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Date 12 June 1989

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**AUSTRALIA - UK TRADE AND INVESTMENT CONFERENCE: STUDY BY
COOPERS & LYDRAND**

As you know, my Secretary of State and his Australian opposite number, Senator Button, jointly commissioned a study from Coopers & Lybrand earlier this year in preparation for the Australia-UK Trade and Investment Conference on 22 June. The consultants were asked to analyse the trade and investment between the UK and Australia, and to identify obstacles to and opportunities for further development of trade and investment between the two countries.

Coopers & Lybrand have now submitted their study, and a copy of the Executive Summary is attached. My Secretary of State wanted the Foreign Secretary to be aware of its contents, and of how he intends to respond to the suggestions in Chapter 7 for Government action, before the Conference.

The study contains the welcome conclusion in section 1 that a new dynamic Potential began to emerge in the bilateral trading relationship in the late 1980s. It states clearly in section 4 that the UK has advantages over the rest of Europe as an investment location for Australian companies, both in itself and as a springboard (or expansion into the Single European Market. The study also concludes in section 5 that Australia offers UK companies advantages as an operating base for attacking the Asia-Pacific markets. These conclusions are as welcome to us as I expect they will be to the Australian Government.

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Section 6 of the summary gives the consultants' recommendations to businesses - to take advantage of the new trading opportunities offered by 1992 and the expansion of the Asia-Pacific region they need a change in perceptions and strategic thinking. In brief, they need to consider whether collaboration with other firms would be advantageous.

The study suggests, in section 7, that the UK should continue to press for reforms in the Common Agricultural Policy through the European Community; and that the UK and Australian Governments should lobby through GATT negotiations for reductions in manufacturing and especially services protection. The report also suggests that there are a number of areas of mutual interest which could form agenda items for a strengthened relationship between the DTI and DITAC (Senator Button's Ministry) and the Australian Trade Commission. The first two of these suggestions are in line with existing Government policy, and the third is acceptable. My Secretary of State will respond positively to them in his keynote speech at the Conference.

The only possibly contentious suggestion in section 7 of the report is that "both the UK and Australia need to communicate better their rules regarding competition policy and mergers and acquisition activity and, where these are demonstrated to be restrictive on trade and investment flows, to seek to reduce the restrictive elements". My Secretary of State thinks this is just about acceptable, but he intends to include a major passage in his opening speech to the Conference making it clear, as he has done in previous speeches, that foreign investment is welcome and that UK competition rules do not restrict it.

I am copying this letter to Charles Powell at Number 10 and Duncan Sparkes at the Treasury.

Yours ever

Ben Slocock

BEN SLOCOCK
Private Secretary





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AUSTRALIA – UNITED KINGDOM
TRADE AND INVESTMENT INTO THE '90s

**A STUDY OF
AUSTRALIA-UNITED KINGDOM
TRADE AND INVESTMENT**



AUSTRALIA - UK TRADE AND INVESTMENT

SUMMARY OF A REPORT

PREPARED BY COOPERS & LYBRAND (UK AND AUSTRALIA)

FOR

THE UK DEPARTMENT OF TRADE AND INDUSTRY

AND

THE AUSTRALIAN TRADE COMMISSION

1 AUSTRALIA - UK TRADE AND INVESTMENT: MARKET DYNAMICS

Respective traditional strengths provided the historic base for trade. But in the 1970s the two countries focused on different markets - the UK on Europe and Australia on the Asia-Pacific markets. A new dynamic potential began to emerge in the bilateral relationship in the late 1980s.

Traditional strengths

- Australia's vast agricultural and mineral resources were the foundation for exports to the UK dominated by primary products and processed food and minerals (agricultural products, materials and coal represented some 50% of Australian exports to the UK in 1987).
- The UK's strength was in machinery and equipment, chemicals and consumer products, serving the Australian consumers with their import requirements (chemicals and machinery and transport equipment comprised 60% of UK exports to Australia in 1987).

Changing Regional Focus

- From the early 1970s the relative importance of trade between the two countries declined dramatically. 17% of Australian imports came from the UK in 1973; by 1987 the figure was 7%; over the same period the Australian share of UK imports fell from over 2% to less than 1%. What happened?
- As a result of the UK's accession to the EC in 1973, both countries became more closely aligned with their different regional markets. The UK's trade shifted to Europe (half its exports going to Europe in 1987) while Australia looked more closely at the rapidly growing Asia-Pacific markets (half its exports went to these markets in 1987) where it could exploit its natural resource advantages.
- The UK's major investment presence in Australia was founded mainly on natural resources and services. Here too there was relative decline as other locations became more important to UK investors and other countries sought to take advantage of Australian opportunities. The UK share of overseas investment fell by one half from 40% in 1970 to 20% in 1987. The UK was replaced by the US as Australia's largest overseas investor. But it remained the second largest investor in Australia.

