



HELLA AUSTRALIA PTY LTD

SUBMISSION TO THE PRODUCTIVITY COMMISSION REVIEW OF POST 2005 ASSISTANCE ARRANGEMENTS FOR THE AUSTRALIAN AUTOMOTIVE INDUSTRY

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EXECUTIVE OVERVIEW

Hella Australia believes that a level of on-going support for both social and economic reasons is required for the automotive industry due to the following key points:

- **The automotive industry has developed into a strategically important sector of the Australian manufacturing industry**
- **Upstream and downstream effects (linkages) on the introduction of skills based technology, education and learning are significant and critical to Australia's on-going economic and social development**
- **All significant and emerging economies recognise the value of maintaining a viable automotive industry, for economic, strategic and security reasons**

KEY ISSUES

The following are key issues that we believe the commission, and the industry as a whole, need to deal with in the future:

- 1. No further tariff reductions after 2005 (i.e. maintain general tariffs at 10%)**
- 2. Continuation of the ACIS scheme supporting on-going investment in R&D and technology**
- 3. Government action to open regional trade markets – particularly AFTA member countries**
- 4. Enforcement of regulations on ADR compliance including for replacement parts**
- 5. Introduction of more streamlined anti-dumping procedures to allow effective investigation of such activities**
- 6. Review the inconsistent tariff classification (5%) on imported 4 wheel drive vehicles that are essentially used as PMVs in the fastest growing sector of the vehicle market**
- 7. Openly address the industrial relation issues that are damaging the reputation of our industry and threatening the jobs and livelihoods of thousands of Australians**
- 8. Investigate additional tax incentives that could be made to the industry which are comparable to those offered in other jurisdictions**
- 9. Address environmental and safety concerns associated with the excessive age of Australia's motor vehicle park**

The nature and extent of future Government support to the industry should encourage the following attributes:

- **Continued investment in the development of skills based technology, and the introduction of this technology into supporting industries and into the education and learning industries**
- **Efficient and effective use of supporting industry measures (eg ACIS)**
- **The continued development of a competitive industry with a strong domestic base in support of export programs**

ACIS SCHEME

The ACIS scheme in its current structure is effective in encouraging important and significant investment into research and development, and the introduction of new technology into the Australian industry. We believe that post 2005, an ACIS type scheme should also consider:

- **The direct contribution of each participant to a more viable, competitive or relevant automotive industry – within the context of the Global industry**
- **A recognition of the relevance of export sales to the support of the industry as a whole (i.e. ACIS should be aimed at improving the performance of the entire industry – not at supporting export opportunities of individual participants)**
- **the appropriate level of total support required by each sector of the industry**

COMPANY PROFILE

Hella Australia is part of a global corporation with an impressive track record of achievement as a supplier to the automotive industry.

- Operates a manufacturing facility that supports more than 520 employees
- Is a manufacturer and distributor of automotive lighting equipment, as well as plastic mouldings and a broad range of automotive accessories
- Has extensive design and development facilities, and testing laboratories
- Has demonstrated commitment to its longevity by recent and currently planned investments in multi-million dollar production plant and equipment
- Has access to state-of-the-art technology for automotive lighting and electronics from within the Hella group
- Is part of the Hella global network, but holds a unique position, due to its in-depth technical competence in lamp design and development
- Is supporting 120 local parts suppliers and their local suppliers
- Has introduced technologies to Australia that would not otherwise exist in this country
- Has been instrumental in encouraging Hella KG Hueck & Co, its German parent company, to establish a Regional Headquarters in Melbourne which now provides services to 11 manufacturing subsidiaries in the Asia Pacific Region.

1. HELLA AUSTRALIA'S INVOLVEMENT IN THE AUSTRALIAN INDUSTRY

1.1 Hella Australia

Hella Australia has been directly involved with the supply of automotive components to the Australian industry since the company's start-up in 1961. Our company motto is: "from concept to reality..." We are a subsidiary of a global group operating in the automotive industry and benefit from product and process development that membership of such a group offers. The Hella philosophy has always been to establish facilities in order to become a provider of product and services to the local OEMs, and to service the local market. Hella recognises the Australian industry as part of the global automotive industry, but we also appreciate that its on-going development means that there are some important issues to confront.

