



Australian Automotive Aftermarket Association Ltd

“Beyond the Fluffy Dice”

**Recognising Aftermarket Manufacture
as the Third Sector of
Australia’s Automotive Manufacturing Industry**

**Submission to the Productivity Commission’s Inquiry into the
Automotive Manufacturing Industry**

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1. Introduction & Executive Summary

1.1 This submission is lodged on behalf of ...

This Submission to the Productivity Commission's Inquiry into Post 2005 Assistance Arrangements for the Automotive Manufacturing Sector is lodged on behalf of the 650 members of the Australian Automotive Aftermarket Association (AAAA).

AAAA represents the manufacturers, re-manufacturers, importers, distributors, wholesalers and retailers of automotive parts, accessories, tools and equipment in Australia. This includes replacement parts and accessories for Passenger Motor Vehicles (PMVs), Light Commercial Vehicles (LCVs) Four Wheel Drive vehicles (4WDs) Sports Utility Vehicles (SUVs) and tools and equipment for the workshop and garage repair sectors.

AAAA believes that, when aftermarket manufacturing employment is combined with employment in the retail/wholesale/distributor sectors, total employment in the aftermarket is 35,000.

1.2 The aftermarket involves ...

An understanding of the scope of Australia's aftermarket can be gained from the following definition provided by a member:

"The automotive aftermarket involves the supply of parts for motor vehicles fitted after the vehicle is sold as new. The aftermarket includes both genuine, ie manufactured by carmakers or their Original Equipment (OE) suppliers, and non-genuine parts. Despite the brand name distinction, many non-genuine parts are also manufactured by the original equipment manufacturers and are often virtually identical to equivalent genuine parts. However, non-genuine parts enjoy wider distribution than genuine parts as the latter are usually distributed through car dealers associated with the particular market".

Aftermarket manufacture thus has two elements – genuine and non-genuine. The term "non-genuine" is not used in a pejorative sense. The manufacturers of non-genuine product are subject to the same quality, price, delivery and technology expectations as manufacturers of genuine product.

Genuine and non-genuine manufacturers are distinguished from a third category of suppliers to the aftermarket – counterfeiters. These manufacturers produce copies of genuine and non-genuine product that:

- Are of lesser quality;
- Do not perform to the same standard as genuine and non-genuine products; and
- Often have similar names as the genuine or non-genuine original or may even be falsely labeled as if they were the genuine or non-genuine original



1.3 The preparation of this Submission has involved ...

This Submission reflects the views of AAAA's members gathered by Interview and Survey. Interviews were conducted with senior executives in the sector and information gained from responses to a Survey of aftermarket participants.

This approach was adopted to ensure that this Submission provides a "whole of aftermarket" response to those questions posed in Attachment B to the Commission's Circular of 21 March 2002 that are relevant to the aftermarket. Based on the results of these interviews and the survey, together with our research, we advise the Commission as follows.

1.4 The aftermarket does not fully participate in current assistance arrangements

The eligibility criteria for the centerpiece of the current assistance arrangements – the Automotive Competitiveness Investment Scheme or ACIS – operate to exclude a minimum of 55% of aftermarket manufacturers from the "rewards (for) production, investment and research and development" provided by ACIS.

Other aspects of the Federal Government's Automotive Action Agenda:

- Tariff reform; and
- Opening export markets under the direction of the Automotive Trade Council and funded by the Automotive Market Access and Development Fund of \$20 million and involving:
 - the Prime Minister's Special Automotive Envoy;
 - the Automotive Market Facilitator and the Department of Foreign Affairs and Trade market access activities; and
 - Austrade's delivery of a four year Automotive Market Development Program;

have been of little benefit to the aftermarket.

This situation is best demonstrated by the overview of ACIS as shown in Figure 1 in paragraph 3.2.2, which shows the boundaries of ACIS. The true picture of the automotive manufacturing sector is shown in the figure on the following page.

1.5 The restructuring of the industry has affected the aftermarket

"Proposed tariff reductions, combined with adjustment assistance, have seen major restructuring of the Australian automotive industry. The need to sustain the pace of improvements in productivity, quality and innovation remains as Australia approaches the APEC deadline of 2010 free trade. It is vital that the industry ... secure its all-important domestic base and to establish a substantial position in global markets¹."

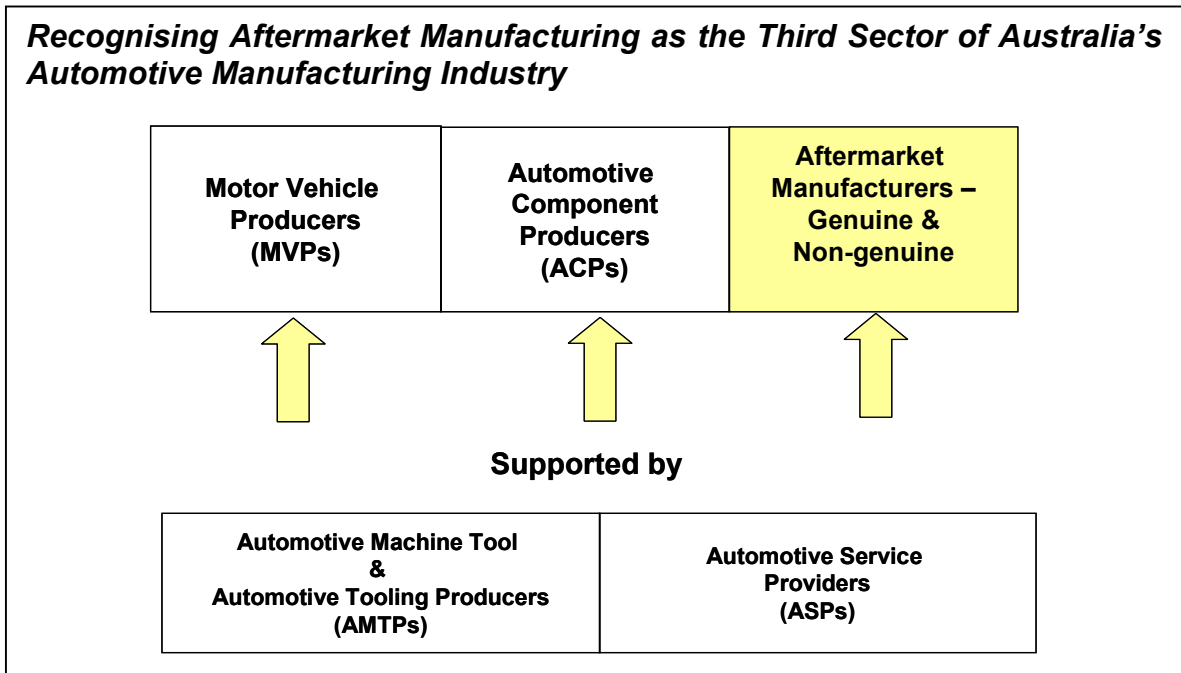
The restructuring has led to changes in the composition of the Australian vehicle fleet and the age of the fleet, changes that are still continuing. The increased proportion of imported vehicles in the fleet and the potential for the age of the fleet to reduce expenses

¹ Automotive Action Agenda, Department of Industry Tourism and Resources website.



Australia's aftermarket manufacturers to international competition in the same way as Motor Vehicle Producers (MVPs) and Automotive Component Producers (ACPs) have been exposed to that competition.

AAAA contends that aftermarket manufacturing is only now feeling the full impact of international competition as a result of the restructuring of the industry. For this reason alone, the aftermarket should be a full participant in any Post 2005 Assistance Arrangements for the industry.



1.6 A seat at the table

The primary function of the Automotive Trade Council is to develop strategies that open up export markets for Australian made automotive product.

This Submission examines the aftermarket's export performance, a performance that has been achieved without access to the support presently available to OE manufacturers.

Aftermarket manufacturers were eligible to participate in the Export Facilitation Scheme (EFS) established under previous assistance arrangements. Since the cessation of EFS and the introduction of ACIS, aftermarket manufacturers' "export propensity" has reduced. For example:

- AAAA has, for many years, facilitated exhibits by Australian aftermarket manufacturers at the Specialty Equipment Market Association annual exhibition in the USA, an exhibition that has generated many export orders for the manufacturers. Since the cessation of EFS, participation on the AAAA stand has fallen from 20 exhibitors to 8; and
- Previously, Austrade has assisted aftermarket manufacturers by assisting with the cost of exhibition space at international trade shows. Since the cessation of that funding, AAAA has been forced to reduce the size of the Australian exhibition at Automechanika Frankfurt, an important industry trade show, by 60%.



AAAA believes that the export performance of the automotive manufacturing industry as a whole can be enhanced if aftermarket manufacturers are represented at the Council. AAAA believes that a full appreciation of the aftermarket manufacturers' attributes (as enumerated in 1.7 and 1.8 below) by the Council will enable it to develop a broader range of strategies for entering export markets.

We therefore submit that aftermarket manufacturers be represented on the Automotive Trade Council and that representation commence immediately.

1.7 The aftermarket should participate in available assistance

To the extent that current assistance arrangements are extended in the same or a modified form, the aftermarket should be eligible for that assistance because it:

- Is highly innovative;
- Creates employment – over the period from 1997 to 2002 employment in aftermarket manufacturing grew by 3.5%;
- Reduced its investment in plant and equipment and R&D as a result of its exclusion from ACIS;
- Can be nimble and agile in pursuing innovation and new markets because it is independent;
- Underpins the profitability of automotive component manufacturing in Australia;
- Supports the viability of the automotive manufacturing sector by:
 - enhancing the appeal of locally made vehicles in both their domestic and export markets;
 - controlling the cost of manufacturing of the four domestic MVPs by providing both genuine and non-genuine product at prices that are not subject to exchange rate fluctuations;
 - providing volume to ACPs, thereby encouraging investment in plant and equipment and R&D;
 - supporting MVPs special vehicles divisions with product that enhances the performance and appearance of their vehicles;
 - providing non-genuine replacement parts to MVPs to satisfy the MVPs extended warranty programs; and
 - testing components on behalf of MVPs after vehicles have been launched;
- Is not as constrained by Just in Time delivery requirements as OE suppliers and can therefore take manufacturing outside of the core automotive States of Victoria and South Australia and to regional Australia;
- Provides competition to imported genuine and non-genuine aftermarket product, thereby assisting to control the cost of motoring

The eligibility criteria for Post 2005 Assistance Arrangements should be flexible enough to reflect the nature of aftermarket product. There should not be a nexus between the production of vehicles and engines and the ability to participate in the Arrangements; the sales value and units criteria should reflect the Small & Medium Size Enterprise – SME – nature of the majority of aftermarket manufacturers.



1.8 There should be aftermarket specific assistance arrangements now and after 2005

As a demonstration of the Federal Government's commitment "to a viable automotive manufacturing sector", we submit that:

- the Post 2005 Assistance Arrangements for the industry should include elements that are "aftermarket specific"; and
- because there is a hiatus of over two years before the Post 2005 Arrangements become effective, the suggested arrangements should be introduced forthwith.

These arrangements should recognise that:

- The aftermarket is the Third Sector of Australia's automotive manufacturing industry; and
- The majority of Australia's aftermarket manufacturers are SMEs.

These arrangements should:

- Support the R&D activities that underpin the aftermarket's high level of innovation;
- Support the growth of the sector through a "best practice" diffusion program that emphasises training, quality and effective use of IT;
- Support the growth of the sector by assisting to make the industry "export ready" and in taking their product to market.

Finally, the aftermarket is less constrained in its activities than most of the industry's ACPs. Australia should take advantage of the opportunities presented by this freedom by providing the support we recommend.



Table 1: Responding to the Commission's questions – the following questions were seen as relevant to the Aftermarket.

How have previous and current assistance arrangements influenced the structure, competitiveness, investment decisions and performance of the automotive manufacturing industries? How have these arrangements affected related industries (eg motor vehicle retailers and service providers) commercial users and consumers?

How effective is ACIS in meeting its objectives? Has it had any unintended or undesirable impacts? What are the impacts on each of the four classes of program participants? Is there a case for extending a similar scheme beyond 2005? If so would modifications to the current scheme be required? Would there be a case for a different industry specific arrangement under a very low or zero tariff environments?

What are the key linkages between the various sectors of automotive manufacturing and with the rest of the economy?

Given that the "Button Plan" envisaged three domestic vehicle producers, is the current situation of four producers (and the range of models) sustainable?

Are firms encountering significant trade barriers (tariff and non-tariff) or other difficulties in further developing export markets?

How do profits and returns on investment made by the industry from supplying the domestic market with locally manufactured products differ from those made on exports and OE supply?

Is sufficient industry R&D undertaken in Australia? How much relevant new technology is essentially 'home grown' rather than imported from overseas? How much technology is exported?

What are the emerging opportunities for the Australian automotive industry? Will these mainly arise in export markets or will the domestic market also provide new opportunities?

Are there particular niche markets for the Australian industry? Do Australian manufacturers have strengths in certain areas, such as design and production of particular components ... ?

What impacts have other generally available government assistance programs, such as TRADEX, R&D grants and the Strategic Investment Incentive program and State government grants had on the industry? Do program requirements facilitate access by the automotive industry?



2. An overview of the Aftermarket

2.1 An industry that covers a broad range of products

AAAA defines the automotive aftermarket industry as:

“that part of the automotive industry concerned with the manufacturing, re-manufacturing, distributing, wholesaling and retailing of all vehicle parts, tools, equipment and accessories except those products which are supplied for use in the manufacturing of original equipment”.

