Productivity Commission Submission

Post 2005 Assistance Arrangements for the Automotive Manufacturing Sector

Executive Summary

A*f*MA is a membership based not-for-profit organisation with almost 600 members representing fleet managers responsible for an estimated 800,000 fleet vehicles. Fleets acquire 75% of the Australian manufacturers' passenger car production, and more than 50% of all new vehicles registered each year are sold to fleets.

While the commission's focus is on local manufacturing, the Association contends the demand side, rather than the supply side is more critical to the continuing prosperity of Australian manufacturers. The model of the company vehicle was relativity stable over the period up to 1996/7. Since then there has been substantial pressure challenging the previous model of ownership of the company vehicle.

Any review without due consideration of the importance of the company-supplied vehicle as an integral part will not reflect a holistic system or many of the issues reflecting its sustainability. The vitality of domestic vehicle manufacturing is inexorably tied to domestic sales, and therefore the fleet industry.

At a cost of $30,000 per vehicle along with operating costs, the company vehicle makes a significant demand on company funds. Whilst it remains a major investment for the organisation, the fleet will never be anything other than a depreciating asset losing half of its value in the first three years.

The challenge of fleet management and a fleet manager's prime role is to ensure the organisation's transport requirements are met in the most cost effective manner possible.

It is on the demand side that the greatest impediment lies and we believe that to minimise risks and reduce costs, including tax, organisations will move to divest company vehicles and/or extend retention rates from 2/3 years to 5/6 years.

Direct assistance to manufacturing, either by tariff protection or investment assistance, is clearly a push system. Providing encouragement and impetus to demand, a pull system, we believe will deliver greater benefits to local manufacturing.

To achieve this the Association would suggest that the following be considered:

- Reducing the tax burden associated with the company vehicle;
- Limiting Fringe Benefits Tax (FBT). FBT forms a major Whole of Life cost for the operation of vehicle fleets. This cost is reflected not only in the level of tax, but also in the administrative cost of compliance.

- Change the effective life. Not from its present level to 8 years, as we believe is under consideration by the ATO, but reduce it to 3 years, the present preferred passenger vehicle retention period.
- Stimulate sales by encouraging the retirement of older vehicles. A*f*MA understands that over 55% of all registered vehicles are over 11 years old. Such action would also deliver environmental benefits to the community, a prime objective of the Federal Government and the Kyoto principles for climate control.

To do nothing we believe will result in an acceleration of change whereby companies will move to divest themselves of the fleet.

We believe this new model will be one based on financial remuneration where individuals will be left to choose their vehicles. This should not to be confused with the current push towards novated leasing; this will be a new model entirely.

The Association is not suggesting that any local manufacturer support be substituted. Our contention is that the demand side is critical for its continued development and should be an integral part of any considerations.

The pressure on the automotive industry and traditional model of supply of the company vehicles has been intense with many organisations already beginning to question the wisdom of continuing to supply a company vehicle.

The benefits of divesting the fleet are considerable and the pressure for change is undeniable; A*f*MA is in no doubt that the industry is already in transition. The only remaining question is will government actions and/or intervention influence the outcome in a positive way.

Submission on behalf of the Australasian Fleet Managers Association (A*f*MA)

By inviting submissions from a broader range of interest than manufacturers, the Commission has acknowledged that the question of the retention and expansion of a vibrant vehicle manufacturing industry goes beyond the manufacturing process. Manufacturing is only one part of the complex interactive system between Government, manufacturing, the service industry, and importantly the product end user.

A*f*MA is pleased to accept the invitation.

A*f*MA as an Organisation

A*f*MA is a membership based not-for-profit organisation with almost 600 members throughout Australia and New Zealand representing fleet managers who are responsible for an estimated 800,000 fleet vehicles.

The Association's membership covers all the three levels of government, general industry and service industries. A*f*MA has embraced the entire spectrum of the fleet industry by forging close associations with manufacturers, importers, distributors and suppliers of all types of vehicles.