Hella Australia currently supplies the majority of vehicle lighting requirements of the Australian OEMs. This market share is vigorously pursued by various suppliers including affiliated partners of the Japanese OEMs, as well as independent component suppliers in Asia. We have maintained our business in the face of this competition by integrating our design and development capabilities with our manufacturing capabilities. In so doing, Hella Australia offers a unique local capability to the industry.

1.2 Design Support for OEMs

The Australian OEMs do not generally employ engineers or designers in areas of supplier-sourced specialist componentry. This includes automotive lighting. At Hella Australia our designers work in conjunction with the vehicle stylists and designers from the early stages of development. During this development phase, the challenges of the physical appearance of the motor vehicle need to be balanced in line with the introduction of new lighting technology and systems. This is also apparent during the very important "facelifts" that most vehicle platforms go through at least once during their lifetime. The styling lines of the vehicle can be significantly altered by the introduction of new lighting designs, and Hella's design engineers work closely with vehicle stylists to achieve the appropriate outcome – whilst achieving optimum performance and fulfilling the requirements of Australian Design Rules (ADRs).

1.3 Investment

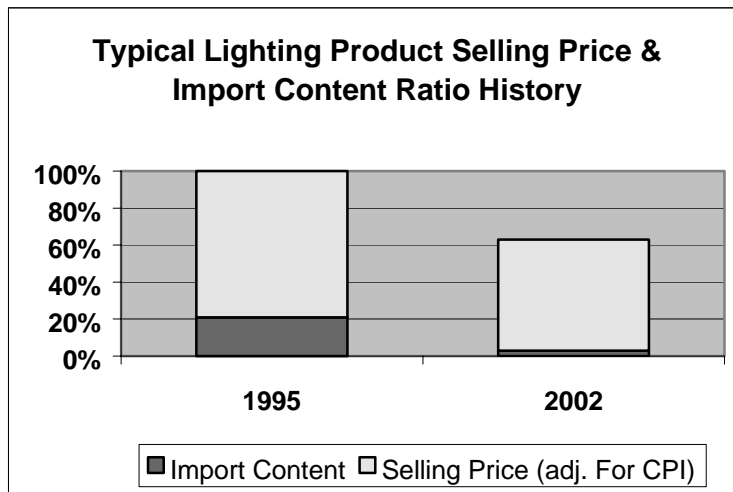
In the last five years, Hella has directly invested more than \$17mio into its Australian subsidiary. Furthermore, tens of millions of dollars of additional investment has been directed into the Australian economy as part of tooling contracts managed by Hella on behalf of the OEMs. During this period, the industry has struggled to adjust to globalisation. In Australia this has been particularly significant as the local industry has faced the necessity of lower costs and increased productivity due to the tariff reduction program that has been in place.

Over recent years, while the Australian industry attempted to come to terms with the flood of imported vehicles, particularly from countries in Asia (South Korea), Hella continued to introduce new technology into its Australian operations as part of its coordinated approach to localisation and cost reduction. This resulted in technological advancement for the industry as a whole. In 1997, Hella invested \$4.5mio into a polycarbonate headlamp lens facility. At that time, all Australian built vehicles (and most imported vehicles) used glass lenses. Now all new vehicles make use of this safer and more reliable technology – Hella manufactures these lenses locally. The previous situation was that 100% of glass automotive lenses were imported. This technology also offers the stylists at the OEMs greater freedom for new styling concepts.

1.4 Improved Competitiveness

The impact of introducing new technology and process improvements and the effect of global price pressures can be seen in the following chart.

During the period between 1995 and 2002, the selling price of a typical Hella Australia product for an Australian manufactured vehicle fell by 28% in real terms, and by 39% if adjusted for CPI inflation. During this same period, the level of imported content reduced from 21% to around 3%. Similar results have been achieved throughout the industry. As a result, Australian built vehicles, given the features offered, and the standard of manufacture, are now significantly better value than they were 10 years ago.