As can be seen from the definition and the range of products handled by the aftermarket enumerated in Table 2, the industry is broad.

An alternative definition used by a AAAA member is:

“The automotive aftermarket involves the supply of parts for motor vehicles fitted after the vehicle is sold as new. The aftermarket includes both genuine, ie manufactured and marketed by carmakers, and non-genuine parts. Despite the brand name distinction, many non-genuine parts are also manufactured by the original equipment manufacturers and are often virtually identical to equivalent genuine parts. However, non-genuine parts enjoy wider distribution than genuine parts as the latter are usually distributed through car dealers associated with the particular market”.

Aftermarket manufacture thus has two elements – genuine and non-genuine. The term “non-genuine” is not used in a pejorative sense. The manufacturers of non-genuine product are subject to the same quality, price, delivery and technology expectations as manufacturers of genuine product.

Genuine and non-genuine manufacturers are distinguished from a third category of suppliers to the aftermarket – counterfeiters. These manufacturers produce copies of genuine and non-genuine product that:

- Are of lesser quality;
- Do not perform to the same standard as genuine and non-genuine products; and
- Often have similar names as the genuine or non-genuine original or may even be falsely labeled as if they were the genuine or non-genuine original

A further distinction between the participants in the aftermarket can be drawn using its distribution networks. Genuine product is usually distributed through the MVPs dealer network, which is referred to as the “OE aftermarket”. Non-genuine product is distributed through the “Independent Aftermarket”, which comprises wholesalers, distributors, independent and company owned service stations and repairers, franchised repairers and fast fit organisations, parts and accessory shops and mass retailers. An over view of the aftermarket and its participants can be found in Figure 2 in Part 4.1.



AAAA requests that the Commission take particular note of these definitions.

The Association contends that, in the Australian context, automotive manufacturing goes beyond the activities of the Motor Vehicle Producers (MVPs) and Automotive Component Producers (ACPs) and includes the many manufacturers of the products listed in Table 2. This Submission will demonstrate the importance of taking this holistic view of automotive manufacturing in Australia to the future international competitiveness and global integration of Australia's automotive manufacturing sector.



Table 2: The aftermarket's product range

Accessories	<p>Car care polishes, washing detergents, cleaning agents, chamois, cleaning cloths, deodorizers</p> <p>Protection accessories seat covers, car covers, mats, mud flaps, head lamp covers, louvers, sun screens</p> <p>Car security alarms, locks, immobilizing devices</p>
Safety, comfort, appearance, entertainment & information	<p>air conditioning, sun roofs, body kits and items, steering wheels, road wheels, seats, baby/child devices, safety belts, load restraints, sound systems, navigation systems, telematics</p>
Functional performance	<p>tow bars, bull bars, off road/long distance equipment, auxiliary lighting, roof racks, carriers, jumper leads</p>
Body components	<p>Panels, bumper bars, glass, seals and rubber products</p>
Tools & equipment	<p>Jacks, ramps, stands, tool kits, hand tools, manuals, test equipment, workshop equipment</p>
Mechanical	<p>Internal engine parts</p> <p>Performance parts</p> <p>Electrical systems parts – ignition, lamps, batteries</p> <p>Fuel system parts (other than electrical & filters)</p> <p>Filtration products – fuel, oil & air</p> <p>Cooling systems parts – fan belts, hoses, clamps, caps, radiators</p> <p>Under car parts – suspension, shock absorbers, steering, brakes, exhausts, transmissions, drive lines.</p>
Lubricants, additives, chemicals	<p>Oils, grease, penetrants, additives, coolants, hydraulic fluids, chemicals other than car care.</p>

2.2 A profile of the industry participants

2.2.1 Activity, size and location

Chart 1² profiles AAAA's membership by activity. While this Submission focuses on AAAA's manufacturing members, as will be seen from the examination of interdependencies in Part 4, the activities of the Distributor/Wholesaler and Retailer sectors are equally important in understanding the importance of the aftermarket to the future of Australia's automotive manufacturing industry.

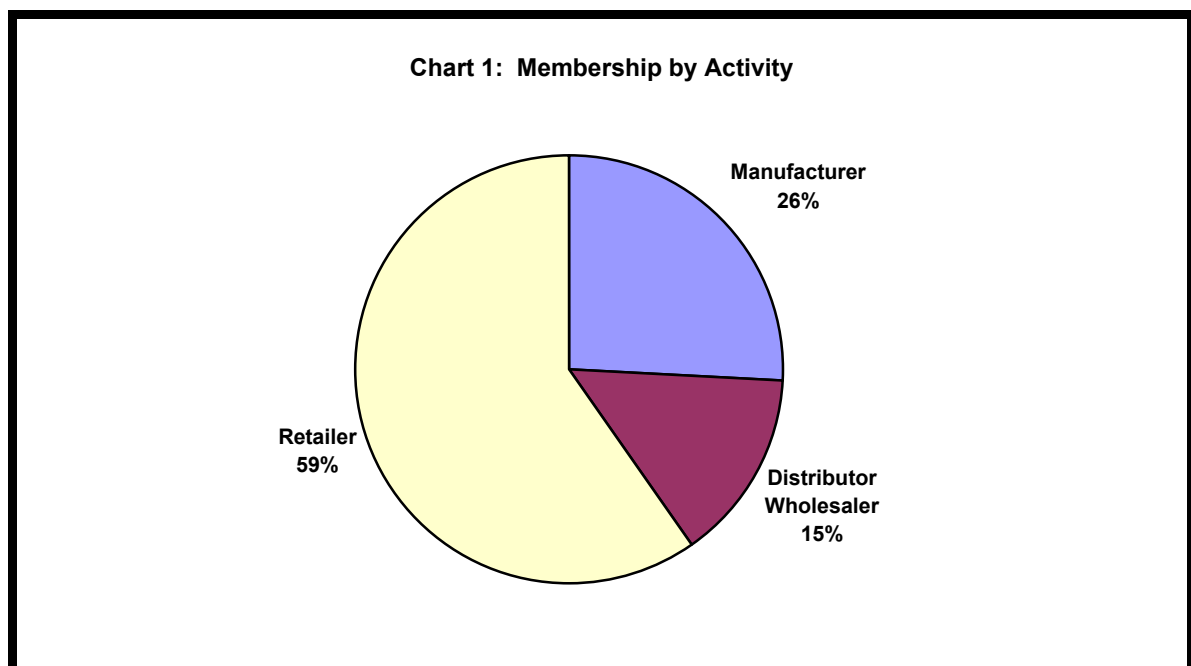


Chart 2³ analyses aftermarket manufacturing activity. Manufacturing members of AAAA fall into two distinct categories - those that manufacture for the aftermarket and OE and those that manufacture for the aftermarket only. Forty-five percent of AAAA's manufacturing members fall into the former category, with the remaining 55% falling into the latter. Using the alternative definition of the aftermarket given in 1.1, the "Aftermarket Only" and Performance manufacturers could be described as manufacturers of non-genuine parts.

Aftermarket and OE manufacturers supply MVPs with components used in the assembly or manufacture of vehicles that either:

- Last the life of the vehicle or are replaced irregularly during the life of the vehicle, usually as a result of a crash or a major mechanical failure – eg, seats, instrument panels, engines and transmission; or
- Are replaced regularly throughout the life of the vehicle as a result of normal wear and tear – eg filters, tyres, wiper blades, spark plugs, bulbs, batteries and brake pads.

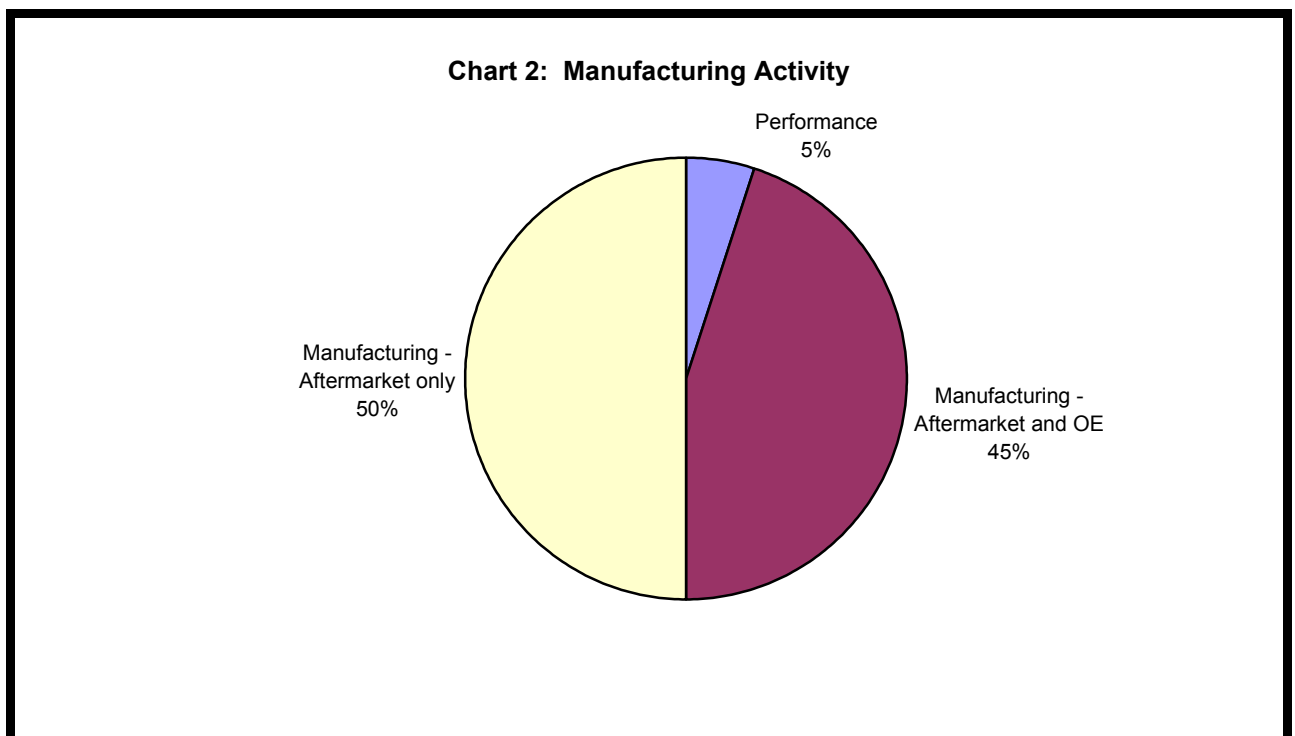
² AAAA membership records

³ Based on survey of AAAA membership carried out as part of preparing this Submission.



The manufacture of the latter type of component – replacement parts – is an important and significant element of aftermarket manufacture.

The second category manufactures all of the products used to maintain or enhance the appearance of vehicles. These products are set out in Table 2 – accessories, safety, comfort, appearance, entertainment and information, functional performance, body components, tools and equipment, mechanical, lubricants and additives and chemicals. These manufacturers also produce “non-genuine” replacement parts. Generally the end users of the majority of these products are the second and subsequent owners of vehicles.



Charts 3, 4 and 5⁴ analyse the Manufacturer membership category. Chart 3 provides an indication of the size of enterprise in this category based on employment numbers. Charts 4 and 5 look at the location of the enterprise.

These charts demonstrate:

- The majority of participants are SME's – Small or Medium Enterprises – generally acknowledged as significant drivers of employment in the Australian economy;
- Aftermarket manufacturers spread automotive manufacturing beyond the “core” automotive manufacturing States of Victoria and South Australia; and
- Aftermarket manufacturers assist in taking manufacturing activity to regional Australia.