A*f*MA's Role in Fleet Management

The Association's charter is to enhance the profession of fleet management and provide a forum for the sharing of knowledge and expertise within fleet management.

A*f*MA fulfils its functions by providing the following member opportunities and services:-

- Educational seminars, workshops and conferences;
- Professional qualifications: A*f*MA oversees and promotes a Graduate Certificate and Diploma of Corporate Management for Fleet Managers in conjunction with Deakin University. Certificates and diplomas are accredited and fully transferable into other postgraduate and masters programs;
- Networking opportunities and capabilities with other fleet and industry professionals;
- Access to extensive fleet information on A*f*MA On-Line, a members only website;
- Exposure to data on trends, products and innovations;
- Access to A*f*MA's Peer Network, a knowledge database of members expertise;
- Access to the Greener Motoring Program, a joint Federal Government and A*f*MA initiative for reducing fuel usage in fleets;
- Benchmarking programs where members evaluate their performance against a series of fleet industry benchmarks;
- Recognition of best practice within the fleet industry through a series of awards for Fleet Manager of the Year, Fleet Safety and Fleet Environment.

A*f*MA gives a particular emphasis to advising governments of the likely impact from proposed legislation of the potential effects on the fleet industry, and any unintended outcomes.

For example, A*f*MA presented its members' views on the effects of the GST transitional arrangements imposed at the introduction of the revised taxation system two years ago. In essence it was A*f*MA's contention that the transitional arrangements would lead to fleet owners deferring purchases for an indefinite period.

The Association's conclusions were drawn from analyses of surveys of members conducted annually since 1998 in January and February. The 2000 and 2001 surveys in particular revealed many organisations had taken firm decisions to defer purchases of passenger cars in particular, to reduce their tax burdens. There was a clear indication from the majority of survey participants that organisations were changing their purchasing policies and behaviour because of impending legislation. Events confirmed this to be correct and Government removed the transitional arrangements a year earlier than programmed.

Considerations for the Productivity Commission

While the commission's focus may well be local vehicle manufacturing and supply, the Association contends that this is only half of the issue. The demand side, rather than the supply side we would see as being more critical to the continuing prosperity of Australian manufacturers. Any review without due consideration of the importance of the company-supplied vehicle as an integral part will not reflect a holistic system or many of the issues reflecting its sustainability.

AfMA members influence on Australia's automotive manufacturing industry

The provision of the company vehicle places the Fleet Manager in a pivotal role that is vital to any continued success of manufacturing, as it is the fleet owners and managers whose annual purchases take the majority of the local manufacturers' output.

[1]Fleets acquire 75% of the Australian manufacturers' passenger car production, and more than 50% of all new vehicles registered each year are sold to fleets. The vitality of the domestic vehicle manufacturing is inexorably tied to domestic sales, and therefore the fleet industry.

Domestic versus exports

While the focus of some manufacturers is to develop exports, our observations suggest that exports might not be the saviour it is imagined. A recent news article, The Australian, Business – page 19, Thursday April 18th has Mr Geoff Polites President of Ford quoted as saying: -

[1] This was a finding of the Industries Commission in 1995. It has not changed significantly in any year since.

> "Exports are marginal business. There are 20 million units of excess capacity in the world today, and about 8 million of that is wandering around the world looking for a home.
>
> Exports, by nature, are not strong in terms of the returns they give you, he said. So if you can sell your capacity domestically then it is better business. And the cheapest way to sell capacity is to sell it domestically."

While Toyota export 60,000 we believe they import 110,000 units

Changing face of fleet management

The fleet industry is operating in one of the most challenging periods it has ever experienced. The new tax system, duty of care legislation, globalisation, technology, economics, environmental protection and risk management issues all challenge the old approaches for effective corporate governance.

At a cost of $30,000 per vehicle a fleet of 100 vehicles costs the company $3 million; add to this the operating costs and you have a significant demand on company funds.

