



Victorian Auditor-General

SPECIAL REPORT NO. 37

*Promoting
industry development
Assistance by government*

OCTOBER 1995

VICTORIA

Auditor-General
of Victoria

SPECIAL REPORT No. 37

**PROMOTING
INDUSTRY DEVELOPMENT**
Assistance by government

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**VICTORIAN
AUDITOR-
GENERAL'S
OFFICE**

*Auditing in the
Public Interest*

October 1995

The President
The Speaker

Parliament House
Melbourne Vic. 3002

Sir

In accordance with section 16 of the *Audit Act 1994*, I transmit the Auditor-General's Special Report No. 37, "*Promoting industry development: Assistance by government*".

Yours faithfully

C.A. BARAGWANATH
Auditor-General

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2	Works Contracts Overview - Second Report	June 1983
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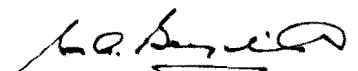
Foreword

This Special Report addresses 2 areas of government activity of significance to the State's economic prosperity, namely, industry assistance and regional development. It focuses on the Industry, Regional and Trade Support Program managed by the Department of Business and Employment. The Program is the principal catalyst for implementation of the Government's policy objectives for the 2 areas.

The decision by audit to undertake a contemporary assessment of the Department's management of the Program was influenced by the fact that it is now around 6 years since an earlier and highly-critical report of the Auditor-General was presented to the Parliament on the State's industry assistance arrangements. It is very pleasing to be able to convey to the Parliament in this Report the message that the important lessons of the past have been heeded by the Department in the development and implementation of its management strategies for the Program.

The opportunity was taken during the audit to utilise, for the first time, the powers of access to documents of private or public sector recipients of government assistance which were assigned to the Auditor-General under July 1994 amendments to the State's audit legislation. The level of co-operation and assistance received by audit from both the Department and industry representatives was of a high standard. Some interesting comments by management representatives of visited companies on the operation of the Program were gathered and documented during this phase of the audit.

I trust that the issues addressed in this Report will be of benefit to the Government in providing an independent assessment of its progress to date in this very significant area. I also hope that the Report will be viewed by the Parliament and the community as of interest and relevant to their needs.


C.A. BARAGWANATH
Auditor-General

Part 1

Executive Summary

Part 1.1

Overall audit conclusion

1.1.1 Successive Victorian governments have operated a range of industry assistance programs aimed at facilitating economic growth within the State. The current Government's strategic approach to this area is documented in 2 major policy statements relating to industry and regional development which it released in 1993 as part of its overall economic strategy.

1.1.2 The Department of Business and Employment has a lead role in the implementation of the 2 government policies through its management of the Industry, Regional and Trade Support Program. This Program is principally aimed at attracting, through financial assistance and other facilitation services, major additional investment that otherwise might not occur in Victoria, and projects offering significant net economic benefits to the State in terms of export growth, import substitution or increased employment.

1.1.3 This Report outlines the Department's initiatives and the intensity of its management efforts to have in place a framework for the program specifically designed to minimise the risk of recurrence of the State's past problems in this area. These past problems were identified in a highly-critical 1989 Special Report of the Auditor-General to the Parliament on industry assistance arrangements, including the activities of the former Victorian Economic Development Corporation. The information presented in Part 4 of this Report clearly shows that careful attention has been directed by the Department to ensuring that the lessons of the past have been heeded.

1.1.4 Although the Program is still in its early stages, projected economic benefits to the State associated with industry projects approved to progressively receive assistance from 1994-95 are significantly greater than the equivalent position in 1993-94. In this regard, projects approved in 1994-95 are estimated to generate additional investment within the State of around \$1 billion (\$806 million, 1993-94) which was consistent with the Department's target for the year for this particular category of economic benefits.

1.1.5 The Department needs to direct attention to a number of matters identified by audit in order to build further on its initiatives to date and have a sounder foundation for directing its scarce resources towards those areas with the greatest potential for benefiting the Victorian economy. These matters include:

- establishing targets for projections of economic benefits in the Program's remaining key categories, namely, export growth, import substitution and increased employment, which can be associated with projects approved for assistance;

-
- prioritising the various industry sectors having regard to their capacity to contribute to the State's economic advancement; and
 - through improved cost recording and monitoring, developing an enhanced basis for decisions on the allocation of resources to its non-financial facilitation services to industry and the cost-effectiveness of such services.