Changing Pattern of Exports

- Something began to happen in the Australian pattern of exports to the UK in the mid 1980s. Over 12% of Australian exports of electrical machinery went to the

UK in 1987 - double the 1973 share. Whilst the UK pattern of exports remained broadly unchanged, other EC countries seemed to be adjusting to new opportunities in the Australian market.

- There were some significant developments. New products based on Australian natural resources appeared on the shelves of British stores. Equipment such as electrical power machinery found its way onto the British shop floor. Australian components featured in British products. And Australian consumer goods such as furniture began to be sold in the shops.
- Australian business increased its direct investment in the UK from a small base (from virtually nothing to nearly 12% of total foreign direct investment flows in 1987). Most of this was in the services (finance, media and transportation) and brewing sectors. The increase was dramatic both in the numbers and in terms of the public profile.
- Australian manufacturing and services were looking outwards from the domestic market just as the 1992 process of European integration unfolded.
- These developments present the potential for a new dynamic relationship in Australia-UK trade and investment based on complementary activities in serving respective regional markets.

Into the 1990s

- The 1992 process of European Community integration will reinforce the changing focus of UK trade and investment on Europe; but it will also open up opportunities for Australian exporters and Australian business investing in the UK perhaps as a springboard into Europe.
- The Asia-Pacific region is expected to continue to be the fastest growing area of economic and trade growth. Australian business focus on the region is likely to be reinforced; but the substantial UK investment base in Australia could provide a platform for export expansion into the region.
- The Uruguay Round will have implications for Australia-UK trade and investment relations but, given the complexities, the outcome must be regarded as uncertain at this stage. The UK and Australia may find common cause on European agricultural reform and on deregulation of services. Any reduction in tariffs and non-tariff trade barriers could have mutually beneficial effects in encouraging outward looking and complementary strategies for both Australian and UK companies.

The UK is in many ways a natural market for Australian business. It offers a variety of advantages. Australian exporters are seizing the opportunities in non-traditional as well as traditional export categories. Our case-studies provided insights into the general advantages of the UK market, the constraints on exporting to the UK and the successful strategies needed to overcome the latter in order to make the most of the former.

The case studies were taken from the following categories:

- Traditional areas of Australian advantage in primary products, eg wool and copper;
- New areas of advantage but based on natural resource endowments, such as wine;
- New areas of specialised high value-added manufactured products, such as automotive components, medical and scientific equipment, telecommunications equipment;
- Services based on Australian business experience in serving a geographically large but thinly populated domestic market, for example transport and communications, financial services and computer software.

Advantages of the UK Market

- The size of the market offers the prospect of significant Australian sales and profits.
- Successful market entry enhances credibility in other European markets, Japan and North America.
- Common language, culture, education, legislation and legal processes, business and financial environment.
- Access to technology; the UK is at the leading edge in a number of technologies and physical presence in the market can be used for technology transfer.
- Relatively low Australian labour costs and the high quality of its human resources provide the basis for serving the requirements of the UK market for advanced, skill intensive products and services.
- Multinational enterprises (MNE) are a major feature of the UK market; establishing credibility with an MNE either in Australia or the UK can provide Australian businesses with the opportunity for entry into other markets.

Constraints

- UK market conditions presented constraints: well-established purchasing patterns and strong competition in the highest quality goods and services from the USA, Japan and Europe, increasing market entry difficulties for Australian exports; the disruption and financial costs and risks of establishing a physical presence in the UK market; low profit margins available in the UK compared with Japan and North

America (especially on sales to the public sector): Just-in-Time management techniques being adopted in the UK requiring close contact with component suppliers to the relative disadvantage of Australian business; increased importance being placed on after-sales service needing the local presence of well-trained staff.

- Australian supply conditions presented difficulties: a small, fragmented domestic market and industry; a lack of outward looking strategies of Australian management, especially in manufacturing; an inadequately developed venture capital market; surface transport problems giving rise to high shipping and dock handling costs; the lack of exporting strategies reflected in (and exacerbated by) shortages of competent marketing and export managers.
- General factors: exchange rate fluctuations after a long period of relative stability; European Community legislation and regulations and restrictions on imported processed agricultural products; uncertainty about the 1992 process and its implications for Australian exporters.