⁴ Based on AAAA membership records



Chart 3: Size of Manufacturer based on Employment Numbers

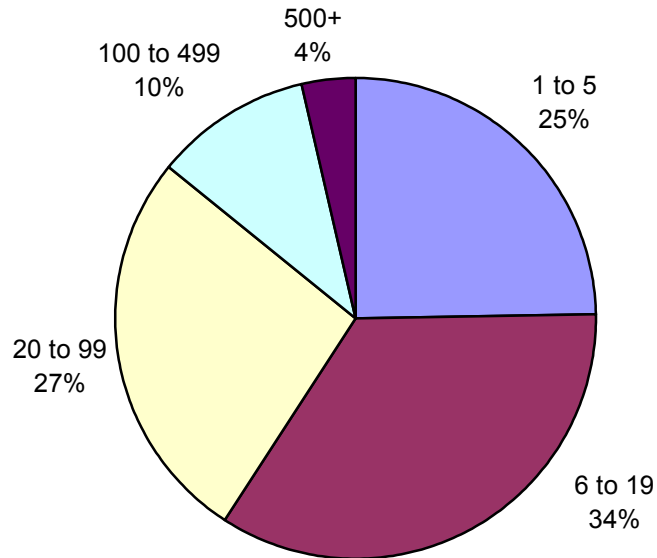


Chart 4: Location of Aftermarket Manufacturers

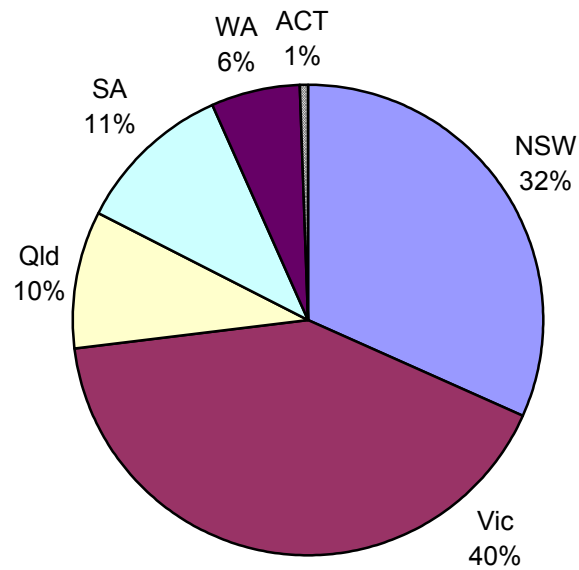
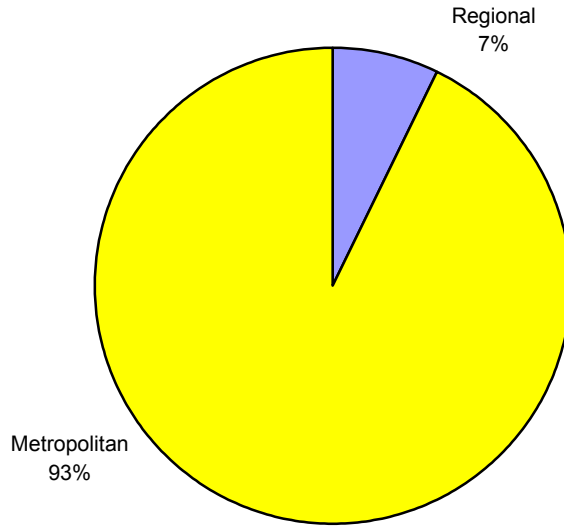




Chart 5: Manufacturer by Location

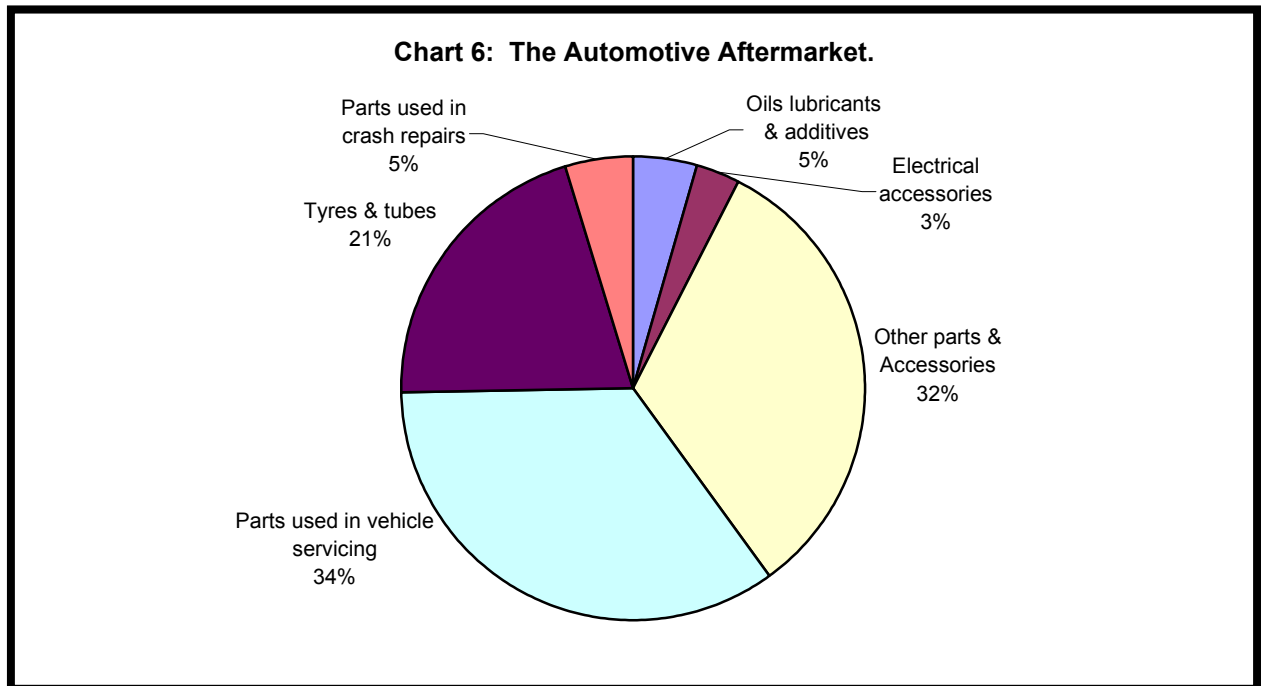




2.3 The size of the aftermarket

2.3.1 The size of the Australian market

At a retail level, the Australian automotive aftermarket is valued at \$6.3 billion⁵. This market is analysed in Chart 6.



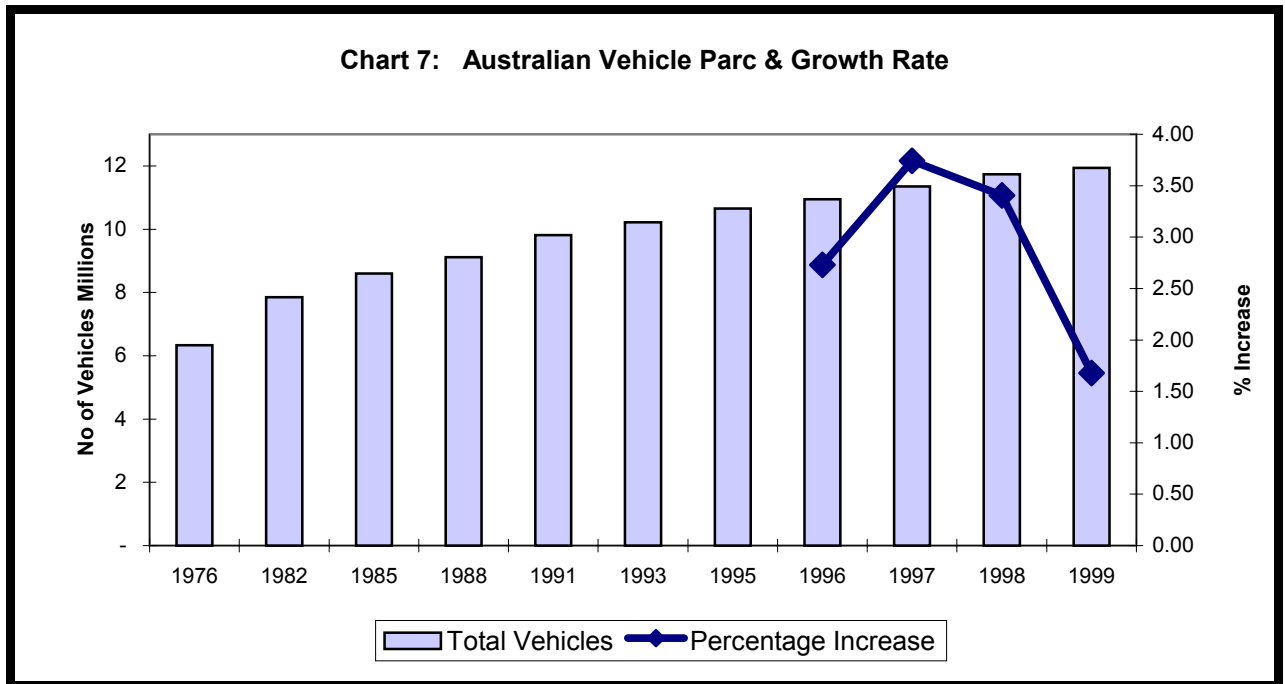
At a minimum, approximately 74% of this market comprises manufactures – electrical accessories, other parts and accessories and parts used in vehicle servicing and crash repairs. This values the aftermarket for manufactured components at \$4.66 billion at a retail level.

2.3.2 Drivers of market size

The primary indicator of aftermarket demand is growth in the number of vehicles in use. As can be seen from Chart 7⁶, the rate of growth in the car parc has slowed in recent years.

⁵ "AutoStats 2001 – a report by the Australian Automotive Aftermarket Association Ltd" – published 2001

⁶ Australian Automotive Intelligence Yearbook, November 2001, pages 23 and 25



Other drivers of demand include:

- The age of the vehicle fleet – refer to Charts 8 and 8(a)⁷;
- Vehicle usage as measured by the number of kilometres traveled – refer to Chart 9⁸
- Changes in the type of vehicles driven – eg, the increased number of 4WDs in the Australian market has driven demand for specialty equipment to suit those vehicles;
- Government regulation – including scrappage incentives and safety or emission testing programs;
- The increasing use of higher value added electronic systems and components; and
- Per capita income, which dictates the propensity for more frequent maintenance and aftermarket modification.

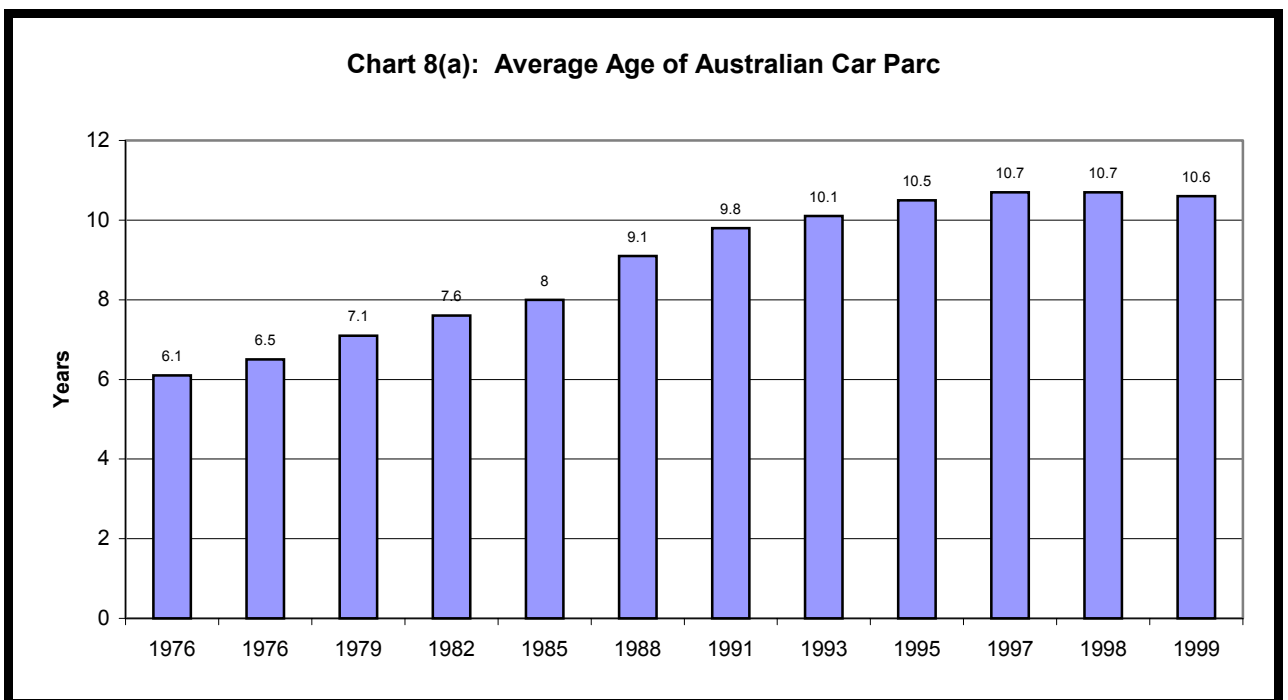
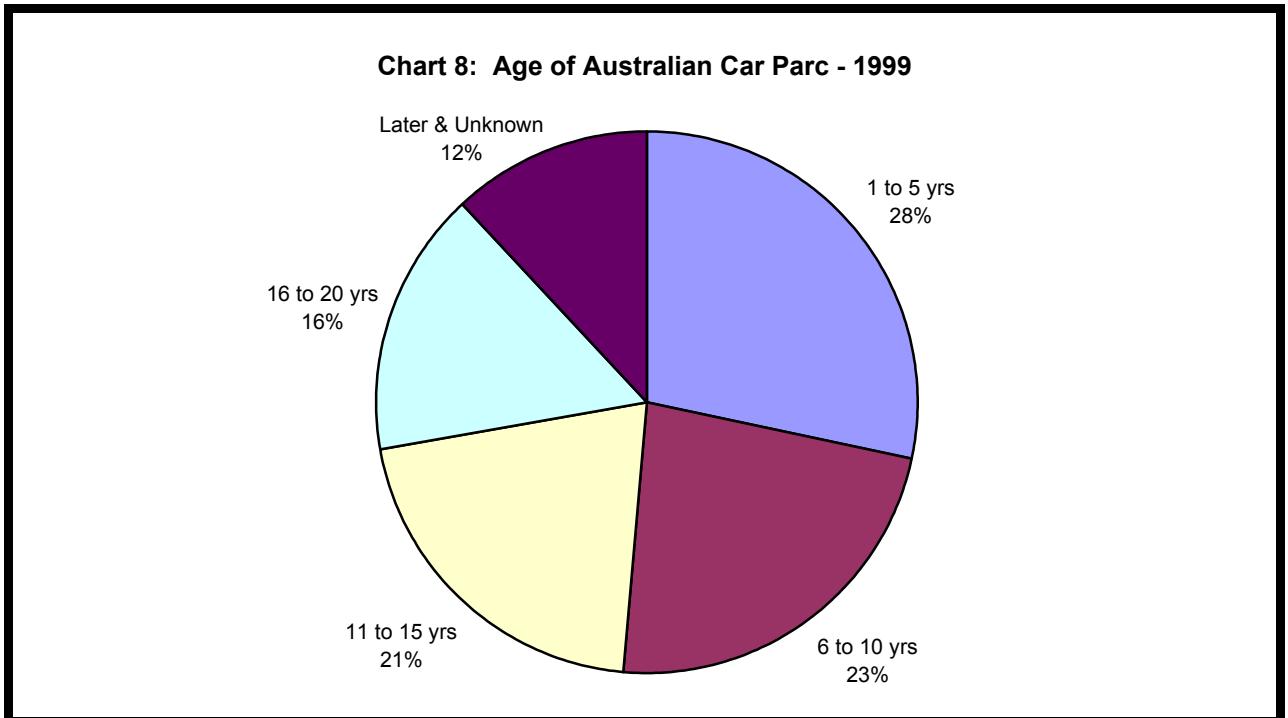
These factors are considered in Part 5 of this Submission, which examines the strengths, weaknesses and opportunities of the industry.