1.5 Local Content

In total, local employment costs and the local purchase of raw materials, fabricated components and services and supplies accounts for 80% of Hella’s total operational costs in servicing the local vehicle building industry. The only significant alternative suppliers of PMV lighting are off-shore. Hella is committed to maintaining its facilities to provide this local content for as long as it is economically viable. We believe that this is a crucial issue, the importance of which is often overlooked when evaluating the significance of our local component sector. It is an important factor, which underpins the local manufacturing industry.

1.6 Engineering and Tooling Costs

It is also important to recognise that, relative to other developed countries, for instance in Western Europe and USA, the engineering development and tooling costs in Australia are very competitive. Tooling costs compared to Germany are as much as 40% lower. However, the local competition nowadays has moved towards developing countries, and these economies as well as benefiting from lower unit costs of employment (supported by reduced employment-related taxes and a more casual interpretation of employee welfare), are offered significant Government support. It is important that these significant economic (and cultural) differences are recognised by the Australian Government if we are to maintain a viable and robust local tooling industry – which in turn, is essential to maintain a local automotive industry.

1.7 Australian Design Rules (ADR)

Hella Australia operates its own NATA approved laboratories, and is therefore able to certify products as being ADR compliant. Because of this we take the requirements of ADR very seriously. The provisions of our ADR license require that our products are regularly and independently tested for Conformity of Production (COP). We are

concerned, however, that the same rules do not apply to imported componentry which enters the replacement or service industry market. The law, as it currently stands, does not explicitly require that imported replacement parts meet ADR. Because of this we are concerned that non-compliant parts are being imported into Australia and fitted to vehicles that are driving on Australia's roads with scant regard for the safety implications. This is not a new issue, but it must be adequately addressed.

1.8 Market Size and Critical Mass

The local automotive industry continuously confronts this issue. This particularly affects supplier companies like Hella who are involved in each new vehicle development phase – including facelifts. The low level of production build in Australia, limits the opportunity to recover development funds and increases unit cost. The industry has struggled to come to terms with this in the light of the increased competition for capital from other vehicle manufacturing locations around the World. The international OEMs and the global component supply companies are now investing significantly into emerging economies, and the Australian industry and economy must be competitive if it is to attract this investment. The ACIS scheme has been a direct reaction to these industry requirements, and has encouraged investment that would not otherwise have occurred in Australia.

2. AUSTRALIAN EXPORT OPPORTUNITIES - ISSUES

2.1 Investment Funds

There is intense competition for the investment funds of global companies in the industry. Capital is a scarce resource, and competition for capital is a commercial reality. Multi-national companies are required to present a business case to their respective headquarters for allocation of investment funds. Due to Australia's mature market with limited growth opportunities, the allocation of investment funds is becoming increasingly difficult. Other emerging markets, such as China, are competing for these funds, and are increasingly obtaining preference over Australia.

2.2 Tariffs

Australia is now one of the most open economies in relation to automotive parts and vehicles. Even the USA has tariffs of 25% on light commercial vehicles, trucks and Sports Utility Vehicles (SUV) – this market segment represents 70% of 16.5 million vehicles. In Australia, the majority of such vehicles are, (as a consequence of an unintended anomaly), subject to a tariff of 5% upon importation.

Tariffs on components in Thailand range from 10%-46%, Malaysia from 25%-42% and Korea from 10%-13%, just to name a few possible markets. It is often uneconomic to export into those markets due to tariff (and non-tariff) impediments.

2.3 Trade Barriers

Non-tariff protection in competing countries also includes tax incentives for the establishment of manufacturing facilities, employment subsidies and so on. These arrangements restrict the opportunity to export into these countries, and global companies are encouraged into direct investments, licensing and joint venture arrangements in order to enter those markets. This makes it even more difficult for Australian companies to directly export into these markets.

2.4 Threats to Export Markets

Key export markets of the industry are vulnerable as other carmakers or component suppliers from developing economies, such as China, enter them. These emerging economies have access to significant assistance schemes, including investment incentives, tax concessions, regional development incentives and other government support mechanisms.

