event transcript

CEDA
COMMITTEE FOR ECONOMIC DEVELOPMENT OF AUSTRALIA

Launch of the Competing from Australia Project Report

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Address to CEDA, Melbourne, 09/07/07

Let me first congratulate CEDA on what I think is an outstanding and comprehensive report. And the timing of it is absolutely spot on because we're currently witnessing in this country an intense debate about the drivers of our future prosperity. Can we continue our current, very prosperous economy? We're having a debate about productivity growth. A debate about our workplace relation system, about education and training and how we create the skilled workforce that our industries need and a number of other items in that national debate. At the same time we have got many Australian companies facing major shifts in the relative competitiveness and in the global structure of the sectors in which they compete. The rise of China is presenting new markets for many but also placing enormous competitive pressure on others. The resources boom has raised the spectre of the so called 'Dutch disease'. The idea that investment and resources might crowd out investment in other sectors such as manufacturing. And of course the high Australian dollar is a mixed blessing. It makes imports cheaper but our exports are less competitive. And industry consolidation continues at pace and in many industries global sourcing arrangements are making it harder for Australian suppliers to stay in the game. And of course we have that perennial worry that Australia is a small country, a long way from export markets. So this morning I want to cover really three broad topics. First a brief overview of the sector I'm most familiar with which is manufacturing and the challenges of competing from Australia in that sector. I want to give a few practical examples of some of the successful strategies that have been adopted by Australian companies I have been associated with, mainly positive but I'll highlight a couple of negatives and how you can grow markets from Australia. And finally the lessons I have learnt over my 30 years competing from Australia and a couple messages from that for policy makers.

It is important to start from a premise that manufacturing continues to make an important contribution to Australia's prosperity despite prophecies of doom and gloom from some quarters. Manufacturing contributes about 11% of Australia's GDP and while that is a declining number it's still larger than either the mining sector which is about 7½% so 11% verses 7½% or agriculture which on a normalised basis about 3%. We are not different though from other development countries in that services at about 78% is the biggest contributor to our GDP but again manufacturing employs about a million Australians and I think importantly is the largest source of private sector investment in research and development spending.

When I first started exporting and investing offshore in the early 80s, the idea that Australian companies needed to seek growth outside of Australia was relatively uncommon. Today of course it's widely recognised as an important growth strategy for Australian companies. So for these companies domestic markets are often small, often mature and the growth options become limited. So domestically focussed manufacturing operations often lack that scale, the world scale that can enable them to be competitive. So for these companies growth offshore either through exporting, through investment in offshore manufacturing facilities or a combination of both has been critical to their success.

Generally developed companies in developed countries have used two strategies to globalise and remain competitive. And the first strategy has been to relocate domestic production into lower cost countries using new capital equipment but retaining product development and R&D as a core capability at home. And that strategy first became I guess fairly well documented when the Japanese outsourced their auto components and whitegoods businesses into the Asian companies back in the early 1980s. Typically that strategy relies on low labour costs, high capital productivity based around new plant and equipment and good labour productivity. It is of course a pretty low risk strategy because the markets were already established, the brand name is established and the companies that use that typically are not particularly concerned about local market access where they are manufacturing but rather to use that market as a basis for low cost exports to their established markets.

The second strategy is one that's been followed by many Australian companies and that's perhaps because they lack global brands and it's focussed on participating in fast growing offshore markets and becoming part of global supply chains. We've got close to three billion people on our doorstep in countries such as China and India, rapid economic growth and very large middle-classes and they are obvious target markets for Australian companies.

And if we then look at how does one access Asian markets, Investment by Australian companies to service these Asian domestic markets generally again fall into two categories. First, large investment in state of the art facilities to produce Australian standard product for domestic Asian markets. There's a danger in that approach. It's fairly easy to produce the quality of product and although the markets are large as a whole the demand for premium products in the premium segment is often not sufficient to deliver the required volumes and margins in the reasonable timeframe and I think you can all think of a few write-offs of companies that are invested in that area and been unsuccessful. In addition to that in some countries foreign investors also face major problems in distributing their products due to inadequate local infrastructure. So the investments I have been associated with have placed a high priority on risk mitigation. So companies in this category typically will take relatively small investments, test the water as they learn more about the local market and grow with the market. In other words they let their investments grow with the market and don't bet the farm.