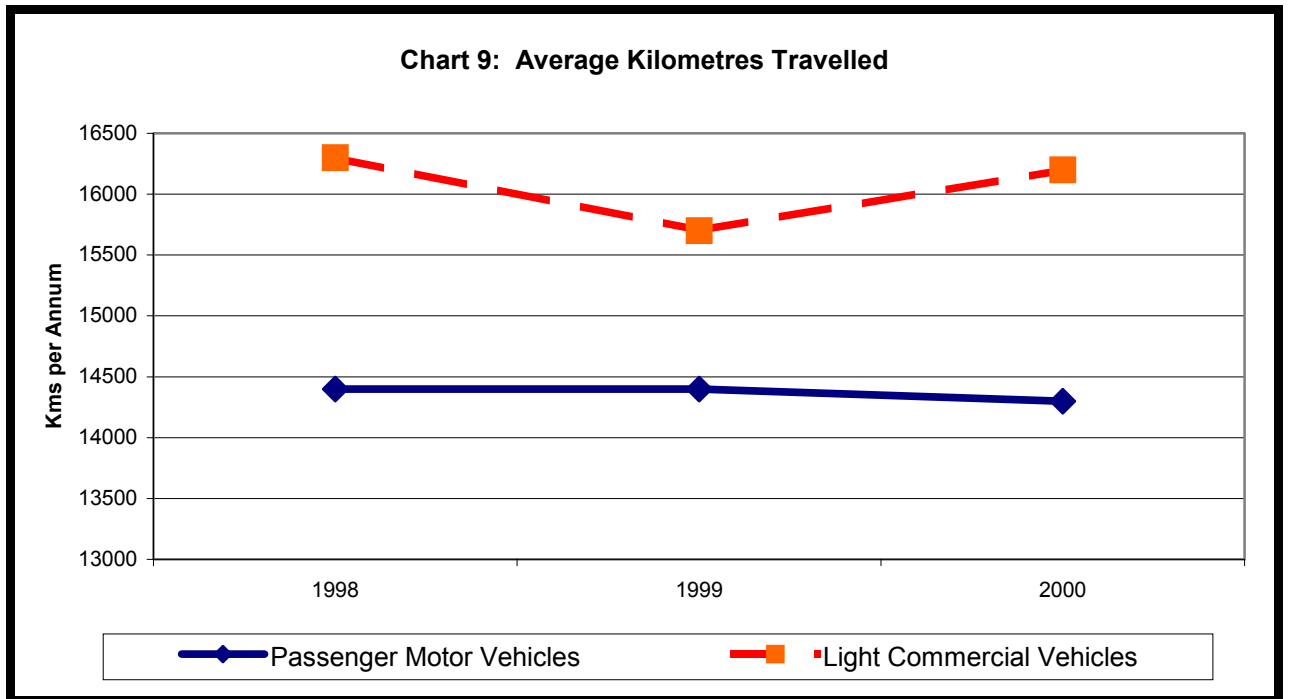
⁷ "AutoStats 2001 – a report by the Australian Automotive Aftermarket Association Ltd" – published 2001.

⁸ *ibid*



Constraints on growth revolve around the rising durability of original equipment components. MVPs specifications often require a part life of up to 160,000 kilometres. This durability leads to infrequent replacement of parts. This requirement has led to an average annual growth rate in sales of automotive parts in the US of 2% to 3%. US industry commentators expect this rate of growth to continue for the foreseeable future. Based on data gathered in our survey, growth in the Australian aftermarket has averaged a little over 4.5% per annum over the five years to 2002.





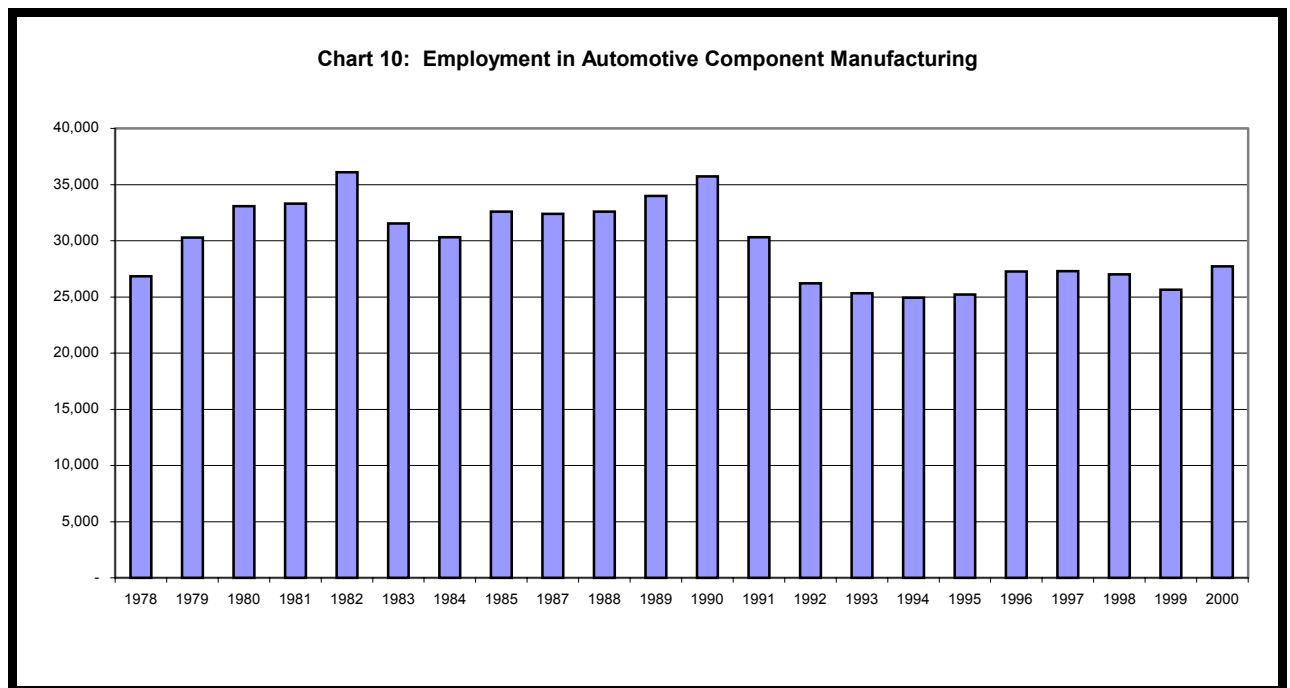


2.4 Employment in the sector

Chart 10⁹ shows employment levels in the automotive component manufacturing sector. The chart indicates employment in the sector grew approximately 1.5% between 1997 and 2000.

Manufacturing respondents to our Survey were asked to compare employment levels at 1997 with the current year. Their responses indicate that employment by aftermarket manufacturers grew by almost 3.5% over the period. This indicates that aftermarket manufacturers are more successful at job creation than the automotive component manufacturing sector as a whole.

AAAA believes that, when aftermarket manufacturing employment is combined with employment in the retail/wholesale/distributor sectors, total employment in the aftermarket is 35,000.



⁹ Australian Automotive Intelligence Yearbook, November 2001, page 33



ARB Corporation Limited – Innovation has led to export opportunities.

ARB Corporation Limited – ARB – is an excellent example as to why AMPs should be eligible for assistance measures provided to the automotive manufacturing sector.

Since its establishment in 1976, ARB has developed and grown its business from a fabricated metal designer and manufacturer to one with a multitude of products and a strong distribution system for the domestic and foreign 4WD markets. It has capitalised on its engineering expertise in developing new products for the evolving 4WD vehicle and has successfully identified and pursued product opportunities.

Examples include:

Bull bars

ARB produces a range of bull bars to suit 4WD vehicles. Each bar is individually designed to complement a particular 4WD model and is assembled using the most exacting laser cutting and tube bending equipment available. Bull bars are fitted to both new and second hand vehicles.

Air operated locking differentials

The development of the ARB Air Locker demonstrates ARB's engineering and product development expertise. The product has received high acclaim on its introduction to the US market.

“Old Man Emu” Suspension Systems

This product group comprises a large range of springs, shock absorbers, bushes, shackles and related hardware. Established sub-contractors carry out the majority of manufacture. The range is recognised as a leader in 4WD suspension set-ups. A suspension can be developed to suit any 4WD and any specific purpose for which it may be used.

ARB has successfully exported two products – the ARB Air Locker and “Old Man Emu” suspension systems. Over 90% of Air Lockers produced by ARB are exported and export sales of the product have increased each year. Further export opportunities exist in the US, Africa, South East Asia and the Middle East given the high level of 4WD ownership in those regions.

ARB has pursued export markets for these products because the products are difficult to copy, have high gross margins, are simple to freight and have a high degree of market acceptance.

Export sales have grown from \$9.7 million in fiscal 1997 to \$25.5 million in fiscal 2001, an increase of almost 163%. Export sales now represent almost 37% of total sales, compared to 25% in 1997.

To achieve this result ARB has:

- Invested an average of \$2 million per annum on plant and equipment; and
- Consistently spent over \$2 million per annum on Research & Development activities.



3. Current Assistance Arrangements

3.1 Introduction

This part of AAAA's Submission focuses on the following questions set out in Attachment B to the Commission's Circular of 21 March 2002:

- how have previous and current assistance arrangements influenced the structure, competitiveness, investment decisions and performance of automotive manufacturing industries?
- has (ACIS) had any unintended or undesirable impacts?
- is there a case for extending (ACIS) beyond 2005?
- if so would modifications to (ACIS) be required?

In responding to these questions, the following matters are considered:

- the application of ACIS to aftermarket manufacturers;
- the impact of ACIS on investment decisions;
- the impact of assistance arrangements on product sourcing decisions.

3.2 The application of ACIS to the aftermarket manufacturers

3.2.1 The importance of aftermarket manufacture has not been sufficiently recognised ...

As noted in the introduction to this Submission, AAAA believes that post 2005 assistance arrangements for the automotive manufacturing sector must:

- recognise the importance of aftermarket manufacture to the international competitiveness and global integration of Australia's automotive manufacturing sector; and
- frame the eligibility criteria for those arrangements so as to include aftermarket manufacturers.

This contention begs the question as to why certain aftermarket manufacturers are excluded from the current arrangements. One reason might be a biased, narrow view of the aftermarket adopted by many sector participants, relevant government departments and some industry observers.

It is a view that was reflected in the Report issued by the Industry Commission at the conclusion of the last inquiry into Australia's automotive industry. AAAA believes that, in this Inquiry, the Industry Commission recognised only one of the categories of membership – manufacturers of aftermarket and OE components.



In its Report, the Industry Commission noted:

“Automotive components are produced for sale as original equipment to motor vehicle manufacturers and to consumers as replacement and aftermarket parts.

The components supplied ... fall into broad categories:

- *components that are devoted to original equipment (OE). That is, these components are used in the assembly or manufacture of specified PMV's. The suppliers of these components are frequently SCPs; and*
- *components that are fitted to a vehicle at any time after the final stage of production. These automotive components are referred to as replacement and aftermarket components”.*¹⁰

3.2.2 ... which has led to a narrow application of ACIS

This narrow view has been reflected in the scope of ACIS. Eligibility for this scheme has been restricted to four groups within the automotive manufacturing sector:

- Motor Vehicle Producers – MVPs;
- Automotive Component Producers – ACPs;
- Automotive Machine Tool & Automotive Tooling Manufacturers – AMTPs; and
- Automotive Service Providers - ASPs.

Figure 1: The Application of ACIS

Motor Vehicle Producers (MVP's)	Automotive Component Producers (ACP's)
Automotive Machine Tool & Automotive Tooling Producers (AMTP's)	Automotive Service Providers (ASP's)

The Commission has sought responses to the question “has (ACIS) had any unintended or undesirable impacts”? AAAA believes that the narrow application of ACIS has had such an impact. In summary, the undesirable impact has been the effective exclusion of a large group of aftermarket manufacturers from ACIS and hence from the “rewards (for) production, investment and research and development”.

¹⁰ “The Automotive Industry – Overview, Recommendations and Findings”, the Industry Commission Report No. 58, May 1997



3.2.3 Eligibility for ACIS

An ACP was eligible to register for ACIS if:

- in the previous twelve months, it produced an automotive component for use in at least 30,000 new cars or engines and the production value of that component was at least \$500,000; or
- in the previous twelve months, the value of automotive components produced in Australia for use in new cars or engines was at least \$500,000 and made up at least 50% of total production value for all automotive components.

These eligibility criteria apply to only 45% of AAAA's manufacturer members. The inequities of the criteria will be demonstrated later.