2.5 Competition

Cost competitiveness with developing regional countries is becoming more difficult with the increased competition from emerging economies such as Thailand, China and South Korea. These economies do not have impediments to business such as pay-roll tax and worker's compensation and leave benefits (at least to the same level as Australia). Industrial relations in Australia are complex and disruptive. Substantial real reform must be achieved to provide a more competitive, efficient and flexible working environment.

2.6 Export Opportunities for HA

Hella Australia has been for a number of years self sufficient in relation to the design, prototyping, testing and manufacture of its products and offers a compete service to current and future customers. This capability is being promoted to obtain contracts for niche products. This capability was established to meet the requirements of local vehicle manufacturers. Hella Australia participates in the export programs of the local vehicle manufacturers in developing unique products.

3. STRATEGIC ROLE OF AUTOMOTIVE INDUSTRY IN AUSTRALIA

3.1 Skills Development

The automotive industry in Australia is a strategic player in the country's economic and knowledge base development. It has been referred to as the "nursery of engineering skills". The industry has developed skills, technologies and management disciplines, which flow into other business sectors. Over the years, the automotive industry has been the "trailblazer" for many advances in quality systems, productivity, management practices, supply chain management, R&D, just to name a few. These developments have and will continue to occur due to the highly competitive nature of this industry. If the industry were to disappear, other manufacturing disciplines would suffer due to the reduced availability of a trained workforce, which had previously emanated from within, or around the automotive industry. These skills would be lost to the country – not just the industry.

In this regard, the industry can claim a "special" importance warranting "special" recognition.

3.2 Upstream and Downstream Effects (Linkages)

The automotive industry plays a very significant role in supporting a multitude of other goods and service providers within the Australian economy. If we take the workforce of Hella Australia as an example, we can see clear evidence of this. Approximately 50% of Hella's workforce are actively involved in manufacturing. The balance includes engineers (in several disciplines), sales and marketing personnel, logistics and distribution personnel as well as managerial, supervisory and professional staff in various fields. These statistics relating to just a single component supplier illustrate the depth and breadth of the industry, and provide a clear understanding of just how much influence and effect the automotive industry has on the economy and on the Australian society as a whole.

3.3 Import Replacement

A key role for the automotive industry is import replacement. This receives little publicity and is "unfashionable" at present. Within the balance of payments, this is as important as achieving export growth. The same issues of profitability also apply – as they do to exports – this activity is needed to support the economic development of Australia, it does not hinder it. The significant productivity and pricing improvements that have been referred to elsewhere in this document, give evidence of the automotive industry's efforts to achieve a positive contribution. In vehicle sales alone, the industry is responsible for import replacement of around \$5.0billion, and this number would increase significantly if other spin-off activity was taken into account.

The massive increase in imported vehicles following the reduction in tariffs, has of course resulted in a major turn-around in the industry's overall affect on Australia's trading performance. As the following charts show, the trend in imported vehicle sales, relative to total vehicle registrations, has reversed the previous ratio of local to imported vehicles. This is a disturbing trend for the local automotive manufacturing industry.

Figure 1 Australia Local VS Imported Vehicles (1987-2001)

