. This was evidenced by the majority (51 per cent) of respondents that believed that this issue would have no effect on their current investment plans. Also, there was a small positive net effect (5 per cent) on future investment plans emanating from increased competition from the Original Equipment manufacturers.

In a potentially positive sign of things to come from the Australian automotive aftermarket segment was the 39 per cent of respondents to the survey who said that non-automotive opportunities was currently a positive for their current investment plans. While, not surprisingly the single largest response to non-automotive opportunities was that it currently had no effect, identified by some 43 per cent of all respondents.

Q20. The determinants of investment and business expansion in the future, if a radically different Australian Automotive Sector were to exist.

The role of this question was to ascertain the views of the industry on the future of their investment plans and how they would react differently to various investment determinants if the future of the Australian automotive sector were to involve the following market characteristics:

- First, the local vehicle manufacturers completely depart the local manufacturing market.
- Second, this fundamentally changes the nature of the market between the Original Equipment (OE) and the aftermarket manufacturing sectors.
- Respondents were then asked how such a fundamental shift in the Australian automotive market would impact on their future business plans.

In order to understand how such a changed market dynamic would impact on the Australian automotive aftermarket manufacturers, this section focuses on the responses that represent a noticeable variation from how businesses in the sector currently make investment plans given today's industry structure.

In relation to the majority of demand and/or capacity drivers of investment activity, the responses received around the impact of demand drivers to future investment activity, was on average, lower than what was received to the responses on these drivers under the current market arrangements. For example, the number of respondents stating current demand to be an inducement in a new market structure was 40 per cent, compared to 66 per cent in today's environment. This decline (of some 26 percentage points) in current demand conditions were reflected in most key demand and/or capacity issues.

Such an outcome was influenced by a number of factors, including a perception that the state of the total market could potentially be more vulnerable than it is today, that factors other than simple demand drivers could play less of a role in driving future investment decisions, perceptions around the development of new market opportunities may mean that simple demand performance at a particular point in time may not be as strong in driving investment performance into the future etc.

It is also interesting to note that perceptions around the role of export demand as an investment driver slightly outperformed the role of domestic demand between the two different market scenarios. This is evidenced by the fact that the role of future domestic demand declined by some 29 percentage points between today's market and one where there is no local vehicle manufacturing component. Whereas, the same change between the two different scenarios on the importance of export demand declined by a slightly lower 26 percentage points. This suggests that exports will play a relatively bigger role in determining investment activity within this sector, in a future where there are no local vehicle manufacturers.

On the issue of the absence of locally manufactured vehicles, the percentage of respondents that saw this an inducement to future investment was some 16 per cent of respondents. This was a slight decline compared to today's environment of 22 per cent of businesses believing this to be conducive to investment. This marginal decline is probably indicative of the realities that may impact upon a relatively small number of businesses in which they had to operate in actual market without local vehicle manufacturing, compared to the more theoretical notion of such circumstances applying to today's automotive market.

Similarly, on the impact of competition impacting on the industry from previous Original Equipment (OE) manufacturers, there was a marginal decline in the proportion of businesses stating this to be an inducement to investment. This once again most likely reflects the realities for the industry of having to compete with businesses, which previously would have focused their endeavours on the local vehicle manufacturers for business.

While, in terms of the impact on investment intentions emanating from non-automotive opportunities, some 22 per cent of respondents said that this would represent an inducement to undertake additional investment. While, this represents a decline from today's market, it nevertheless represents an important potential driver of future investment performance.

Australian Automotive Aftermarket Association
Suite 16, Building 3, 195 Wellington Road
Clayton, Victoria 3168 AUSTRALIA
03 9545 3333 **www.aaaa.com.au**