One interviewee's view of policy development and the aftermarket

One of our interviewees is the CEO of one of Australia's largest and most successful Australian owned ACPs. From his involvement with policy development and previous Productivity Commission Inquiries, he formed the view that "the Government view of the Australian automotive industry was limited to the four car makers". He said that it took a great deal of lobbying by his company and other major OE component producers to have that view widened and to have Automotive Component Producers eligible for ACIS.

It is the contention of AAAA that manufacturers for the aftermarket are an equally valid and important part of the industry. OE component producers often express the view that manufacturers that focus on aftermarket do so because they "are not good enough to produce for OE" and have put this view forward to justify the exclusion of aftermarket manufacturers from Government assistance schemes. However, this view is simply invalid, and not borne out by the facts.

For many aftermarket manufacturers the decision to concentrate on aftermarket is purely a strategic one. The interviews conducted to support this Submission identified a number of aftermarket manufacturers whose quality, engineering and manufacturing capabilities are inarguably the equal of OE producers. In many cases the exporting success of these companies is far greater than all but the largest OE producers.



3.3 How many participated in ACIS?

Participants in the Survey were asked whether they participated in ACIS and its predecessor, the Export Facilitation Scheme (EFS). Twenty percent of manufacturer respondents indicated they had participated in EFS. Participation by manufacturers in ACIS has halved to 10%.

When commenting on the operation of EFS, respondents indicated EFS:

- engendered a focus on exports and facilitated strong export growth;
- was based on performance;
- was relatively easy to administer; and
- provided a greater return to participants.

ACIS is seen by those aftermarket manufacturers who are eligible to participate as:

- encouraging enterprises to invest in equipment to improve operations; and
- mitigating the negative margin on sales of product to MVPs;

but

- difficult to plan for because of the modulation provisions; and
- difficult to access because of the revenue targets imposed.

These responses indicate that EFS was more accessible and of more benefit to aftermarket manufacturers.

3.4 The impact of ACIS on investment decisions.

Participants in the Survey were asked whether:

- the exclusion of aftermarket production from ACIS resulted in cancellation or reduction of investment decisions or had no change; and
- the exclusion of aftermarket production from ACIS resulted in the cancellation or reduction of research and development decisions or had no change.

One third of manufacturer respondents indicated that both their investment in plant and equipment and R&D was reduced as a result of the limitations of ACIS. The remaining two-thirds indicated that the operation of ACIS had no impact on their investment and R&D decisions.

The decision to reduce investment in both plant and equipment and R&D is a further undesirable impact of ACIS. It is of concern to AAAA and should be of concern to policy setters.



3.5 Impact on product sourcing decisions

3.5.1 Impact on manufacturers make/buy decisions

Manufacturers have a choice as to whether to manufacture aftermarket components in Australia or to source the parts from overseas manufacturers. Participants in the survey were asked whether the proliferation of imported vehicles in the Australian market had any impact on their make or buy decisions. The rationale for this question is that the reduction in tariffs as part of the current passenger motor vehicle regime has resulted in a greater number of imported vehicles being sold in the Australian market.

The manufacturers were also asked "how would your business change if the number of local MVPs were to reduce"?

The majority - 70% - indicated the impact has been or would be neutral. Those that indicated the impact had been or would be negative referred to:

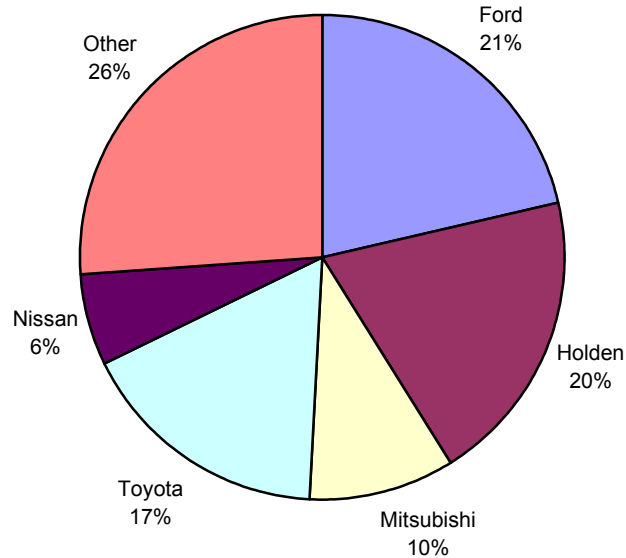
- Increased levels of imported product;
- Reduced R&D activity;
- Reduced levels of tooling expenditure – tooling would only be purchased if justified by anticipated volumes;
- Difficulties in determining products to include in their range; and
- Downsizing of local manufacturing operations

This response reflects the market for aftermarket product. Elsewhere in this Submission reference is made to the unique vehicles produced for the Australian market and the fact that Australian component producers are the only source of aftermarket parts for those vehicles. The responses also reflect the composition of the Australian car parc. Chart 11 shows the composition of the Australian car parc by manufacturer. It indicates that vehicles either produced or imported by the four domestic MVPs and Nissan (which ceased production in 1992) account for 74%¹¹ of the passenger motor vehicle parc.

When this preponderance of locally manufactured vehicles is combined with the age of the parc, aftermarket manufacturers are, to a certain extent, insulated from the impacts of increased sales of imported vehicles in the Australian market. However, the manufacturers believe that, should the age of the car parc change, this may have an adverse impact on their business. In response to the question "How would your business change if the age of the Australian car parc were to reduce from the present level of 10.6 to, say, eight years", 47% believe it will have an adverse impact on their business. Twenty-one percent believe the impact will be neutral and 32% believe it will have a positive impact on their business. This response would indicate there is a case for extending ACIS beyond 2005.

¹¹ "AutoStats 2001 – a report by the Australian Automotive Aftermarket Association Ltd" – published 2001. Note that the proportions attributed to each manufacturer will include CBU's imported by the manufacturer.

Chart 11: Composition of Australian Car Parc by Manufacturer



3.5.2 Sourcing decisions by retailers, wholesalers and distributors

Aftermarket retailers, wholesalers and distributors can also choose to source product from local manufacturers or from overseas. In our Survey, questions were asked to determine:

- factors influencing product sourcing decisions;
- the impact of the proliferation of imported vehicles on sourcing decisions;
- the impact of changes in the age of the car parc; and
- the opportunities for replacement of imported product with locally manufactured product.

Factors influencing product sourcing decisions

Charts 12 and 13 summarise the responses to the following questions:

- in deciding whether to purchase aftermarket product from a local manufacturer rather than directly from an off-shore manufacturer you will have considered a number of factors – please ranks the following factors in order of importance to you; and
- what would cause you to change your source of supply from a manufacturer to a wholesaler or distributor.

The responses indicate that quality of product is the most important determinant in supplier choice, followed by price.

AAAA believes Australian aftermarket manufacturers must have equal access to assistance arrangements to assist them in meeting customer quality and price expectations. This can be achieved by product innovation through R&D and investment in plant and equipment to ensure cost effective production.



Chart 12: Factors Influencing Product Sourcing Decisions - Local vs Overseas Manufacturer

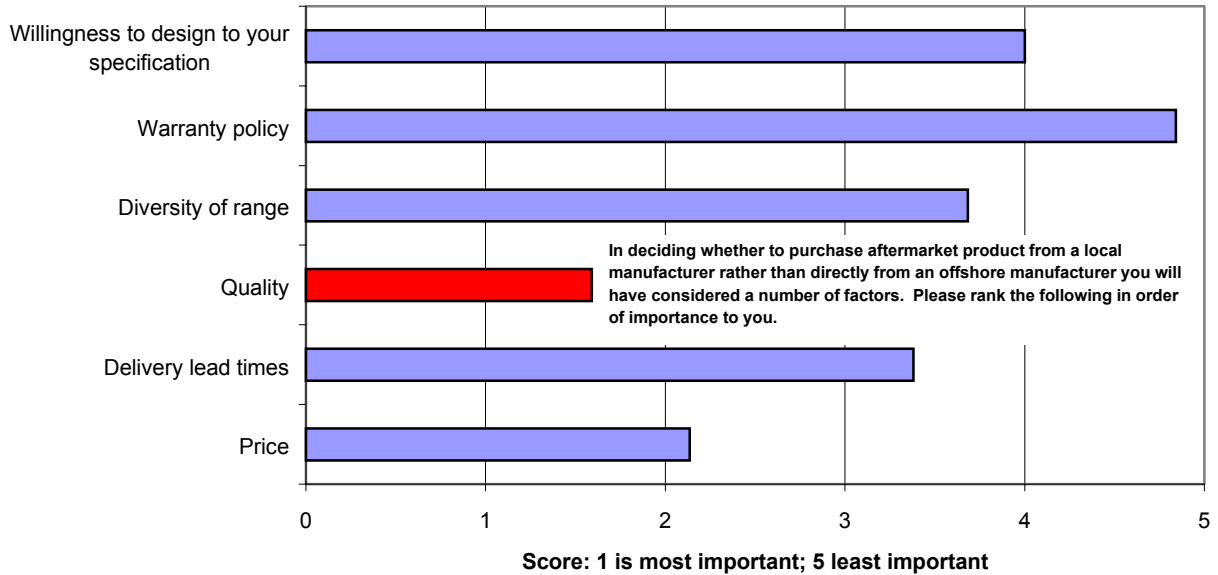
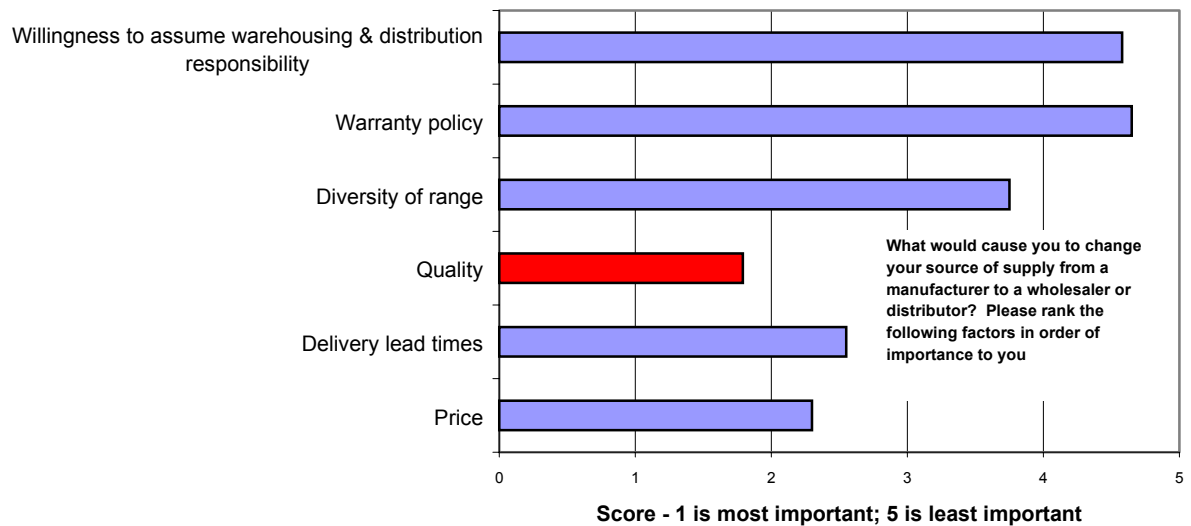


Chart 13: Factors Influencing Product Sourcing Decisions - Manufacturer vs Wholesaler/Distributor





Impact of imported vehicles

The increasing proportion of imported vehicles in the Australian parc has no effect on product sourcing decisions according to the majority of respondents. AAAA believes the response reflects the “insulation effect” referred to in 3.4.1 above. This effect applies to retailers, wholesalers and distributors as much as it applies to manufacturers.

Changes in the age of the parc

Forty-two percent of retailer, wholesaler distributor respondents to the question “how would your business change if the age of the Australian car parc were reduce from the present 10.6 years to, say, 8 years” indicated that the change would have little or no impact on their business. Twenty-one percent indicated it would have a positive effect while the remaining 37% indicated it would have a negative effect.

Negative respondents referred to reductions of business, one indicating that business would fall by as much as 15%.

If the change in age were to be the result of the increased level of imported vehicles in the parc, the “insulation effect” referred to earlier may be reduced.

3.5.3 Conclusion

Both manufacturers and the retail/wholesale/distributor sector are taking some comfort from the “insulation effect” referred to in 3.4.1 above. The fact that Australian made vehicles presently comprise the majority of vehicles on Australian roads and the unique nature and age of those vehicles provides some protection for aftermarket manufacturers. However, a significant proportion – 47% of aftermarket manufacturers and 37% of the retail/wholesale /distribution sector – believe changes in the age of the parc will have a negative impact on their businesses. Those manufacturers that recognise the impact of change on their business and are working to mitigate the impact of that change should have assistance measures to support them in this task.