Whilst it remains a major investment for the organisation, the fleet will never be anything other than a depreciating asset losing half of its value in the first three years. The challenge of fleet management and a fleet manager's prime role is to ensure the organisation's transport requirements are met in the most cost effective manner possible.

It is on the demand side that the greatest impediment lies. The model of the company vehicle was relatively stable over the period up to 1996/7. Since then there has been substantial pressure challenging the previous model of ownership of the company vehicle.

Residual value risk has been a major issue.

Allied to residual value risk, any move away from company cars to employee ownership and responsibility will see less new vehicle purchases and longer retention periods.

- New approaches
    - Good management practice suggests that any organisation should divest itself of the company vehicle.
    - Not all will proceed in this way; but they should consider changes in retention rates; i.e.
        - Business from 3 to 5/6 years
        - Tax exempt from 2/3 to 5/6 years (see below)
    - Many previous tax-exempt organisations have not yet modified their purchasing policies developed under the Wholesale Service Tax (WST) regime. For this group it was possible to buy and sell their vehicles and achieve a zero ownership cost, or as was the predominant case, return a profit. This was achieved because of their exemption from WST. While this

advantage has gone under GST, most businesses purchases are either GST exempt or qualify for input tax credit, yet many tax-exempt organisations have not modified their purchasing behaviour or systems.

- Risk profile with regard to residual values is still high. The organisation holding the residual risk has seen values fall by as much as $3,000 per vehicle as vehicle lease arrangements mature.
  Many organisations are beginning to see that holding a vehicle beyond what was the traditional retention period, usually 3 years, substantially reduces the residual risk as it is beyond the first three years that the depreciation curve flattens out.

- Additional strain on present model
  - The Australian Taxation Office (ATO) wants to change the effective life of the vehicle from six and two-thirds to eight years. This effectively brings tax forward and raises the cost of ownership over the early years of ownership.

  - A*f*MA's purchase intentions survey confirmed that business would change its approaches in response to government intervention such as changes to the taxation system.

    There is speculation in the United Kingdom that a trend towards employee ownership of vehicles, to replace employer ownerships is likely under the imminent "carbon dioxide-based company car tax system". A fleet industry person declared: -

    > [2]"The multi marque leasing company, Alphabet, forecasts that by 2007 up to a quarter of Britain's Company cars could become owner drivers as their employees adopt structured employee car ownership plans that see drivers own their own cars, thereby avoiding taxation."

The changing Fleet Manager

The role of the fleet manager is changing, with the function becoming more important to the organisation. Traditionally that person has looked after the fleet in terms of managing acquisition, administration and disposal within a broad policy.

The Fleet Manager is now more of a business specialist dealing with a complex series of tasks requiring a diverse range of skills such as system analysis, change management, policy development, risk analysis and risk minimisation and contract management; and makes a direct contribution to the development of the organisation's business.

This new role is far less about 'fleet management' than 'personal business mobility'. In many cases, some of the routine parts of the traditional fleet management role may be assumed by a leasing company, fleet management company, dealership or even a manufacturer's service company, allowing the corporate fleet manager to have a much

[2] See Appendix B – "Car suppliers urge customers to keep their cool".

more innovative and strategic role in terms of maximising the effectiveness of personal business mobility; and minimising the cost and risk profile associated normally with the fleet.

The message is clear. Over the last 4 years the system for the supply of the company vehicle is under strain. The time has come for positive intervention, one that stimulates rather than dampens demand.

Best practice would suggest that the system should already be under transition. The implications of continuing with the present structure are becoming obvious. Organisations are beginning to see that divesting the fleet (not to be confused with outsourcing) presents a more acceptable risk profile.

Direct assistance to manufacturing, either by tariff protection or investment assistance, is clearly a push system. Providing encouragement and impetus to demand, a pull system, we believe will deliver greater benefits to local manufacturing.