So let me now just give you a few practical examples of this model. As CEO of Pacifica back in the 80s we started a Malaysian automotive parts business supplying Japanese customers with whom we already had established links and then moved into plastics packaging businesses, again starting in Malaysia. And when I retired from Pacifica we had ten plants in Malaysia, Thailand and China making a range of products and all were profitable. They were all meeting our return on investment hurdles and so you would say a pretty successful strategy, fast growing businesses. The negative was we had at the end of that ten relatively small fast growing businesses, not a great deal of synergy between them.

As Chief Executive of SouthCorp in the 90s we established a relatively large water heater plant in China, six packaging plants in Indonesia, Malaysia, China and Thailand and we built these with relatively small investments, again not betting the farm and we made good quality products which of course is the easy part. But we did find market segmentation an issue and our understanding of it. We were running our water heater plants profitably, volume and growth though was slower than we had anticipated. Primarily because the market for super premium product, the Australian designed product was smaller and growing less quickly than we had anticipated. So when we introduced a second tier Chinese design model we were able to fully load the facility and then create a successful operation.

If I can just give you a couple of examples then from my non-executive experience and just quickly Brambles, worlds leading pallet supplier. Some 250 million pallets around the world. It's the market leader in the supply chain for fast moving consumer goods in just about every developed country in the world. But in emerging markets the demand for pallets is less developed. So for Brambles the market entry strategy in China for example has been to develop a new generation of pallets, innovation and to look for closed loop systems. Looking at beverage suppliers supplying to western type supermarkets in China. In other words a mini supply chain. And at the same time we are working with the regulatory authorities to police overloading of vehicles and to establish standards for a delivery of goods. So the broad objective there is to establish the position early and have a first mover and advantage in part of what is a long-term growth strategy for Asia.

And I would now like to just give a few examples from Bluescope who which I think has a very interesting Asian strategy. Bluescope Steel is a global company, over 18,000 employees and servicing customers from 90 manufacturing plants and many sales offices and operations through 17 countries. And importantly on a global basis we export about a third of our production from wherever we happen to manufacture it. Our overall strategy is to build on our very strong Australian base to develop multi-domestic businesses. We focus investment growth in the Asia Pacific region and then use it to stage approach to market growth. Firstly building market niches in building and construction and then integrating backwards after priming the market. Our first stage is comprised small investments in downstream Lysaght, [Rolf Warming] operations that produce steel roofing, cladding and other building products for Asian domestic building and construction markets. A typical investment here is around $20 million so you are not betting the farm but we now have 24 of these plants throughout Asia from India to China. To support this investment we've established out brand credentials, a very important component, by winning contracts to supply a number of high profile trophy sites. And that's particularly been the case in China. So you have venues such as the Beijing International Airport, the Qinhuangdao and [Tenzhien] Sports Stadiums, metro stations on the new Beijing Olympic rail lines, the Jin Mao Tower in Shanghai's Pudong district and now the worlds tallest building, the Shanghai Finance Centre, all of those feature high quality Bluescope Steel products and provide very high visibility for our brands in the Chinese market.

How do we do that? Well the key to it has been a combination of the strong brand names of clean colour bond and zincalum but more importantly an innovative product specifically designed to cope with high humidity and polluted environments. So the first stage is that Lysaght's small investment. Second stage has been to vertically integrate upwards by investing in colour bond and zincalum manufacturing plants to supply both our own roll formers and indeed the competitors. A typical investment for one of these manufacturing facilities is much more significant, two or three hundred million dollars and today we have five of those in China, Malaysia, Indonesia, Thailand and Vietnam with a further plant scheduled for India. The advantage of this two stage strategy is that we can prime and develop the market, get to know the market with relatively small investments and then when the major investment comes on stream that's the investment in a coding and painting plant, it's much quicker to achieve break-even volumes. The negative of that of course is that the supply chain issues in that two stage process are quite a bit more complex. And that just raises the issue that investing in Asia comes with risks, they include the market, the distribution and regulatory risks. So for example it's not unheard of for [Karafin] quota rates to change, sometimes quite markedly and even from the time you've had an investment approval to the time your plant is up and running. And of course there's always the risk of economic volatility as we saw in the Asian crisis in the 90s and more recently, following the Thailand coup. On the other hand there are plenty of advantages and many things we can learn. And one of the most interesting I think and most important is that the Chinese are absolutely expert at cutting red tape. The most telling example of many I could give here is that the difference between two Bluescope Steel investment decisions, one in China and the other in Australia, announced at the same time. The major Guangzhou plant in China has been operational now for nearly a year. The similar but much more Australian operation will come on stream later this year. Why that big difference? Most of it is due to the much more complex planning approvals processes in Australia. So that Asian story today we have 26 plants, 4,500 employees in nine different Asian Countries and we've planned to be in full production in all of those in 2009.