Strategic Opportunities

- The appropriate market entry strategies for exporting goods have tended to involve niche positioning based on specialised technology and skill-intensive resources, and on careful product differentiation and a long-term marketing strategy. In some cases, experience in supplying multinationals in Australia has been helpful.
- Australian automotive component manufacturers built on their credibility in operating flexible short production runs with MNEs in the Australian market.
- Australian wine is a recent success story in the UK market. Here, the Australian producers overcame consumer resistance and competed with the established advantage of European wine producers with a marketing strategy which demonstrated the quality and value for money of Australian wines.
- Successful exports of Australian services were dependent on establishing a reputation for quality and reliability. The 'Australian' image was not always an immediate advantage in this respect. But particular attention to intra-company culture, the use of joint-ventures and success of Australian products have changed the Australian image. Exposure to Australian problems of distance, a low regard for established practice and lateral thinking have been cited as competitive advantages in Australian service exports.
- Australian computer software has built on the sophistication of the Australian insurance and finance industries and now has a reputation for excellence and innovative thinking in the market.

The regional repositioning of the UK after accession to the EC caused its share of sales to the Australian market to fall dramatically. Yet the UK has relative export advantage in products and services for which demand is likely to grow in Australia. Other EC countries have shown that European companies' sales penetration into the Australian import market can be increased. British business may be missing export opportunities.

UK Export Advantage

- From our statistical work, relative UK export advantage was identified in a range of products, including defence and aerospace, chemicals, machinery (especially for processing material inputs, such as food processing machinery) and consumer products like books, furniture and textile fabrics.
 - There were sectors where the UK was less successful in selling to the Australian market than it was to the rest of the world, such as vehicle components, computer equipment and instruments.
 - Even where the UK had relative export advantage, it still lost ground in Australian import markets whilst other EC countries were increasing share, for example in chemicals and pharmaceuticals, paper and board, non-electrical machinery, furniture and travel goods.
- #### Australian Market Growth
- The Australian market presents opportunities for renewed UK export penetration. It is the second

largest market in the Asia-Pacific region – the Republic of Korea is the next largest but only half the size. It has had GDP and private consumption growth rates in the 1980s which exceeded the average for industrialised countries. And it has levels of per capita private consumption higher than the average of European OECD countries.

- Demand growth for capital goods is likely to be sustained in areas where UK companies are strong such as defence and aerospace, mining and transport equipment, process plant.
- Increasing affluence is creating and increasing consumer market growth in areas where there are strong UK products such as quality food and drink, fabrics and furniture.
- Increasing demand growth for services especially in education and health, entertainment and tourism provides the opportunity for UK exports of services as well as the manufactured goods that support these service sectors.
- AUSTRALIA has identified a range of products and services in which strong potential exists for Australian export growth. Many of these are in areas of traditional UK export advantage. So, while they represent a potential source of competition, they also represent an opportunity for complementary trade. Software, communications equipment, processed food and mining machinery may offer specific opportunities of this kind.

4 THE UK AS A DESTINATION FOR AUSTRALIAN INVESTMENT: SPRINGBOARD INTO EUROPE?

The UK has advantages over the rest of Europe as an investment location for Australian companies. However, there are constraints, some of which can be influenced and overcome provided Australian companies are prepared to be flexible.

UK Advantages

- Commercial advantages are realised because parallel legal, accounting and fiscal systems reduce 'transaction costs' of entry and operation in the UK.
- Parallel institutions and practices also make certain products and services more easily transferable from Australia.
- Common language and similar culture provide real commercial advantages for the UK as a location for Australians.

Commercial Obstacles; Possible Solutions

- Among the commercial obstacles to investment encountered in the UK are:
 - the need to control a business from 12,000 miles away;
 - the current image of Australian companies and the focus on their financial substance and degree of commitment by some UK banks and business service providers.
- There is no perfect solution to the first of these; some companies have developed culture and management systems that they can impose from long distances; others have addressed the problem by having all strategic decisions taken from Australia.
- The second obstacle derives partly from an image problem which can be influenced and will change over time and partly from different attitudes to business risk. Australian companies may need to package their UK financial structure to take account of these differences.

Institutional Obstacles

- Institutional obstacles to investment expansion in the UK include restrictions on foreign ownership in certain industries (eg media, airlines). There is also a perception in some quarters of adverse UK attitudes to large, hostile takeovers by Australian companies.
- These factors cannot be influenced in the short term, but they will not affect many Australian companies seeking to invest in the UK. The companies that are affected may need to think creatively about co-operative arrangements and strategic alliances with UK companies.