4. Interdependencies

4.1 Introduction

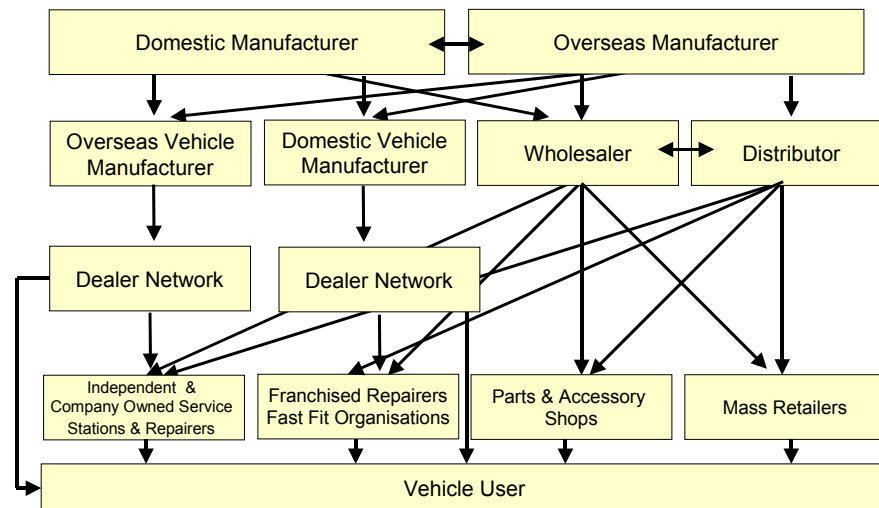
The Inquiry's Terms of Reference require the Commission to "comment on the interdependence between the vehicle assemblers and component producers of the sector, and the sustainability of one segment if the number of firms in the other segment were to decrease." In Attachment B to the Terms of Reference, the Commission posed the following question:

- What are the key linkages between the various sectors of the automotive manufacturing with the rest of the economy?

The Terms of reference do not provide a definition of "interdependencies". For the purpose of this submission, AAAA has considered the term to mean "the extent to which one participant in the sector is dependent on another for its viability."

The links between the various sectors of the automotive manufacturing sector and the broad automotive market are shown in Figure 2. There is a strong level of interdependency between each of the sectors depicted in Figure 2.

Figure 2: Overview of the Australian Automotive Aftermarket





Our interviews have revealed:

- a high level of interdependency between MVPs and manufacturers, particularly in relation to replacement parts;
- a high level of interdependence within the manufacturing sector; and
- a high level of interdependence between the manufacturers and the retailer, wholesaler and distributor sectors.

Our interviews also indicate that MVPs do not generally recognise the importance of the aftermarket to the marketability of their vehicles.

4.2 The importance of replacement parts

AAAA members that manufacture for both the aftermarket and OE are involved in the manufacture of products that are replaced regularly throughout the life of a vehicle as a result of normal wear and tear – filters, tyres, wiper blades, spark plugs, bulbs, batteries and brake pads. These products are important to the viability of aftermarket manufacturers.

To quote one interviewee “the life of the component continues when vehicle production ceases”. This is best demonstrated by Table 3 below, which shows worldwide sales of selected OE and aftermarket components for passenger cars in 1999. As can be seen from the table, sales for the aftermarket exceeded OE with only two exceptions – headlamps and shock absorbers.

Table 3: Worldwide sales of selected OE & aftermarket components for passenger applications, 1999

(Millions of units)

	OE used in Assembly	OE and Independent Aftermarkets	Total
Alternators	34.4	68.6	103.0
Batteries	34.4	106.5	140.9
Clutches	17.2	31.8	49.0
Exhaust systems	34.4	112.8	147.2
Air filters	34.4	254.6	289.0
Oil filters	34.4	386.2	420.6
Headlamps	68.8	10.5	79.3
Shock absorbers	137.6	96.8	234.4
Spark plugs	137.5	914.6	1052.1
Starter motors	34.4	76.0	110.4
Tyres	220.5	488.4	708.9
Wiper blades	86.1	292.2	378.3

Source: EIU World Automotive Components, Economist Intelligence Unit Ltd, 2000



The importance of replacement parts is examined under the following headings:

- Volume;
- The dependence of MVPs on aftermarket manufacture
- Profitability; and
- Consequential exports.

4.2.1 Volume

“Aftermarket pays the rent”

The heading for this section is a quote from one interviewee. It emphasises the importance of replacement parts to aftermarket and OE manufacturers.

In Attachment C to the Commission's Term of Reference, the Australian vehicle market is described as “small, mature and diverse.” The size of the market and the limited prospects for growth require local component producers to seek volume to (quote one interviewee) “help with the fundamental economics” of manufacture. Another advised, “Anything that adds volume is a worthy contributor”.

This volume can come from aftermarket and OE supply to both domestic and export markets. OE supply contracts are usually written to cover both the supply of parts during the manufacturing life of the vehicle and the supply of replacement parts to the MVPs Parts & Accessories (P&A) operations. One interviewee advised that “if aftermarket sales are lost, then OE manufacture dies”, going on to say that it lacks volume unless it has aftermarket sales.

Another advised that

- There is lag between the time a new vehicle enters the market and the time the aftermarket commences to supply the owner of the vehicle;
- This lag depends upon factors such as the nature of the part, and the warranty policies of the MVPs;
- As a result the component producer benefits from the sales of OE product and subsequent aftermarket sales; and
- The benefit is enhanced by the age of the Australian car parc, which provides a “long tail” for sales of the part.

4.2.2 MVP's need aftermarket manufacture

As much as aftermarket manufacturers rely on replacement parts for volume, MVPs rely on replacement parts – to enhance the market appeal of their vehicles and to control the cost of manufacture.

4.2.2.1 To enhance the market appeal of their vehicles

The ready supply of replacement parts in the event of breakdown or for regular service is important to vehicle users. Elsewhere in this Submission reference is made to the unique nature of Australian designed and manufactured vehicles and the fact that replacement parts can generally only be sourced from local manufacturers. While this uniqueness provides a measure of protection to the parts manufacturers, it comes at the cost of maintenance of high inventory levels to ensure supply of parts to vehicle owners.



This is equally important in both the warranty and post warranty periods. Reliable supply of replacement parts in the post warranty period assists in maintaining the re-sale value of vehicles, another important factor in vehicle selection.

4.2.2.2 To control the cost of manufacture

Local sourcing of OE and replacements parts insulates local MVPs from the adverse effects of currency fluctuations, thereby controlling the costs of manufacture.

As the concept of manufacturer responsibility for recycling develops, the ability to return parts to local manufacturers rather than shipping them to overseas suppliers will also assist in MVP cost control.

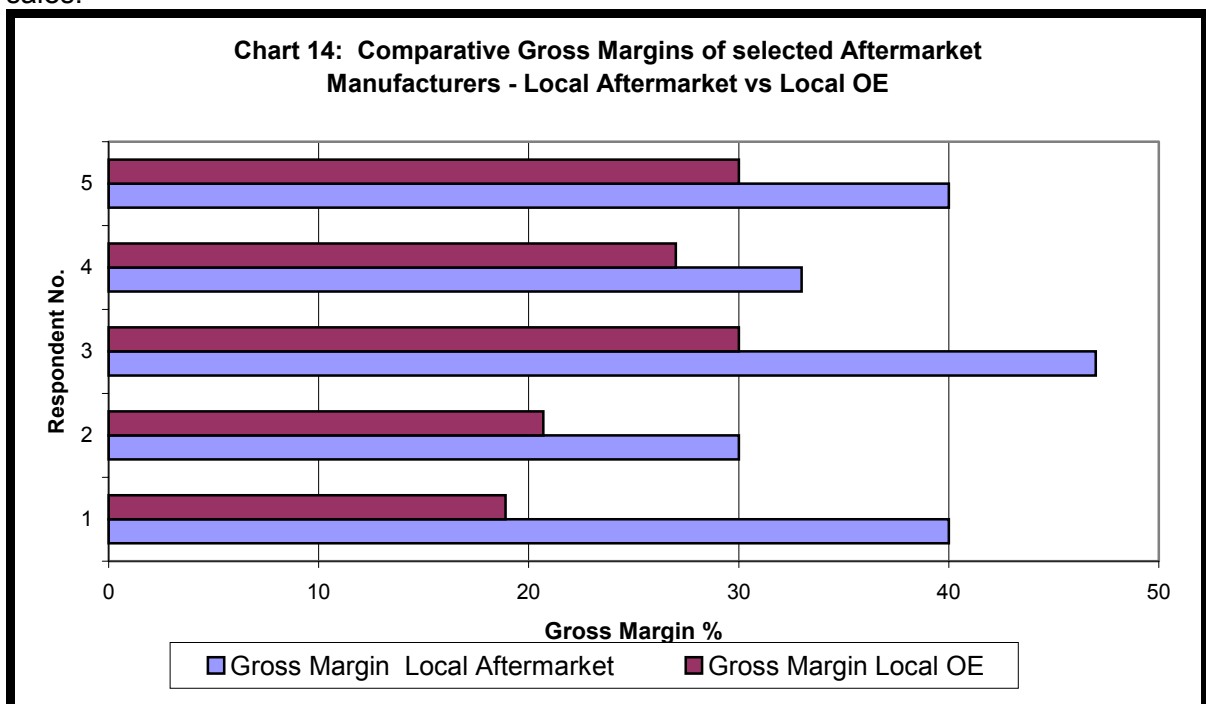
4.2.3 Profitability

Chart 14 compares gross margins achieved by five respondents to our survey from sales of locally manufactured aftermarket and OE products. Note that the respondents manufacture both genuine and non-genuine products developed specifically for the aftermarket.

The chart indicates that aftermarket margins can be up to double those earned from sales of OE products. The sample drawn from our survey indicates that, on average, margins from aftermarket product exceed those from OE by 45%. The extent of the additional margin earned on aftermarket sales depends on the market position of the manufacturer, the nature of the product (commodity or specialist application) and the level of competition from imports.

The data reinforces the comment made above that “aftermarket pays the rent”.

It also indicates that decisions to invest in plant and equipment and R&D for the manufacture of automotive product for OE supply and the genuine aftermarket and/or non-genuine aftermarket rely in part on the greater margins earned from aftermarket sales.





4.2.4 Consequential exports

Opportunities to export parts to markets developed by Australia's vehicle manufacturers are "consequential exports". With forecasts of 155,000 vehicles to be produced for export in 2005, the consequential export opportunities appear sound.

At the aftermarket level, manufacturers of replacement parts have the opportunity to supply to the aftermarket in the export destination of the vehicle. This opportunity exists for as long as the Australian manufactured part is able to meet the price, delivery and quality expectations of the export market. To meet these expectations, aftermarket manufacturers must invest in plant and equipment and R&D. This investment can be justified by the additional volume generated by consequential exports.

The points made under 4.2.1 regarding the enhancement of market appeal of vehicles apply equally here.

Manufacturers of non-genuine product that can be fitted to exported vehicles are also presented with consequential export opportunities. A recent AAAA Trade Mission to the Middle East, destination of vehicles produced in Australia by Holden, Mitsubishi and Toyota, indicate a high level of interest in Australian made aftermarket parts.

4.3 Interdependence within the component manufacturing sector

One manufacturer interviewee advised that his organisation has developed an aftermarket product, which is produced by another manufacturer on a "sub-contract" basis. The product is not used in the assembly of a vehicle but fitted after sale to enhance vehicle performance. The "sub-contract" manufacturer produces the product using plant and equipment that qualifies for ACIS, yet, somewhat illogically, the R&D activity that developed the component does not qualify for ACIS.

Taking the example further, the sub-contract manufacturer has, through the production of aftermarket and OE components and through its sub-contracted production, achieved a volume that justifies its investment in new plant and equipment. The justification for the investment is enhanced by ACIS.

AAAA believes it is inequitable the R&D activities that give rise to the product that provides some justification for investment in ACIS qualified plant and equipment does not itself qualify for ACIS.

This example demonstrates interdependency at the following levels:

- The manufacturer that produces OE and aftermarket parts is dependent upon the volume available from the four domestic MVPs;
- These manufacturers are also dependent upon the volume generated from any sub-contract production of parts for other manufacturers; and
- Manufacturers that design parts specifically for the aftermarket but have limited manufacturing capability, are dependent upon other enterprises manufacturing capabilities.



4.4 Interdependence between the component producers and the retailer, wholesaler and distributor sectors

Figure 2 shows a complex relationship between the manufacturer and retailer/wholesaler/distributor sectors of the aftermarket. The retailer/wholesaler/distributor sector comprises those enterprises so described in Figure 2 as well as independent and company owned service station and repairers, franchised repairers, fast fit organisations, parts and accessories shops and mass retailers.

Apart from the supplier customer relationship, there is an information flow between the manufacturer and retailer/wholesaler/distributor elements of the aftermarket regarding product performance and fitting and servicing of parts. The latter information flow is of increasing importance as parts become more complex.

The flow of information from retailer/wholesaler/distributor to manufacturer is as important as the opposite flow. Difficulties with servicing parts and data regarding the performance of product are being fed back to manufacturers to assist in the improvement of product.

There are examples of such information flow in the Australian market. Robert Bosch Australia supports its "service partners" in this fashion. Any reduction of this locally available support may increase the cost of motoring as the retailer/wholesaler/distributor sectors have to seek support from overseas manufacturers of the parts.

Explaining the Hella Service Partner concept

Extract from an interview with Martin Herbst, Hella Director with responsibility for Hella's Aftermarket & Special OE business division, reported in Just-Auto.com, 15 May 2002

(emphases added by AAAA)

"Our Service partner concept covers the four modules – Lighting, Electrical Systems, Electronic Systems and Air-conditioning. This means that specialists are being developed for in these areas, since our concept not only includes the supply of replacement parts but extensive training as well. At present, repairs to electronic systems only make up around 5% of overall repairs, but in another five years this share will have risen to 30%. Independent workshops that have not started with automotive electronics yet will have problems with almost all their repair work in the future.

Hella Service Partners will not have any problems. Nor will any other independent workshop we work with. We will make sure of that.