But the other strategy that is very important, it was mentioned in the CEDA report is to be able to compete from Australia by exporting. And to do this you need to have a sustainable competitive advantage. And that usually comes in the form of unique intellectual property, unique products, strong brands or a sustainable cost advantage over competitors in other countries. And innovation is clearly important. Not just product innovation but innovation in logistics in supply chains, in technical support, in after sale service and the bundling of products and services into a complete solution for customers. These strategies of course are not mutually exclusive. Bluescope steel is an example of an Australian company that's done both, in investments offshore but also continuing to manufacture in Australia for both the domestic market and for export. So from Australia about 50% of our product is actually exported to countries as diverse as the US, Korea, Thailand, Indonesia and the Caribbean. And that export program has a few lessons in it I think. In our upstream markets for products such as slab and hot roll coil, our competitive advantage is built on low manufacturing cost, long-term relationships with core customers and products that are very much optimised for these customers needs and part of their supply chains. So Port Kembla here is a world class steel works with a very competitive position on the world cost curve. That position has been eroded somewhat recently simply by the strength of the Australian dollar but its competitiveness is underpinned by factors such as the high quality raw materials locally sourced adjacency to a very quality deep water port and also I think by our investment over many years in plant and equipment which is world class but also investment in our people. So how do we export from that facility? In the US we've had long-term relationships with core customers. We've optimised the steel coating and the painting operations or rather they have to take the particular grade and quality of the feed stock that we supply. And the same long-term relationship with the same element supplies to a major customer in South Korea, the Don Cook Steel Company.

In midstream markets our export success is built on strong brands, the colour bonds and zincalums and the intellectual property that sits behind them. Colour bond for example is a product that is developed, refined by Bluescope in Australia and provides superior performance attributes to many of our competitors and particularly the clean colour bond in Asia.

So what does all that tell us about competing from Australia? Well firstly I think that there are great opportunities for Australian companies to compete globally but frequently this does not mean investing solely in Australia or making everything in Australia unless you've got some genuine sustainable competitive advantage. I think it also tells us that incremental investment that grows with your markets can be a good way to mitigate risk, that local market knowledge and understanding of the segmentation of markets is absolutely critical. Long-term relationships with customers and ability to integrate into their supply chains is important. And it's important to understand and leverage the sustainable competitive advantage. In our case our low cost manufacturing position, our unique brands, our quality products and the market niche that we've carved out for ourselves in the building and construction sector. So they're lessons for businesses. I think there are lessons also for our policy makers and one of these is the critical importance of a competitive Australian regulatory environment.

And a very important area of regulation which is under quite some debate at the moment is the future climate change and greenhouse gas emissions policy. One of the foundation stones of Australia's manufacturing and resources sector is access to low cost energy based on our abundance of fossil fuels. We are already seeing pressure on energy prices particularly electricity as a result of the current drought, the recent cold snap in Eastern Australia and generation capacity going off line. The imposition of a carbon tax could compound this pressure if it's not very well designed.