1.1.6 The Department's Office of Trade and Investment has generated positive results to date from its overseas trade fairs and missions, and from its subsidisation program for the engagement of export managers by Victorian companies. The Office is currently in the process of implementing remedial action to strengthen the accountability of the Government's 6 overseas business offices in maximising their contributions to enhancing the State's economic standing.

1.1.7 In the important area of regional development, finalisation of the Department's current strategic evaluation of regional needs will provide it with a more structured framework for pursuit of the Government's related policy objectives. This action needs to be accompanied by a greater emphasis on completion of infrastructure studies and assessment of resultant needs for all 5 regions of the State if Victoria is to be in a position to maximise its share of Australian Government funding for infrastructure works currently available under the national regional development strategy.

1.1.8 In line with the Victorian Government's focus on improved performance measurement and reporting by public sector agencies, the Department is in the preliminary stages of developing a suitable performance measurement framework for the Program. It recognises that substantial attention will need to be directed to the formulation of qualitative performance measures to fill what has been a long-standing gap in the management of the State's industry assistance arrangements.

1.1.9 The audit included examination of matters relating to the Strategic Industry Research Foundation (formerly the Strategic Research Foundation established by the previous Government). By 30 June 1996, \$48.6 million of government funding will have been provided over the last 6 years to the Foundation and, through it, to 3 associated research institutes for industry research projects. Because of the inherent nature of the research environment, it is very difficult to be conclusive at this stage on the likelihood of major benefits to the State from this sizeable investment.

1.1.10 With regard to one of the research institutes, the Australian Computing and Communications Institute, some disturbing circumstances relating to its financial viability became evident in recent years and an amount of \$8.1 million advanced by the previous Government to the Institute to fund the leasing of computer equipment is still fully outstanding and unlikely to be repaid. The probable loss of taxpayers' funds in this instance supports the Government's current policy direction of facilitating industry-driven collaborative research rather than the direct funding of proposals cited by particular private sector parties as offering a commercial return.

1.1.11 Finally, there is clear scope for substantial upgrading of the quality of information channelled annually by the Foundation to the Department on its research activities. The importance of strengthening the Department's management review framework governing the functions of the Foundation and the level of accountability to the Parliament is reinforced by the fact that a contingent liability of up to \$5 million may accrue to the Government if, in the event of a winding-up decision, the Foundation is not in a position to meet its financial obligations.

□ **RESPONSE** by Secretary to the Department of Business and Employment

The Department acknowledges the acceptance by audit of the targeting of financial assistance, the matching of assistance categories with the overall and emerging need of industry, the carefully-structured management controls governing assessment, approval and monitoring, and the integration of strategic information with the Department's business planning processes.

The Department also acknowledges the positive responses received by audit from the visits to individual companies. These responses are consistent with those obtained by the survey undertaken, in the first half of 1995, on the awareness, usage and satisfaction levels of a large number of Victorian enterprises, with industry and enterprise services and programs.

The Department notes the Report contains a number of observations on aspects of the Industry, Trade and Regional Support Program. Those observations are the subject of individual responses located throughout the body of the Report.

Part 1.2

Summary of major audit findings

CHARACTERISTICS OF THE PROGRAM AND OF THE DEPARTMENT'S MANAGEMENT APPROACH Page 27

- The Industry, Regional and Trade Support Program's targeting of industry assistance to projects and companies that offer significant economic benefits to the State and are clearly financially viable means that a sound foundation is in place for subsequent realisation of intended economic benefits from assisted projects.

Paras 4.12 to 4.17

- Formulation by the Department of Business and Employment of a diversity of assistance categories and a consultative network with industry representatives has been aimed at ensuring that the Program's general direction meets the overall needs of industry and addresses issues of emerging significance to the State's development.

Paras 4.18 to 4.21

- The Department has directed high priority to the establishment and use of carefully-structured management controls governing the assessment, approval and monitoring stages of assistance provided under the Program.

Paras 4.22 to 4.26

- The Department's organisational structure, which incorporates 4 specific organisational units, each with responsibility for achieving a distinct aim of the Program, complements other features of its overall management approach.