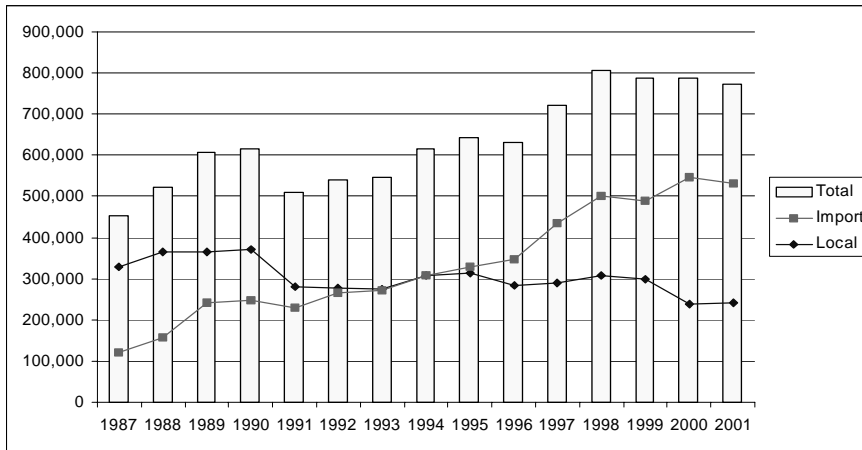
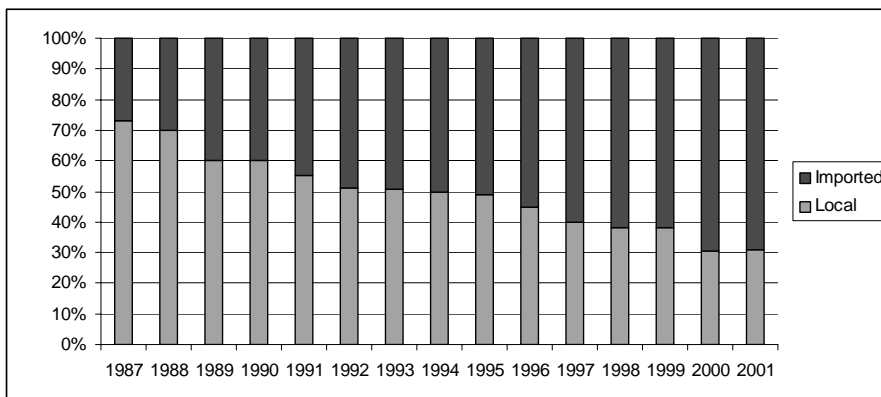


Figure 2 Market Shares (%) of Australia Local VS Imported Vehicles



3.4 Critical Mass

There are currently 4 OEMs, who are being supplied by local component suppliers. At some point the industry will reach a critical mass – not just for vehicle assembly, but also for the viable existence of the supplier base at all levels, as well as associated services such as toolmaking, and also in the support of educational services, etc. The recent concerns over the existence of Mitsubishi’s manufacturing facilities in Adelaide are a good example of this. It is recognised by most participants in the industry that productivity goals must be pursued, but the impact of volumes on cost and the need for a critical mass must also be acknowledged. At Hella Australia, we are operating our current facilities with excess capacity, and although we have strategies in hand to address this it remains a concern if the volume of vehicles manufactured in Australia does not increase.

4. ACIS AND FUTURE SUPPORT FOR THE AUSTRALIAN INDUSTRY

4.1 Competition for Global Investment Funds

The Australian automotive manufacturing industry competes within the global industry for investment funds. In all major economies and most developing economies of any significance, governments actively support their automotive industry.

The reasons for this are many, including:

- The flow-on effect to the rest of the economy (linkages)
- The growth of support industries (spin offs)
- The development of education and training institutions (knowledge development)
- National security concerns
- Effect on the balance of trade

4.2 Current Industry Support

We have already discussed the strategic role of the automotive industry, and the export issues that confront Australia. Current economic support for the industry, includes tariffs (headline rate = 10% after 2005), and the ACIS scheme which currently runs until 2005. There are some other general export support programs, and specific R&D programs – but these do not directly target the automotive industry.

Previous Government support has focussed on import restriction (tariffs and local content rules) and a level of export support, particularly through the export facilitation scheme. The current ACIS scheme focuses specifically on research and development, and on encouraging the introduction of new technology. This has the double effect of supporting import replacement industries and creating export opportunities through improved local design and manufacturing capabilities. This is both effective and correctly targeted.

4.3 Tariff Reductions and Localisation

The local industry has responded in a very positive way to the massive reduction in tariffs that have occurred over the past 14 years (from 57.5%), and the foreshadowed reduction to 10% in 2005. Australian manufactured vehicles are now more affordable, they include a much higher level of features (including safety equipment), and offer some unique features that are attractive to both the Australian market and some significant export markets. Australian component suppliers such as Hella, have also significantly increased the local content of key components. In addition to import replacement, this has had the added benefit of increasing the knowledge and technical expertise of other sectors of the Australian manufacturing industry, including, for instance the local tool making industry.