For the steel industry carbon is an essential ingredient in the chemical process of making iron. You need carbon usually in the form of coal or coke to separate iron from iron ore in a blast furnace. As a result our upstream steel making plants are significant emitters of greenhouse gasses. It is important to note this is an absolutely unavoidable consequence of steel making. There's no alternative technology anywhere in the world that enables you to reduce or sequester those omissions. So steel makings not only energy intensive and emission intensive, it's also trade exposed. Over one third of the world's steel now made in China, a country whose steel industry does not face greenhouse gas regulations. So Bluescope and other steel makers compete against Chinese steel, not only in our export markets but also in the domestic Australian market. So the imposition of a carbon price on Australian steel industry alone would make it uncompetitive. We'd not be able to pass on a carbon price to our customers faced with Chinese and other competition. So the risk we face as a company and indeed as a country is that over time steel production moves to non-carbon constrained countries such as China, so called carbon leakage. This would of course do absolutely nothing to reduce global greenhouse gas emission. In fact it could increase it because the steel would still be manufactured but not in Australia. So all it would be achieved in that would be an outsourcing of our emissions.

There are a number of other emissions intensive trade exposed industries such as aluminium, cement, oil refining and mining that face similar sorts of challenges. And its important to remember that these industries make a very significant contribution to our current prosperity. So we need very carefully developed policies if we're to avoid putting this prosperity at risk.

I think it is important to say here that we are not advocating doing nothing about greenhouse gas policy and climate change policy. We think we ought to get on with and start the process in Australia. And we as a company are currently evaluating a major $750 million dollar project to take waste gasses that are currently flared to the atmosphere, use them to generate electricity and so reduce our demand on the grid. This would reduce our indirect greenhouse gas emissions by some 800 thousand tonne a year. That's the equivalent of taking about 185,000 cars of the road. So it's a very significant prize. But it's important to note that this investment has a very long payback period. So in order for us to be able to do it we need certainty that our Australian steel making operations won't be made uncompetitive by some unilateral imposition of a carbon tax, something that's not well considered. The scheme needs to be sufficiently flexible to recognise that competitive challenges faced by industries such as steel and to provide these industries with the very critical certainty about future regulatory frameworks.

The other key element I think for policy makers and is very relevant in this pre-election environment is the importance of a stable and harmonious workplace. And at Bluescope steel we don't talk about industrial relations or workplace relations but about direct engagement. That's the direct engagement of our management with our staff and an alliance that builds a trusting and mutually beneficial relationship. And I think it's important to say that for Australian companies to compete in global markets we require a single national system of workplace relations that's fair, that's simple and stable and which fosters greater investment and enables us to be internationally competitive. Now I think it's without being political fair to say the current regulatory framework provides most of those requirements, a mix of deterrents and protections to promote workplace harmony and frankly to us it doesn't matter which side of the political landscape is pushing the policy, it is absolutely critical that the policy be correct and whoever has that policy will be supporting that particular policy. And to give some flavour to that, since we listed in 2002 we have been able to make very significant progress with direct engagement with our people. Our employees have become more confident in discussing business and workplace issues generally and directly with the company. We've got greater industrial harmony by an enormous magnitude and this is related to greater productivity, far less supplier disruption, less stress to our customers, far less lost wages and frustration for our employees and that's the sort of direct engagement that is the basis for long-term prosperity for Australia.

One just small illustration of a benefit of the direct engagement policy is been that its been a major contributor to Bluescope Steel's world class safety performance. And I don't use world class lightly, through our 18,000 employees across 17 countries, our annual loss time per million hours worked is 0.4 hours and that is absolutely world class. One of the big contributors to that success of that program has been that 93% of our employees around the world as part of the direct engagement process voluntarily participate in safety audits in our businesses and that has been a major contributor to world class safety performance but you could give the same sort of messages about productivity and other components.

So from our perspective to go back to out-of-date, out-of-touch philosophies of the past which reduce workplace flexibility and impose third parties between us and our workforce would be a major blow to the ability of the Australian businesses to be competitive and successful.

There are a number of other areas we could talk about where ongoing reform is needed, corporate taxation, education and training and infrastructure. I won't talk about these today, they've been well articulated by CEDA, by the Australian Industry Group by the Business Council but they are important ongoing reform issues.

So I want to conclude by thanking you for giving me the opportunity to speak to you today to say that I am optimistic about prospects for Australian companies competing from Australia but policy makers have to be alert to the competitive threats to the Australian industry and mindful that the impact of policy will have not only on industry but on the prosperity of the Australian community as a whole.

Thank you.