UK Advantage as a Springboard

For Australian companies already established in the

UK there appear to be strong reasons for directing their European expansion effort from this base. The same reasons could provide an incentive for other Australian companies to consider the UK as a springboard for European expansion. The advantages of a UK location are:

- Easier access to the financial community and greater visibility in the financial centre of Europe is possible.
- The impact of different legal, accounting and other institutional arrangements and systems can be minimised.
- The scale economies achievable by grouping certain regional corporate activities, such as planning, treasury and financial management, can be maximised in a UK location.
- 1992 harmonisation proposals will not change many of the cultural, legal, financial and accounting practices in the UK - thus, it is likely to remain an efficient entry and financial management point for Australian business.
- Apart from the low transaction costs of establishing in the UK, other advantages (relatively low labour costs, sophisticated capital markets) will also not change significantly in the medium term as a result of 1992.

The Need for a European Strategy and Wider Appreciation of 1992 Implications

- The challenge for Australian companies expanding into continental Europe from a UK base is to integrate their managerial and product/service related skills with local knowledge and contacts in the local markets, while ensuring effective control mechanisms from the UK.
- Companies like Elders IXL and TNT seem to be taking the approach in some of their recent moves that joint ventures might be the best way of dealing with this trade-off in the short term even where full control is the ultimate objective.
- An integrated European market may provide greater opportunity for deploying transferable skills from Australia derived from operating in a larger geographic market (eg skills of logistics, retailing, network management).
- Post 1992, entry into more European markets may mean that more management resources have to be located in the local markets. Whilst financial and other HQ management functions might best be located in the UK, closeness and familiarity with local markets will probably require a distributed management structure and inputs from local management.
- Australian companies in the UK appear to be well informed about the 1992 process, but perhaps need to

focus more on its effects on customers and suppliers, rather than just on the effects on themselves.

- They also need to recognise that 1992 is more than a set of directives: it is about changes in attitudes.

- Broadening the meaning of '1992' in this way means that companies will have to adopt a systematic process for identifying which sources of change are important: few Australian companies appear to have done this.

The UK is the second largest investor in Australia. But are opportunities being missed which other investors are seizing?

UK Investment: Growing in Value; Declining in Share

- UK investment in Australia is growing in value terms but its share of total investment is falling – by one half in the last 17 years.
- There are a number of reasons for this: the increasing importance of other markets, notably the USA and Europe, for UK investors; the removal of Australian investment rules preferential to the UK and elimination of investment restrictions in certain sectors – levelling the playing field; the deregulation of the financial markets and removal of exchange controls; relatively high growth rates in the mid 1980s requiring overseas capital to supplement domestic savings at a higher rate than previously. More open access has inevitably eroded the dominant and somewhat protected position of UK investment.
- Yet better than average growth of direct investment inflows was achieved by the UK in finance and investment, transport and equipment, agriculture, chemicals and mining.

Australia as Springboard to the Asia - Pacific?

- The Asia - Pacific region is expected to continue to expand faster than the rest of the world. But as a market it presents difficulties: a variety of protectionist measures; cultural diversity; cultural differences with US, European and Australian business practice; the multiplicity of small markets; considerable differences between markets.
- Australia offers advantages as an operating base for attacking the Asia - Pacific markets: politically stable; language, cultural and other similarities with the UK; sizeable consumer market; good business infrastructure (except shipping); favourable access to

material inputs and energy; high education levels and a skilled workforce.

- But there are disadvantages too: cultural, business practice differences with other Asia - Pacific markets; distance from the markets; small domestic market (for capital and industrial goods); high labour costs relative to other Asia - Pacific locations; high coastal and international freight rates.
- The balance of advantages and disadvantages is likely to vary by company, sector and country of origin. The Australian springboard has been used mainly for processed primary products (such as foodstuffs, non-ferrous metals, knitted yarns and fabrics) but also for automotive components and communications and office equipment.

UK Strategies for Using the Springboard

- A review of companies operating out of Australia in the Asia - Pacific markets concluded that this was most successful where: Australia is already the biggest, domestic market for a company's product in the region; and the most substantial manufacturing plant in the region is or could be located in Australia to which other corporate functions could be added.
- Many UK companies established subsidiaries in Australia behind the tariff barriers but did not look beyond the local market nor considered transferring acquired skills to other subsidiaries.
- Several reasons were given for this: lack of infrastructure in the companies to manage exports or research and development; no mandate from central HQ to develop products beyond that necessary to meet local standards; and a lack of a defined role for Australian subsidiaries in a regional or global strategy.
- So, Australia can provide a springboard to Asia - Pacific markets. UK companies have the presence in the Australian market necessary to make this possible. But to date they have generally lacked the outward and regional strategy required to make it happen.