Hella Australia has sponsored selected local toolmakers in the introduction of new know how and in the development of skills that would not otherwise exist in Australia. The toolmaking industry and the community are better off as a consequence.

As a result of this, Hella Australia can now contract the supply of very sophisticated plastic moulding tools to local Australian toolmakers. This includes:

- Multi-coloured signal lamp lenses
- Polycarbonate lenses
- Thermoset headlamp reflectors

Previously these tools and components would have been imported. This knowledge and skill is now in the public domain.

4.4 Future Support

Future support for the automotive industry must continue to focus on encouraging the growth of technology, with a view to ensuring Australian facilities are globally competitive (in both technical competence and value). A level of tariffs to reduce the risk of unwanted “dumping” will most likely be a necessity. As well as this, and given the relatively small scale of the Australian industry, it is essential to encourage the global vehicle manufacturers and their supplier base (the significant players of which are also generally subsidiaries of global companies), to maintain and/or install the latest level of technology, and to continue to invest in Australia.

Australian built vehicles must, in order to remain attractive to local customers as well as to current and future export markets, include features or options that are available in other comparable markets.

Again, a key issue is the relative size of the Australian industry and its local market, and the limitation of the size of Australia’s overall economy and its population. Continued investment in the automotive industry in Australia, needs to carefully balance out the flow-on effect to the general economy against the actual cost of any support – both direct and indirect. It is essential to understand both the positive and negative effects of Government support to the industry on the overall standard of living of all Australians.

4.5 The Necessity for On-going Support

In earlier sections of this submission we have highlighted the impact the automotive industry has on the local, regional and national economy. We have also illustrated how the on-going pressure on the local industry to increase productivity has resulted in significantly cheaper products, offering higher levels of technology and with increased levels of local content. This has, however, come at a significant cost. As the global industry has been transformed, and we have maintained the required level of service, and new investment into our operations, it has placed financial strain on Hella Australia – a situation that has been observed by our global parent.

In the light of this, we acknowledge that the ACIS scheme has both supported and encouraged new investment within the industry, and if it is successful it will lead to a more competitive and viable industry. The concern is however, that the global industry is dynamic and any “gains” are short-lived. We must therefore be confident of on-going, targeted industry encouragement – to support our campaign to attract the global investment needed to maintain the technology levels necessary in the industry.

4.6 Continued Investment

Global operators will certainly continue to “require” incentives if they are to continue investing in Australia. This is not an argument in its own right, but it is also necessary if Australia wants to support the continued “spin-off” investment into other industries in the economy, including:

- The general manufacturing industry
- The education and training industry
- The services and technology support industries

4.7 Future ACIS schemes

Future schemes based on the ACIS concept should work towards effectively identifying which R&D activities are supporting the general goal of improving the competitiveness of local industry. This may mean, for instance, ensuring that R&D investment (including any associated ACIS support) has actually been used to develop improved facilities and introduce new technologies and/or new or improved processes.

5. CONCLUSION

We believe that the Australian domestic automotive industry is critical to Australia's continued development as a modern, independent knowledge based economy. It is globally competitive in some product categories and can continue to be so.

The industry has accepted the challenges that have confronted it over the past 10 years in particular, and has made a great deal of progress. This would not have been possible without effective and targeted support arrangements.

The contribution to the Australian society and economy can not be underestimated. The linkages to other industries, and to knowledge and skill formation is profound, although difficult to measure in its totality.

A strong and viable automotive industry cannot exist without a strong and viable local component industry. It is therefore important for both the industry and the nation, that post 2005 assistance arrangements be:

- Well considered
- Well targeted, and
- Well implemented

We trust that the Productivity Commission will consider these points, and the arguments that we have outlined above in reaching its final recommendations.

Peter F. Doyle
Managing Director and CEO
Hella Australia Pty Ltd