When we made the strategic decision to expand the Hella product range by electronics products, we simultaneously allowed for additional staff for this area. Today we have separate product management for electronic parts and a strong separate service department for Hella Service Partners. Since the number of Hella Service Partners is continually growing, we also have to include wholesalers in the obligation to provide information.



5. Strengths, weaknesses & opportunities

5.1 Introduction

The Commission has been asked to identify the strengths, weaknesses and opportunities for the automotive manufacturing sector. To this end, it has posed the following questions:

- What are the emerging opportunities for the Australian automotive industry?
- Will these mainly arise in export markets or will the domestic market also provide new opportunities?
- Are there particular niche markets for the Australian industry?
- Do Australian manufacturers have strengths in certain areas, such as design and production of particular components?

During the interview process, interviewees were asked to identify the strengths, weaknesses and opportunities of the automotive aftermarket manufacturing sector. The responses are summarised below.

5.2 Strengths

In the context of this Submission, a "strength" is an attribute of the Australian aftermarket manufacturing sector that distinguishes it favourably from that sector in other countries. The strengths of the automotive aftermarket manufacturing sector, as identified during our interviews, have been summarised under four headings:

- Structural;
- Capability;
- Market;
- Economic; and
- Independence.

5.2.1 Structural

The main structural strength of the sector is the base of local vehicle manufacturers. As a result of the local manufacturing base, the Australian automotive manufacturing sector produces a full range of automotive products.

One interviewee noted "Australia will have a strong aftermarket manufacturing sector while there is a viable manufacturing sector that produces vehicles or engines for export".

The interviewee (a distributor/retailer) advised that it sources the bulk of its parts for sale from local manufacturers because the parts are manufactured for Australian assembled or manufactured vehicles and cannot be sourced from overseas. Australian component manufacturers are the only component producers that have the tools to produce the parts. Another referred to the "unique Australian OE product", which makes it difficult for developing countries to enter our market.



5.2.2 Capability

Australia's automotive manufacturers are world class. According to a distributor/retailer interviewee this capability has developed as manufacturers have moved from manufacturing for the local industry to manufacturing for the export or global market.

In the aftermarket sector, this world-class capability is used to provide solutions that adapt imported vehicles to better cope with Australian motoring conditions. An example is the fitting of Australian designed and manufactured air and oil filters to imported vehicles so that the vehicles are better able to handle the high dust levels in Australia.

The word most used by interviewees in describing aftermarket manufacturers was "innovative". The sector was described as "brilliant" technically, combining an ability to improvise with technical merit and skill. This results in a high level of innovation in product design, and an ability to exploit niche opportunities. The level of innovation was attributed to the Australian "can do" attitude, which was compared favourably with attitudes in (eg) Europe.

Confidence in the capability of the sector is indicated by local MVPs:

- Sourcing product for their "special vehicles" divisions from aftermarket manufacturers;
- Using aftermarket manufacturers for post launch testing of components; and
- Sourcing replacement parts from "non-genuine" aftermarket manufacturers to meet extended warranty needs

In addition, as noted in 5.2.3, the sector is capable of manufacturing small volumes profitably. This profitability is achieved by using alternative manufacturing processes and/or innovative product design where necessary.

5.2.3 Market

The domestic market for manufactured aftermarket product is small. - approximately \$4.66 billion at a retail level. This compares with the US aftermarket, which was estimated to be \$152 billion to \$159 billion (in 1998) and probably increased another 5% in 1999¹².

The size of the market was identified as a strength by some interviewees. Size enables suppliers to be close to the market. In fact, suppliers must be close to the market. One interviewee noted, "Because of the low volume, everything counts". This direct contact with customers facilitates product development to meet customers' needs. At retail level the market is described as "price sensitive and competitive". Domestic manufacturers are therefore required to respond to these pressures, which has led to a capability to supply small volumes profitably.

Another interviewee's comment that "creative design and solutions have evolved because the local market is very small and sophisticated" reinforces this view.

The age of Australia's vehicle fleet is also a strength. The longer vehicles are on the road, the stronger the demand for aftermarket product.

¹² US Industry & Trade Outlook 2000



5.2.4 Economic

Interviewees consistently referred to the positive impact of a lower Australian dollar. It “supports exports” and “provides a barrier against imports”. One manufacturer advised imports of products that would compete against their locally manufactured product range have reduced by as much as 15% over recent years.

The relative stability of the Australian dollar when compared with (eg) ASEAN and North Asian currencies was also commented upon.

At a broader economic level, the strength of the local aftermarket manufacturing assists in controlling motoring costs generally. The Australian motorist benefits from locally produced components competing against imports in the areas of price, quality and availability.

5.2.5 Independence

In a time when there is so much emphasis placed on being part of a global network, it might seem strange to be considering the importance of independence. Many of Australia's manufacturers are subsidiaries of overseas corporations, with decision-making controlled by “head office”. In many instances they compete with related subsidiaries for capital investment, R&D funds and production contracts. Head office policies often put many potential markets off limits.

The majority of Australia's “non-genuine” aftermarket producers are locally owned, with owner managers involved in the day-to-day management of the business and making strategic decisions as to capital investment and R&D activities. It is this autonomy that enables the pursuit and development of niche opportunities (such as those pursued by ARB)

One interviewee attributed his organisation's dominant market position to technical innovation and its strategy of owning the intellectual property. This organisation is Australian owned and attributes 20% of its turnover to aftermarket sales.

AAAA believes providing genuine and non-genuine manufacturers of aftermarket product with the same level of access to assistance arrangements as those who manufacture for OE customers would support this independence and the economic benefits accruing from these independent investment decisions.

5.3 Weaknesses

In the context of this Submission, a “weakness” is an attribute of the Australian aftermarket that distinguishes it unfavourably from that sector in other countries. The perceived weaknesses of the aftermarket manufacturing sector, as identified by the interviewees have also been summarised under the heading of Structure, Capability, and Market.

5.3.1 Structural

As much as the base of local vehicle manufacturers is a strength, it is also a weakness. Interviewees indicated that the local vehicle manufacturers provide little encouragement



to aftermarket manufacturers to develop product for aftermarket sales through their dealer networks.

The off limits attitude of Head Offices of foreign owned ACPs is also a structural weakness (refer to paragraph 5.2.5).

5.3.2 Capability

Interviewees identified a lack of capability in accessing export markets. One referred to a tendency to work with agents in export markets rather than “do it themselves”. Another referred to a lack of self-belief in capabilities by both genuine and non-genuine aftermarket manufacturers, particularly the latter, and a lack of a planned approach to exporting.

Another who felt there is “a lack of visionaries in the industry” and “an inability to adapt to changing conditions” reinforced this. He believes that most Australian component manufacturers have too strong a focus on OE supply and consider the aftermarket as a mere add on. A retail franchisor indicated that this results in a limited range of Australian made parts for the local aftermarket.

There is also a concern that the capability might be eroded by a lack of interest in manufacturing careers, with limited succession planning amongst SME participants and limited training facilities.

5.3.3 Market

The most consistent comment made by interviewees when discussing the Australian domestic market was the size of the market. Market characteristics such as the slowing rate of growth of the vehicle parc and a plateauing use of passenger vehicles exacerbate the impact of this weakness. The relatively small size of the market means that it alone does not provide sufficient volume to justify the investment in plant and equipment.

One interviewee indicated that the size of the market “makes Australia a marginal opportunity for our near neighbors”. The interviewee advised that it is experiencing “severe competition” from Indonesian, Malaysian, Chinese, Korean and Thai manufacturers in their product sector. Global manufacturers are directing capital expenditure to these “low labour cost countries”. The interviewee indicated that it had spent a substantial amount of capital expenditure over recent years to improve its operations, but doubts whether the capital expenditure to make the next round of improvements would be made in Australia.

Some interviewees also referred to the distance from export markets



5.4 Opportunities

The interviewees identified the following opportunities:

- consequential exports on the back of sales of domestically manufactured vehicles;
- export markets generally; and
- import substitution

5.5 Consequential exports

The success of the local vehicle manufacturers in developing export markets for their vehicles provides a twofold export opportunity for local manufacturers of genuine product. The first opportunity is as a supplier of OE (Original Equipment) components that are used in manufacture of the vehicle and as replacement parts.

The second opportunity arises from the supply of aftermarket product for users of vehicles in export markets. As noted earlier Manufacturers of non-genuine product that can be fitted to exported vehicles are also presented with consequential export opportunities. A recent AAAA Trade Mission to the Middle East, destination of vehicles produced in Australia by Holden, Mitsubishi and Toyota, indicate a high level of interest in Australian made aftermarket parts.

5.5.1 Export markets generally

The matters referred to in 5.2.4 and 5.3.2 above - the advantageous exchange rate and the lack of capability in approaching export markets respectively - provide opportunities to develop export markets. ARB's experience indicates this is possible.

One distributor/retailer indicated that, in his view, opportunities for aftermarket manufacturers are in the hands of the car companies, and they "are there to be got" if the manufacturer can demonstrate world competitiveness.

Another interviewee confirmed this view, advising that his organisation's success in developing aftermarket sales has resulted in the organisation's name being well known in foreign markets. This profile is advantageous when approaching potential MVP customers for OE business.

5.5.2 Import substitution

The inroads made by imported vehicles in the Australian market provide manufacturers with opportunities to develop product across the whole aftermarket range for those vehicles.



6. Policy Options

6.1 “Future growth must come from exports”

In commenting on policy options, AAAA is mindful of comments made in a speech delivered by the Minister for Industry Tourism and Resources, Ian Macfarlane, to a Southern Region meeting of the Federation of Automotive Products Manufacturers (FAPM) held on 26 March 2002.

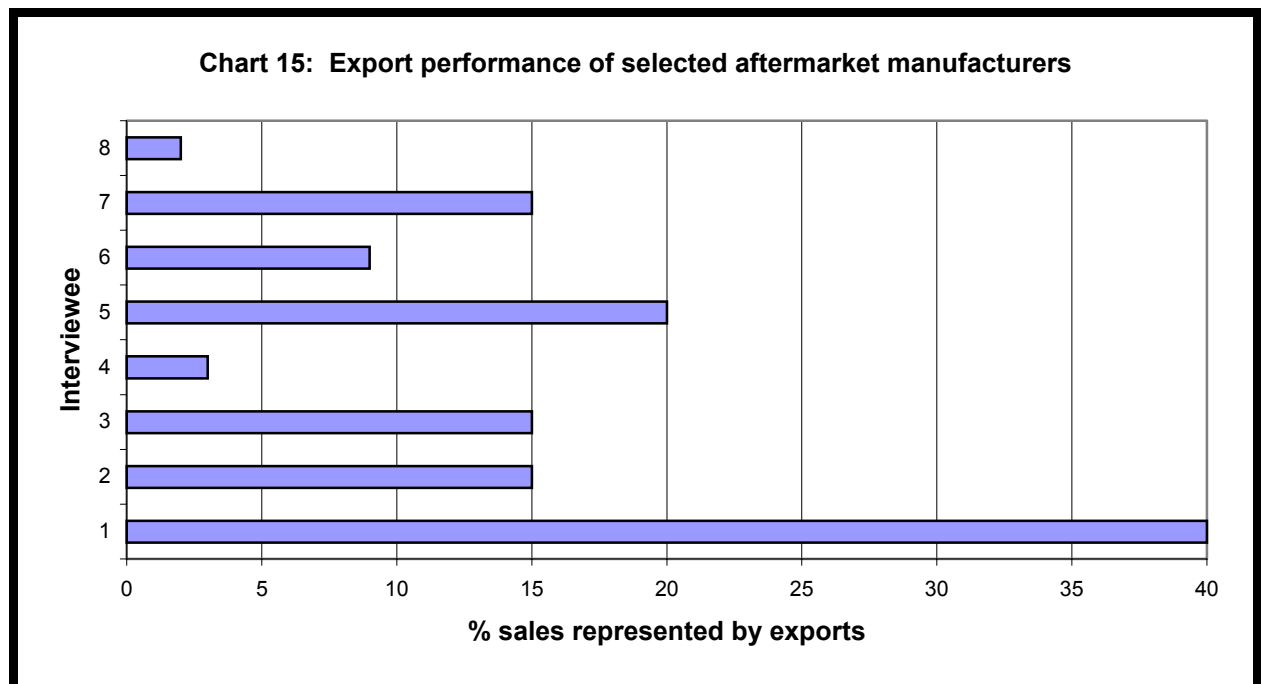
In that speech the Minister noted:

“The fact that component exports fell last year while auto exports grew highlights an important message. In an increasingly global marketplace it’s not enough to strengthen existing markets, new ones must be penetrated. There are domestic opportunities arising – particularly in the 4WD market. But future growth must come from exports”.

AAAA agrees with the assertion that “future growth must come from exports”, and suggest that policy options must create an environment that encourages and supports the export activity of aftermarket manufacturers.

6.2 Export successes

Manufacturers of genuine and non-genuine aftermarket product have been successful in penetrating export markets. During our interviews we sought information on the proportion of aftermarket manufacturers turnover represented by exports. The responses from some of the interviewees are summarised in Chart 15.





Export performance varies, with the most successful being those organisations that have developed niche markets or technically superior products.

Tectaloy Keeps Growing

(Extracted from "Australian Automotive Aftermarket" magazine, February/March 2002 edition, page 33)

When experts in this industry are asked to name the success stories in the aftermarket, one that often slips through most recognition is the Adelaide company, De Ville. Yet from a single site in Royal Park, the business has not only put its coolant on the national map but has put the Tectaloy brand into a dominant position.

What began as a good small business idea is now a booming producer enjoying export success.