Question

One of the things I found interesting in the address today was the assertion that in order to think internationally it is often important to have an overseas presence that you don't have to do everything in Australia to compete from Australia and we are seeing as described in the report more and more companies investing more and more overseas from Australia. Could you give us your thoughts on why it is that the volume of Australian ownership of overseas companies is going up so fast and do you think that reflects at least in part a desire by Australian companies to learn by being in overseas markets directly?

Answer

You know I think the answer is a combination of those things and it will be different for company by company but it seems to me the first driver is typically access to bigger markets and some of the fast growing markets and the excitement of that. But I think as people learn from those markets and see what is really I guess the relatively new phenomena of globalisation of supply chains comes the understanding that to be part of global supply chains you have got a far better prospect of being able to be part of those if you are in a number of companies, countries rather. But I think the other thing we talk about, about distance I think the other tyranny for Australia is the small size of our domestic market and so that not only constrains growth opportunities for companies but it means that when you look at global supply chains very few of them are driven out of Australia. They are driven out of China or they are driven out of the US, perhaps out of Europe, out of areas where there are big markets and big customers so that for us there aren't the obvious supply chains that we can join just because we happen to be in Australia so expanding our linkages around the world I think is pretty important.

Question

Phillip Thorp, Leichardt. Graeme, I hope this is not an unfair question but we've had successes but we've had some famous failures of companies that have tried to compete from Australia. Some have recovered and gone on to success. What do you think we learn from some of the failures and do you think our track record of investment from Australia and running companies from Australia is in better or worse than those of other international groups that have had other starting points of the best of the broad, a lot of [reinvestment] from abroad is *[inaudible].

Answer

Thanks Phillip. I think there is a couple of components to that. The first is I think we tend to beat up on ourselves a bit. We tend to look at the failures. In fact there are an enormous number of Australian companies who have done very well and very successful outside Australia, I mean NewsCorp would be probably the most obvious, a small afternoon newspaper in Adelaide to the global giant that it is today. But you look at Brambles, 85% of Brambles product and markets are outside Australia and you take the top 50 companies in Australia outside the banking sector and just about all of them have 40%, 50% perhaps more of their production or not necessarily their production but their markets outside Australia. So I think actually in total we are pretty good at it but then the element of your question, what do we learn from these failures? I think it's about, to me it's about risk mitigation because clearly there's less risk involved in if you've got the growth opportunity and investing for growth in Australia and market you know the culture, you know all of those things and some of those things you don't even know you know, they are kind of inherent in your background knowledge. So the minute you go into different countries even though they may seem similar, similar customs and whatever, in fact there's a lot of differences in the way businesses run. So you really I think need to think about what are your risk mitigation strategies which can be market research and obviously that's important, product analysis and market segmentation. But even when you do all of that you still can have some problems. I mentioned the water heater example in the US. There’s a couple of major breweries here who know I am sure made very good quality beer in China but found they couldn’t distribute or the market wasn’t big enough so I think the Bluescope example I think is a terrific one of the small investment don’t bet the farm but with a vertical integration strategy. Each company needs to think of its own but it needs I believe to be cognisant of the risk in offshore markets but also the huge opportunity and make sure they do a lot of work before they put significant investments offshore.

Question

Graeme, Ben Fosket from Invest Victoria. One of the clear changes in the Australian economy is the growth of the service sector and being on the account of more than 60% of the Australian economy in the services sector. Your *[inaudible] today was to talk about manufacturing that you also have very significant service sector experience. What do you see is the opportunity in this context for the service sector here?

Answer

I think there’s enormous opportunity for the service sector and I think from a bit of a distance that we have probably been – if we go back a while and think of the inter-relationship between Australia and Colombo plant students in most of Asian countries and many of those people went on to become senior bureaucrats, politicians. I think it took us a long time to take advantage, not just in the services sector but also in the manufacturing sector to take advantage of those potential links but there are clearly the opportunities which are I think now are starting to be taken for us to leverage the fact that we have so many people out of Asia studying in Australia into expansion of our education services, our health services and the like. So I think there’s big, big opportunity there. I suspect the lessons and the elements are not so much different from what I was talking about in manufacturing. You need to be innovative. You need to have a competitive advantage. Those sort of elements will also be in the mix I think.

End of transcript