Paras 4.27 to 4.29

- Projects approved to progressively receive assistance from 1994-95 are estimated to generate additional investment within the State of around \$1 billion (\$806 million, 1993-94), which was consistent with the Department's target for this particular category of economic benefits.
Paras 5.7 to 5.12
- The Department needs to set specific targets for the Program's remaining 3 key categories of economic benefits namely, export growth, import substitution and increased employment.
Paras 5.13 to 5.14
- Prioritising the State's various industry sectors would give the Department a sounder basis for directing its scarce resources towards those areas offering the greatest benefit to the Victorian economy.
Paras 5.15 to 5.23
- The Department's projections of economic benefits expected to flow to the State from projects approved for assistance at 30 June 1995 have been developed on a sound basis and reflect all known conditions at that date.
Paras 5.24 to 5.29
- A suitable balance should be maintained over time between direct financial assistance to industry and the valuable non-financial facilitation services available to augment industry activity.
Paras 5.30 to 5.36
- Although import substitution is identified as a priority source of economic benefit under the Government's industry policy statement, emphasis to date has been directed towards projects with a direct export outcome rather than projects which focus exclusively on import substitution.
Paras 5.37 to 5.41
- Use of a management information system which enables separate recording and monitoring of costs incurred in the provision of facilitation services would provide the Department with an enhanced basis for assessing the cost-effectiveness of these services.
Paras 5.42 to 5.45
- Given the importance to Victoria of a strong balance of trade position, scope exists for the Department's Office of Trade and Investment to direct greater priority to assisting major projects in the Victorian export industry.
Paras 5.48 to 5.49
- The Office of Trade and Investment should be commended for the very positive results achieved to date from its overseas trade fairs and missions, as perceived by industry participants.
Paras 5.50 to 5.56
- The Department is currently taking action to strengthen the accountability of the Government's 6 overseas business offices in maximising their contributions to enhancing the State's economic standing.
Paras 5.61 to 5.65

- Finalisation of the Department's strategic evaluation of regional needs will provide it with a more structured framework for pursuit of the Government's objectives covering regional development within the State.
Paras 5.69 to 5.73
- A proactive approach by the Department in its liaison with the Australian Government is necessary if the State is to achieve maximum benefit from funds currently available under the national regional development strategy, particularly in relation to infrastructure studies.
Paras 5.74 to 5.86
- The Department recognises that substantial attention will need to be directed to the formulation of qualitative performance measures for the Program to fill what has been a long-standing gap in the management of the State's industry assistance arrangements.
Paras 5.87 to 5.98
- Future annual reports of the Department should disclose actual performance against all performance targets set for the reporting period, and the amount and type of financial assistance provided to each company assisted under the Program.
Paras 5.99 to 5.101

- The results of audit visits to several companies provided added assurance that financial assistance has been appropriately applied to projects that are contributing to the economic growth of the State.
Paras 6.4 to 6.13
- Some interesting comments by management representatives of visited companies on the operation of the Program were gathered and documented during the audit.
Paras 6.14 to 6.28

- By 30 June 1996, \$48.6 million of government funding will have been provided under the Program over the last 6 years to the Strategic Industry Research Foundation and its 3 associated research institutes.
Paras 7.12 to 7.15
- The Government's restructuring of the Foundation in 1993 was designed to facilitate an expanded participation by industry in the identification and pursuit of innovative research.
Paras 7.16 to 7.24
- Because of the inherent nature of the research environment, it is very difficult to be conclusive at this stage on the likelihood of major benefits to the State from its sizeable investment in the Foundation and its institutes.
Paras 7.25 to 7.46
- An amount of \$8.1 million advanced by the previous Government to the Australian Computing and Communications Institute to fund the leasing of IBM computer equipment is still fully outstanding and is unlikely to be repaid.
Paras 7.30 to 7.34
- There is scope for a significant improvement in the quality of the Foundation's annual reporting to the Department on its research achievements.
Paras 7.47 to 7.54
- The results of the Government's current triennial review of the Foundation's activities will assist it in determining the nature of its future involvement with the Foundation and the level of associated funding to be provided to the body.
Paras 7.55 to 7.57

Part 2

Background

2.1 At both Australian and international levels, governments have maintained policies of industry assistance as a means of enhancing the economic performance of industry, particularly in terms of employment growth and business investment. Despite this relatively common feature of government activity, the form of assistance generally varies according to the respective aims of each government, the nature of prevailing economic conditions and any locally-identified needs for development. Typical forms of assistance provided by governments include:

- direct financial assistance to industry through loans, grants and subsidies;
- "in-kind" assistance such as land, infrastructure requirements and other assets;
- planning advice and related information services to facilitate the establishment and ongoing development of industry; and
- direct protection of existing industries through the imposition of tariffs, quotas and other mechanisms that protect domestic markets.

