

Tracking Progress on SIP Round 1 Claims

Now that we are into full swing with the lodging of claims for the first year of TCF Strategic Investment Program (SIP), it is valuable to catalogue the sorts of questions and feedback being received from AusIndustry in relation to its interpretation of the Scheme, as well as decisions on the eligibility of certain expenditures for Type 1 and 2 grants for the first few claims that have been assessed.

This month's 'Advisor' undertakes a broad review of a number of case studies relating to the sorts of expenditures that AusIndustry have accepted or rejected. These have been taken from a sample of the early stages of the agency's processing of claims, as well as the range of questions being asked in support of claims relating to Type 2 Innovation.

Gerry Frittmann
Managing Director
TCF Services Pty Ltd

Principal SIP Expenditure Types

The TCF Strategic Investment Program provides for benefits to be claimed on three main types of expenditure. The first - Type 1 - covers capital expenditure on plant and equipment (including IT and software). Type 2 expenditure covers research and development activities, innovative product design, innovative process improvement, brand support, market research and the obtaining of industrial property rights. Type 3 works to uplift benefits on Type 1 and 2 expenditures, and is determined by a prescribed calculation set out in the Scheme.

The fundamental principles adopted by AusIndustry in relation to Type 1 Capital investments are:

- must relate to the core activities supported by the Scheme relative to design, production, warehousing and distribution;
- must be new at the time of purchase;
- must be capitalised in the book of accounts; and
- the financial owner must be the entity that is registered which is still carrying on the eligible activity at the time of receiving a grant.

Within these fundamental principles, AusIndustry appears to be taking a more mature view on certain eligibility questions, and has determined that:

MULTI-MEDIA SYSTEMS/PROJECTORS - are not considered eligible, given current legal advice the Scheme excludes equipment used for 'Training' purposes.

LAPTOP COMPUTERS - are eligible in certain circumstances. AusIndustry's initial FAQ of September 2000 took the view Laptop computers were not eligible. However, the approach has become more positive with Laptops now being considered eligible if they are used in those 'core' activities considered supported by the Scheme (i.e. as listed above). The total cost of Laptops may be required to be apportioned if they are also partly used in other areas not supported by the Scheme. Nevertheless, a laptop computer used in field-testing was not considered eligible on the basis that field-testing is an after-sales service function, and thus considered post-production.

FORKLIFT TRUCKS - again, despite earlier advice that Forklifts would not be considered eligible, followed by advice that specialised Forklifts would be considered, AusIndustry are now allowing all Forklifts to be claimed.

TELEPHONE SYSTEMS - may be eligible for SIP benefits, but only to the extent that the system has the capacity to improve communications in the core activities supported by the Scheme. Progression of a successful claim in this area will therefore require that the total cost be apportioned, meaning telephone systems are partly claimable.

RACKING - it appears that AusIndustry are not willing to pay grants on 'Racking' unless it is part of an advanced/automated sortation system. Whilst it would be nice if everyone could afford one, the reality is that some companies don't need to go to this extent. TCF Services has reviewed the SIP legislation and concluded that Capital investment in the area of warehousing is eligible for assistance. Accordingly, and if appealed through the AAT, it is likely AusIndustry would have no option but to pay grants on this equipment.

Essentially, the feedback coming from AusIndustry's evaluation of initial claims is that any piece of new plant or equipment (which includes tools or apparatus) may be either fully or partly eligible - depending upon each individual case - as long as the equipment is used in the core activities of the business assisted under the Scheme.

Type 2 and 'innovation'

AusIndustry has similarly adopted some fundamental principles in relation to Type 2 expenditures in regard to 'innovation'. In effect, Type 2 expenditures must be:

- relative to new Product Design and;
- Process improvement in the areas of Design and production and;
- certain Market research and Brand support costs relative to the new innovative product/s and;
- the costs associated with the preparation and lodgement of Intellectual property rights relative to the new innovative product/s.

It has now become apparent from AusIndustry's evaluation of initial claims that whilst an entity may be developing a new product or process, this does not necessarily mean that the project is in fact eligible unless it also meets the 'innovation' test. Whilst this has broadly been the concept portrayed from earlier Departmental/Agency guidelines and advice, only recently has the 'fog' of interpretative doubt cleared. Through TCF Services' discussions with AusIndustry, and the feedback being gained from the claims process, what we are now seeing is where the line is being drawn in terms of eligibility.