Our study has persuaded us that there have been significant changes and new opportunities emerging which could transform Australia - UK trade and investment relations. To take advantage of these opportunities a change in perceptions and strategic thinking is required based on a broader and longer term perspective.

Australian Companies

- More outward looking export strategies have emerged in Australian manufacturing and services: a lagged response to currency depreciation and wage restraint; the use of new manufacturing techniques and technology; an increasingly open trading framework; the emergence of a growing cadre of dynamic managers prepared to take on export markets.
- 1992 presents significant potential for further broadening of Australian businesses' outward strategies. But it requires a wider perspective extending beyond the 'directives' and embracing effects on customers and suppliers.
- To sustain the development of outward strategies and to exploit the opportunities presented by 1992 may require management training and experience, perhaps through joint ventures, specifically in integrating distributed local knowledge and skills with effective central management control mechanisms.

UK Companies

- Generally, UK companies do not appear to be making the most of the more liberalised trading environment in an expanding Australian market.
- The strategies of those UK companies already present in Australia seem to be focused on the domestic market.
- The expansion of the Asia - Pacific region and the

uncertainty of the Hong Kong role after 1997 would suggest that consideration should now be given to Australia as a potential location for UK companies wishing to serve that region; it will not be suitable for some, but it should at least be considered as an option.

Complementary Collaboration

- There is emerging evidence of increasing complementarity between the two economies. One form this can take is strategic alliances.
- Such alliances have to date been largely confined to the primary sector. But we regard alliances in other areas to be potentially significant based on risk and technology sharing and on complementary and mutual support in respective regional markets.
- We have identified potential alliances in the following categories:
 - materials, minerals and agricultural processed products, combining Australian resource endowments with UK processing and marketing expertise, eg in tanning, food and wool processing;
 - input products based on Australian resource advantages and UK strengths, eg in pharmaceuticals and processing equipment such as food processing machinery and mining equipment;
 - services based on Australia's ability to cope with the 'tyranny of distance' and utilising UK marketing and technology strengths, as in transaction processing and financial services;
 - collaborative R&D and technology transfer arrangements to exploit complementary specialised research strengths, as in medical and scientific equipment, biotechnology and computer software;
 - mutually beneficial marketing arrangements based on multinational enterprise connections, such as automotive and aerospace components.

Our study has persuaded us that there is the potential for a new dynamic in Australia - UK trade and investment. It will require more outward looking strategies on the part of UK and Australian business. The respective Governments can assist by liberalising and facilitating.

Further Liberalisation

- The Australian Government has recently announced that wide-ranging tariff reductions and the elimination of quotas will be completed by 1995.
- Over the past six years the Australian Government has floated the currency, eliminated exchange controls and liberalised the financial sector.
- The UK should continue to press for reforms in the CAP through the EC; Australia should continue to lobby through the Cairns Group.
- Both the UK and Australia need to communicate better their rules regarding competition policy and M&A activity and, where these are demonstrated to be restrictive on trade and investment flows, to seek to reduce the restrictive elements.
- The UK and Australian Governments should lobby through GATT negotiations for reductions in manufacturing and especially services protection.

Governments' Facilitating Role

- The UK Government, through the Department of Trade and Industry (DTI), sees its role as creating a

suitable policy framework conducive to the development of company level initiatives.

- The Australian Government through the Department of Industry, Technology and Commerce (DITAC) and the Australian Trade Commission (AUSTRADE) has a more proactive role including formulating industry strategies for targeted sectors.
- In practice there are a number of areas of mutual interest which could form agenda items for a strengthened relationship between the DTI and DITAC/AUSTRADE:
 - The provision and dissemination of information on the benefits of the UK as a location for Australian investment and as a springboard into Europe; on the 1992 process to dispel any misconceptions held by Australian business; on Australia as a springboard into Asia - Pacific markets; on the encouragement of joint ventures through the exchange of information on areas of complementary trade;
 - The exchange of information between the DTI and DITAC/AUSTRADE on policy matters of mutual interest such as collaborative R&D and inward investment and acquisition policies;
 - The promotion of trade, investment and collaborative (especially technological) opportunities;
 - The maintenance of the renewed interest at senior Government level in Australian - UK trade and investment.