To achieve this the Association would suggest that the following be considered:

- Reducing the tax burden associated with the company vehicle;
- Limiting Fringe Benefits Tax (FBT). FBT forms a major Whole of Life cost for the operation of vehicle fleets. This cost is reflected not only in the level of tax, but also in the administrative cost of compliance.

  In promoting effective and responsible fleet management, A*f*MA encourages business strategies that optimise vehicle usage and minimise environmental impact and whole of life costs.

- Legislative conflicts. There are instances where the declared aim of government is in conflict with taxation legislation. One such area is FBT.

  A*f*MA in conjunction with the Federal Government is implementing a fuel reduction program for the fleet industry. However, organisations that implement fuel reduction through reduced distance travelled each year will be disadvantaged should their efforts bring them into a lower kilometre travelled per year category.

  At present the FBT system levies a penalty for vehicles being available for private use. This penalty varies in line with the yearly distance travelled where between: -

  - 0 to 14,999 kilometres incurs a penalty of 26% of the vehicle cost
  - 15,000 to 24,999 kilometres requires a payment equal to 20%
  - 25,000 to 39,999 kilometres requires a payment equal to 11%
  - Greater than 40,000 kilometres requires a payment equal to 7%

  The cost impost of moving into a higher FBT bracket is considerable. Moving below 25,000 kilometres a year changes the FBT impost by $2,700 per year for a vehicle with a purchase cost of $30,000 (9%, the difference between 20% and 11%).

- Change the effective life. Not from its present level to 8 years, as we believe is under consideration by the ATO, but reduce it to 3 years, the present preferred passenger vehicle retention period.

- Stimulate sales by encouraging the retirement of older vehicles. A*f*MA understands that over 55% of all registered vehicles are over 11 years old. Such action would also deliver environmental benefits to the community, a prime objective of the Federal Government and the Kyoto principles for climate control.

Supplementary issues

There are a number of issues outside the control of organisations that affect the fleet vehicle, these are: -

- Strength of Australian dollar. A stronger dollar renders imports cheaper where a weaker dollar increases the cost of imported components for installation into local models. While a weaker dollar facilitates exports, it does not increase the level of local demand.

- Interest rates. An increase in rates will tend to dampen consumer sentiment. There are some indicators of a recent decline.

- [3] Falling consumer confidence. Reports are already with us reporting a recent fall in consumer confidence. Any such sentiment affects business confidence which in turn reflects on business spending and acquisitions such as fleet vehicles.

The implications of doing nothing

To do nothing we believe will result in a change whereby companies will move to divest themselves of the fleet.

We believe the new approach will be one based on financial remuneration where individuals will be left to choose their vehicles. This will be a different model not to be confused with the current push towards novated leasing.

The purchasing patterns employed under these circumstances are likely to be that:

- Late model used vehicles will be purchased in place of new;
- Imported rather than local vehicles will be purchased, continuing an existing trend;
- Vehicles will be retained by the individual for longer than the current preferred three-year period.

Where the company fleet is retained there will also be changes:

- There will be a greater use of nearly new vehicles in preference to new;
- Retention rates will extend to five or six years

[3] See Appendix D – "Consumer Confidence nose-dives" The Age 18 April 2002

Conclusion

We often hear the manufacturing industry comment on its need to restructure its approach from one of selling the product it produces to producing the products it has sold.

A*f*MA would support this view as the favoured approach, and provide its view for consideration.

The Association is not suggesting that any assistance that may already be under consideration to support the local manufacturers be substituted. Our contention is that the demand side to the industry is critical for its continued development and should be an integral part of any considerations.

The pressure on the automotive industry and company vehicle tradition has been intense with many organisations already beginning to question the wisdom of continuing to supply a company vehicle.

The benefits of divesting the fleet are considerable and the logic for change is undeniable. This leaves A*f*MA in no doubt that the industry is already in transition. The only remaining question is how will government actions and/or intervention influence the outcome and will it be positive or negative for local manufacturing and the company vehicle.