AusIndustry's 'tests' for TCF innovation

In seeking to draw a more definitive ring around the term 'innovation', AusIndustry are now asking claimants to provide answers to the following types of questions, on a project by project basis:

- 1 - What were the technical risks or challenges that you faced, and what techniques did you use to overcome the difficulties associated with this technical challenge?
- 2 - How is the innovation different from existing methods, i.e. what is the point of difference?
- 3 - Can you pinpoint how the new techniques are innovative, and illustrate why they are not routine?
- 4 - Why are these projects not considered standard variable design changes?
- 5 - What new skills or production capabilities does your firm now possess which distinguishes it from its competitors?
- 6 - How has the innovation established competitive and comparative advantage?
- 7 - What trials, testing and experimentation were performed?

Refining the case on technical change

The key point coming through loud and clear is that whilst an entity may have developed or improved a new product or process, unless they can evidence that a technical change has occurred - for which the entity did not possess the knowledge or skills prior to commencement of the project, which in turn required a systematic experimental stage - then the project is unlikely to be eligible. It would have been of far more use to the industry if these points were

articulated clearly to all concerned at the commencement of the SIP program, rather than at the claim stage. For example, if a project is aimed at higher productivity gains through a factory layout change to improve cycle time and reduce waste whereby the order or sequence of the processes have changed, the project is unlikely to be eligible without a technical change to one of the production processes.

Similarly, if a software program is devised on a standard Microsoft software program like Excel, which leads to better quality data being available to the managers - which in turn allows for better production and distribution planning - the project is also unlikely to be eligible without a technical change to the way the goods are actually produced. Even if a technical change to the design or production process has occurred, claimants still need to meet the 'innovation' test.

Clothing now looking grim, based on the innovation test?

Based on these tests and assumptions, some direction has now emerged on the extent to which many companies in prime industry sectors, such as Clothing and Footwear, will be able to take advantage of the Scheme - compared to Textile manufacturers - in their pursuit of long-term survival in a volatile future business environment. As everybody knows - one size does not fit all - and it is very difficult to have one set of rules for all sectors coupled with the fact that most Clothing companies do not directly manufacture their products themselves. Given that stylistic changes to colour, pattern, and silhouette are not eligible in the absence of any technical innovation, the application of the Scheme for the Clothing industry is likely to be limited. The major differences from earlier assumptions regarding this test is based on a reading of the words in AusIndustry's own 'What is Innovation' document, which was still on their web-site as we went to press.

This document states 'innovation' is envisaged as "a broader concept than that associated with the high levels of technical risk generally associated with traditional Research and Development." It also says that innovation will be tested at the entity level, must be strategic and will be assessed objectively. The current Innovation test is quite different than earlier industry expectations, when it was clearly communicated that companies should review the scheme and self-assess how it could be used to improve their business. In reference to the word 'innovative', prospective SIP claimants were told to refer to the Macquarie dictionary, which states that the word means, "new or something different".

Now AusIndustry maintains that without a level of 'technical' risk, a project that appeared to meet all the requirements may not be eligible. Technical risk is not the only driver that was expected to be supported by the Scheme, and this view was certainly not communicated at the commencement of the program. As it stands, the SIP Scheme has become very much bent to manufacturing businesses. Designers - whilst being able to register for the Scheme - have become much more isolated in terms of what they can claim.

More to eligibility than commercial risk

Current opinion on these developments is that, if an entity does invest and innovate, it must be very careful not to overstep the mark in terms of their expectations from the Scheme, due to the rigidity related to the interpretation of 'innovation' in the absence of technical risk. AusIndustry have informed TCF Services that commercial risk in it's own right is not a determinate of eligibility. Therefore, prospective claimants may improve a process, it may be innovative for your entity, it may be strategic and involve a element of commercial risk. However, in the absence of objectively assessed 'technical' risk, such activity may not ultimately be eligible. TCF Services will keep clients informed of further intelligence from AusIndustry Round 1 SIP claim evaluations in future editions of the 'Advisor'.

The Textiles, Clothing & Footwear Industry Advisor (C) 2001 [Co-Operative Ventures (Australia) Pty Ltd] brings you the latest facts, analysis and contacts regarding Australia's TCF industries and related Government support programs.

The Newsletter is published on a regular basis for **TCF SERVICES PTY LTD** [ABN 88 053 245 926], PO Box 141, Surry Hills NSW 2010. Tel: +61 2 9310-2900/Fax: +61 2 9319-3670. Correspondence should be addressed to the Editor.

Reproduction in whole or in part is not permitted without permission in writing from the publishers.