2.2 In accordance with the objective of facilitating economic growth, successive Victorian Governments have, over the years, operated a range of industry assistance programs. Generally, these programs have involved the provision of financial assistance and other forms of facilitation services. However, depending on the detailed aims and strategies of each Government and the prevailing economic conditions, the extent and form of assistance to industry have varied significantly in regard to the mix of financial assistance between loans (which were a feature of the previous Government's program), grants and subsidies and the provision of non-financial services.

2.3 The need for government assistance to Victorian industry has been seen as even more pronounced over recent years. Although Victoria has traditionally enjoyed a comparatively strong position in the Australian economy, the larger impact on the State of the recession of the late 1980s and early 1990s, in comparison with other Australian States, has resulted in a relatively slower rate of economic recovery, especially in the areas of employment and business investment.

2.4 Table 2A illustrates the impact of the recent recession on Victoria.

TABLE 2A
INDICATORS OF ECONOMIC PERFORMANCE, VICTORIA

<i>Economic indicator</i>		1989-90	1990-91	1991-92
Employment	(millions)	1 650	1 515	1 478
Investment -				
Buildings	(\$m)	2 983	2 329	1 490
Equipment	(\$m)	4 855	4 028	3 758
Total investment	(\$m)	7 838	6 357	5 248
Trade -				
Exports	(\$m)	8 523	8 804	9 531
Less imports	(\$m)	16 791	14 907	15 372
Balance of trade	(\$m)	(8 268)	(6 103)	(5 841)

Source: *Monthly Summary of Statistics, Victoria*, (1303.2), Australian Bureau of Statistics.

2.5 While a range of reasons have been advanced for the relatively poorer performance of the Victorian economy, when compared with other States, analysts have generally pointed to the following major reasons:

- the tightening of Australian Government monetary policy in the late 1980s and early 1990s and the resultant increases in interest rates which had a significant impact on the manufacturing base of Victoria;
- a lack of consumer and business confidence resulting from the collapse of certain Victorian financial institutions such as Tricontinental and the Farrow Group of building societies;
- Australian Government micro-economic reforms, such as the reduction of tariffs and other forms of protection, having a specific impact on key manufacturing industries centred in Victoria, such as the textiles industry; and
- the timing of the downturn in the construction industry for both residential and non-residential sectors.

VICTORIAN GOVERNMENT POLICY

2.6 Given the position of the Victorian economy following the recession, the current Government has emphasised in its overall policy direction the importance of the State returning to a position of economic strength. As a consequence, its policies have been aimed at addressing those areas on which the recession had the greatest impact. Of paramount importance to the Government has been the implementation of policies geared towards improving business confidence and competitiveness, increasing economic activity, attracting additional investment to the State and generating employment growth.

2.7 Following its election in October 1992, the Government announced proposals for wide-ranging changes within the public sector and the Victorian economy as a whole. While these proposals were predominantly geared towards reducing the State's current account deficit and public sector debt, they were also aimed at restoring confidence in the Victorian economy and providing an appropriate environment to facilitate the conduct of business.

2.8 In pursuit of its overall policy direction, the Government has, to date, released 2 policy statements related to industry and regional development, namely:

- *"Doing Business in Victoria - Victorian Industry Statement"* (September 1993) which outlines the Government's key aims of improving the business environment, reforming bureaucratic, regulatory and planning processes, facilitating investment and export performance, and, assisting business to improve competitiveness and productivity and to focus on export opportunities; and
- *"Investing in Country Victoria: A nine-point plan for investment and employment growth in provincial and rural Victoria"* (December 1993) which sets out strategies to achieve the Government's objectives in terms of attracting investment to country Victoria, supporting local development organisations, attracting overseas investment, building on regional strengths and promoting regional locations.

ROLE OF THE DEPARTMENT OF BUSINESS AND EMPLOYMENT

The Department of Business and Employment was established in October 1992 and acts as the State's lead agency in the delivery of the Government's industry and employment policies and programs. The Department's mission, as outlined in its 1994-95 Annual Report, is:

"... contributing to the Victorian Government's objective to make Victoria a better place in which to live, work and do business. The Department plays a major role in creating a business environment which encourages increased investment and employment in Victoria, boosts the international competitiveness of local business and provides employment within a safe working environment".

2.10 In line with this mission, the Department is responsible for implementing key components of the Government's policy outlined in the above industry and regional development statements. A significant element of this role is the management of the Government's principal industry assistance program, namely the **Industry, Regional and Trade Support Program**.

INDUSTRY, REGIONAL AND TRADE SUPPORT PROGRAM

2.11 The Industry, Regional and Trade Support Program constitutes the Government's principal catalyst for encouraging business investment and development in the State. The Program is the main mechanism for facilitating investment and export performance, assisting business to improve competitiveness and productivity, attracting investment and assisting development within regional areas of Victoria.