De Ville started 20 years ago to make one product – coolant. Today they still make only coolant, only now the company has around 70% of the Australian aftermarket and their brand is a household name.

But the local market is only as big as our relatively small population, so De Ville is now taking its business offshore chasing exports. And the early results have been very encouraging with the first overseas shipment delivered in February 2002.

Taking the company into the new markets has been its Business Manager, Warwick Prestwood.. He first jumped on a plane last year following a period of research and assistance from Austrade.

"I had the excellent asset of our product being a market force and a complete proven system to sell," he says. "De Ville could be shown to be a dedicated expert manufacturer with the best coolant range to do a top job ... we're the only Australian coolant company to have full standards certification on its range and both local radiator manufacturers endorse our products.'

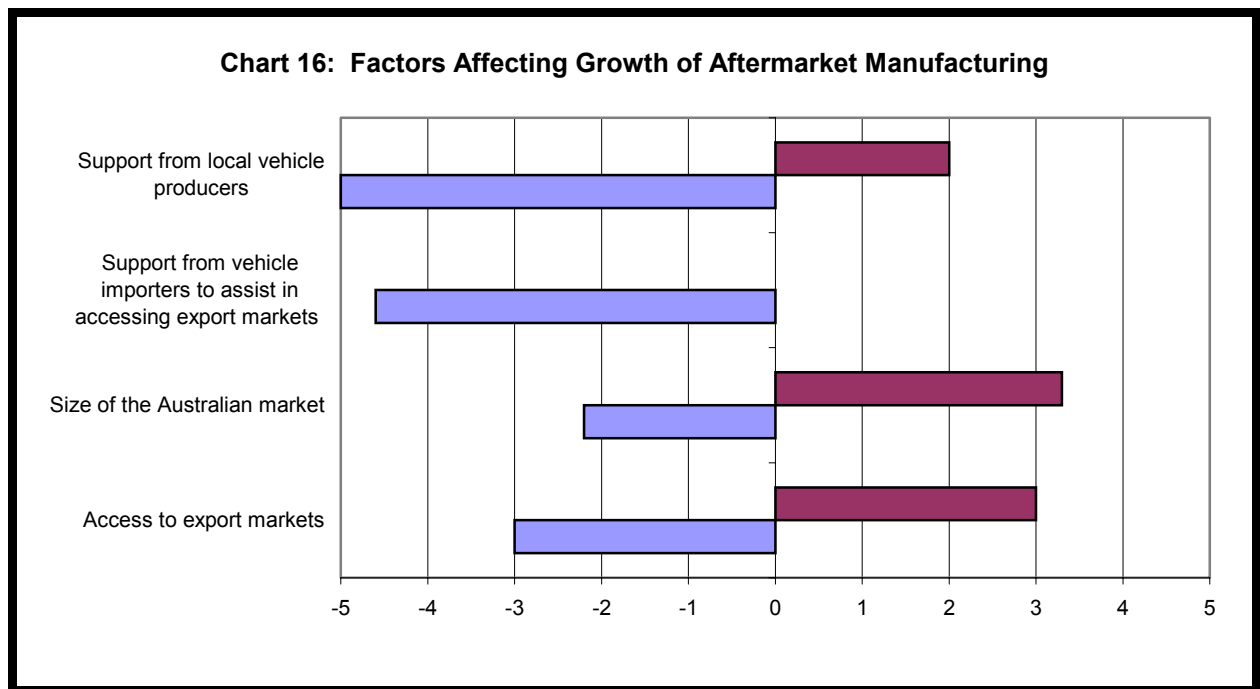
Prestwood realises further gains in the local market are limited. His plan is to develop specialist products for niche markets and to maintain the policy of continual trade education and reseller promotions. As for additional business, that will be coming from exports.

Understandably, the company is not divulging where its coolant is being shipped except to confirm it is in Asia. "We're delighted at the quick results our work in exports is having. Our premium product that we market as a total package impresses overseas customers. There's enormous potential out there. Right now, I expect the size of our company will double in the next five years."

6.3 Factors affecting aftermarket growth

6.3.1 Survey results

In our Survey, aftermarket manufacturers were asked to rank on a scale of –5 for strongly negative to +5 for strongly positive, a series of factors affecting the growth of the aftermarket manufacturing business. The responses for certain of these factors are summarised in Chart 16.



6.3.2 Concerns regarding the level of support

The responses indicate concern regarding the level of support from MVPs and vehicle importers. As noted earlier, one interviewee indicated opportunities for manufacturers are in the hands of the car companies and “are there to be got” if the manufacturer can demonstrate world competitiveness. There is already a strong level of contact between the manufacturers of genuine aftermarket product and local vehicle manufacturers.

During the operation of the EFS, vehicle importers were instrumental in facilitating exports of Australian made genuine product. AAAA has not been able to determine if the facilitation has reduced since the cessation of EFS.

We therefore suggest that the Automotive Council explore this issue to determine whether there has been a reduction in exports of components to parents of local vehicle importers and, should this be the case, if this is an unintended consequence of the introduction of ACIS.



6.3.3 Access to export markets

The responses noted in Chart 16 regarding the size of the Australian market reflect comments made elsewhere. Some aftermarket manufacturers see the size of the Australian aftermarket as a strength because it offers a measure of protection due to the limited opportunities it presents to new entrants. Others see it as a weakness because it provides limited opportunities for growth.

Those that indicated access to export markets has had a positive impact on their growth are already active exporters. Those that indicated the opposite are attempting to break into those markets.

AAAA supports Federal Government initiatives to secure market access for Australian exports such as participation in the APEC Automotive Dialogue and the proposed free trade agreements with Singapore and Thailand.

6.4 Competition

6.4.1 Competition from imports

AAAA is very aware of competition for the Australian aftermarket and export aftermarkets from overseas manufacturers. Apart from the “natural” protection afforded by the unique nature of Australian manufactured vehicles, the Australian aftermarket is an open market.

In this submission we have differentiated between genuine and non-genuine aftermarket product. The manufacturers of non-genuine aftermarket product are more exposed to import competition than genuine.

6.4.2 Equal access to assistance arrangements is necessary

AAAA contend that if non-genuine manufacturers are to continue to compete then these manufacturers must have equal access to post 2005 assistance arrangements for the automotive manufacturing industry. Earlier in this Submission we have referred to:

- Decisions by aftermarket manufacturers not to invest in plant and equipment and R&D because they are effectively excluded from the ACIS; and
- The inequities of ACIS – components produced using “ACIS qualified” plant and equipment developed from R&D that does not qualify for ACIS.

Australian non-genuine manufacturers need to differentiate on the basis of technology and be able to explore niche markets if they are to remain competitive. Success in the non-genuine sector of the aftermarket can often lead to opportunities in the genuine sector, as demonstrated by the examples of EGR and Davies Craig (see boxes)



Finding a Niche – EGR

EGR is a privately owned manufacturing company with its headquarters in Brisbane. The company commenced operations in 1973 producing point-of-purchase products and light plastic fabrication products. Today, EGR is a truly global operation with annual sales of \$100 million and employing 600 people worldwide.

EGR's operations are carried out through three divisions:

- Automotive, which produces automotive components and accessories;
- Display that specializes in point-of-purchase products; and
- Extrusion that manufactures high quality rigid plastic sheeting.

EGR entered the automotive market in 1983 and is now a leading designer, manufacturer and marketer of thermoformed automotive accessories.

The main lines of automotive accessories include ABS fender flares, hood shields, car body kits, headlight guards, window visors, dust deflectors and taillight guards.

The company operates under a just-in-time production environment and is certified to the QS9000 quality assurance standard. It is the preferred supplier to over automotive assembly plants in 40 countries. In 2000 it received a Gold Ford Australia Supplier Excellence Award for the supply of world class components.

EGR claims to dominate the automotive market in its core product groups, with sales and warehousing subsidiaries in North America, the United Kingdom, Brazil and New Zealand.



How DAVIES CRAIG achieved export success through innovation

In 1971, belt-driven fans were the only option for automotive cooling. Then, almost all car engines had a belt driven radiator fan, which was a slave to the engine speed. Every time the engine went round the fan went round too, even if the engine was cold or the car was travelling fast enough for the ram air to cool the engine. When the engine speed was high during acceleration and passing through the gears, the mechanical fan speed was also high and taking more and more power from the drive wheels as its speed increased.

Noting that at higher speeds, most cars do not require cooling Australian engineers Daryl Davies and Bill Craig created the Thermatic Fan. The Thermal Switch activates the fan only when it is needed; protecting engines from overheating (even when carrying heavy loads), saving fuel, better controlling temperature control and improving performance. Electric cooling has now become a standard feature on most of the world's new cars.

DAVIES CRAIG was formed to manufacture the new electric fans, and has since developed a comprehensive range, covering most makes of vehicle. Today DAVIES CRAIG "tailor made" cooling systems are supplied as original equipment to automotive manufacturers throughout the world.

In August 1999 Davies, Craig released its universal fitting electric water pump - EWP - for cars, trucks, buses and boats. The pump was developed in a \$1.2M research and development project undertaken by DAVIES, CRAIG to replace the mechanically driven pump thus increasing power available to the drive wheels of the vehicle and improve cooling.

Initially sold as an aftermarket product, it is anticipated that the EWP will be fitted as OE to new vehicles in the near future.



6.5 Aftermarket manufacturers deserve to participate in Post 2005 assistance arrangements

When considering policy options, we believe that aftermarket manufacturers should be able to participate in any Post 2005 Assistance Arrangements proposed by the Commission. More importantly, because these manufacturers have been excluded from current assistance arrangements and because of the hiatus between now and the time the Post 2005 Arrangements will take effect, we believe aftermarket specific assistance should be put in place now.

6.5.1 The aftermarket does not fully participate in current assistance arrangements

The eligibility criteria for the centerpiece of the current assistance arrangements – the Automotive Competitiveness Investment Scheme or ACIS – operate to exclude a minimum of 55% of aftermarket manufacturers from the “rewards (for) production, investment and research and development” provided by ACIS.

Other aspects of the Federal Government's Automotive Action Agenda:

- Tariff reform; and
- Opening export markets under the direction of the Automotive Trade Council and funded by the Automotive Market Access and Development Fund of \$20 million and involving:
 - the Prime Minister's Special Automotive Envoy;
 - the Automotive Market Facilitator and the Department of Foreign Affairs and Trade market access activities; and
 - Austrade's delivery of a four year Automotive Market Development Program;

have been of little benefit to the aftermarket.

6.5.2 The restructuring of the industry has affected the aftermarket

“Proposed tariff reductions, combined with adjustment assistance, have seen major restructuring of the Australian automotive industry. The need to sustain the pace of improvements in productivity, quality and innovation remains as Australia approaches the APEC deadline of 2010 free trade. It is vital that the industry ... secure its all-important domestic base and to establish a substantial position in global markets¹³”.

The restructuring has led to changes in the composition of the Australian vehicle fleet and the age of the fleet, changes that are still continuing. The increased proportion of imported vehicles in the fleet and the potential for the age of the fleet to reduce exposes Australia's aftermarket manufacturers to international competition in the same way as Motor Vehicle Producers (MVPs) and Automotive Component Producers (ACPs) have been exposed to that competition.

AAAA contends that aftermarket manufacturing is only now feeling the full impact of international competition as a result of the restructuring of the industry. For this reason

¹³ Automotive Action Agenda, Department of Industry Tourism and Resources website.



alone, the aftermarket should be a full participant in any Post 2005 Assistance Arrangements for the industry.

6.5.3 A seat at the table

The primary function of the Automotive Trade Council is to develop strategies that open up export markets for Australian made automotive product.

This Submission examines the aftermarket's export performance, a performance that has been achieved without access to the support presently available to OE manufacturers.

Aftermarket manufacturers were eligible to participate in the Export Facilitation Scheme (EFS) established under previous assistance arrangements. Since the cessation of EFS and the introduction of ACIS, aftermarket manufacturers' "export propensity" has reduced. For example:

- AAAA has, for many years, facilitated exhibits by Australian aftermarket manufacturers at the Specialty Equipment Market Association annual exhibition in the USA, an exhibition that has generated many export orders for the manufacturers. Since the cessation of EFS, participation on the AAAA stand has fallen from 20 exhibitors to 8; and
- Previously, Austrade has assisted aftermarket manufacturers by assisting with the cost of exhibition space at international trade shows. Since the cessation of that funding, AAAA has been forced to reduce the size of the Australian exhibition at Automechanika Frankfurt, an important industry trade show, by 60%.

6.5.4 There should be aftermarket specific assistance arrangements now and after 2005

As a demonstration of the Federal Government's commitment "to a viable automotive manufacturing sector", we submit that:

- the Post 2005 Assistance Arrangements for the industry should include elements that are "aftermarket specific"; and
- because there is a hiatus of over two years before the Post 2005 Arrangements become effective, the suggested arrangements should be introduced forthwith.

These arrangements should recognise that:

- The aftermarket is the Third Sector of Australia's automotive manufacturing industry; and
- The majority of Australia's aftermarket manufacturers are SMEs.

These arrangements should:

- Support the R&D activities that underpin the aftermarket's high level of innovation;
- Support the growth of the sector through a "best practice" diffusion program that emphasises training, quality and effective use of IT;
- Support the growth of the sector by assisting to make the industry "export ready" and in taking their product to market.

Finally, the aftermarket is less constrained in its activities than most of the industry's ACPs. Australia should take advantage of the opportunities presented by this freedom by providing the support we recommend.