2.12 The Program aims to enhance Victoria's industry and regional development through the provision of policy advice, financial assistance and other facilitation services. Its major objectives, as stated in the Department's 1994-95 business plan, are to:

- *"... promote and facilitate improved Victorian industry and regional performance;*
- *improve the international competitiveness of Victorian enterprises and the Victorian business environment;*
- *enhance the export performance of key Victorian sectors and promote Victoria as an investment and business location; and*
- *provide advice on strategies and policies to improve Victoria's business environment".*

2.13 Under the Program, assistance is aimed at attracting major investment that otherwise might not occur in Victoria. Projects identified for assistance must offer significant net economic benefits to Victoria, particularly in terms of increased exports, import substitution or employment growth. In general, assistance is only provided to enterprises operating in trade-exposed, key industry sectors that have been identified by the Department as having significant growth potential, with priority accorded to export competing companies.

2.14 The assistance to industry may be provided by the Department in a number of forms including direct financial assistance in grants and subsidies, "in-kind" assistance such as site location, or through other services such as the provision of information and advice aimed at facilitating the establishment and development of industry and individual businesses.

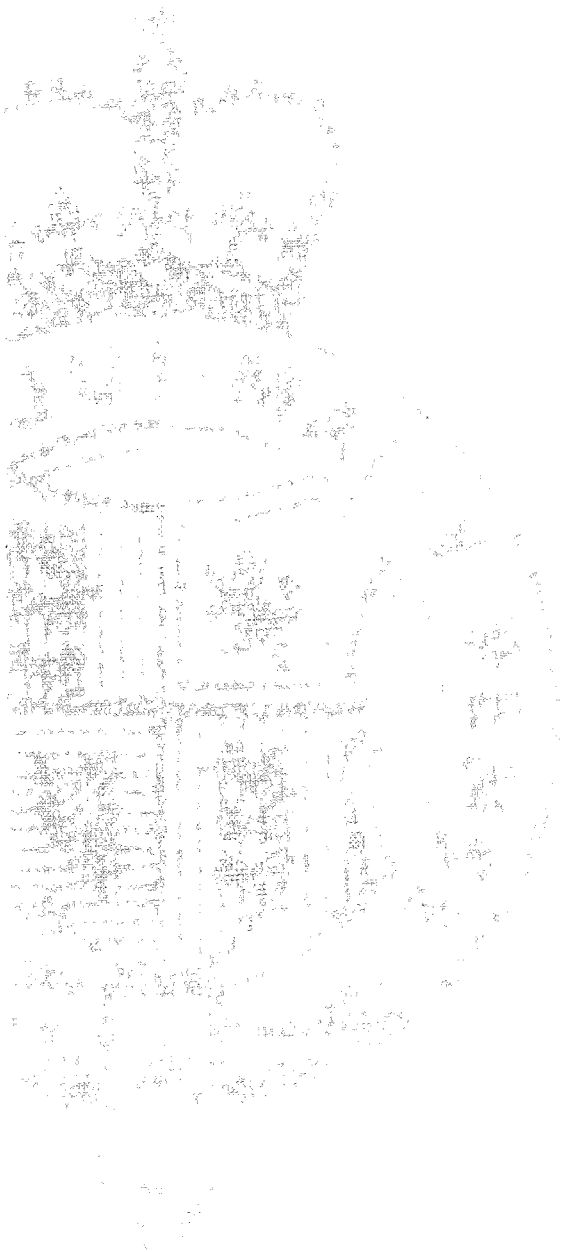
2.15 In 1994-95, assistance provided to industry from the Industry, Regional and Trade Support Program amounted to \$69.3 million (\$45.2 million, 1993-94) and comprised:

- financial assistance to industry and regional development organisations of \$28.8 million (\$17.3 million, 1993-94) including grants for investment attraction, enterprise improvement and export assistance;
- operating costs of the Program of \$35 million (\$21.4 million, 1993-94) incorporating the costs of administering financial assistance, provision of a wide range of facilitation services such as assistance with site selection or fast-tracking of regulatory approvals and management of the Government's overseas business offices; and
- funding to the Strategic Industry Research Foundation and 3 related research institutes of \$5.5 million (\$6.5 million, 1993-94).

2.16 In addition to the above outlays, the Government has determined to fund from the Program the costs of construction of the new Melbourne Exhibition Centre (\$69 million, 1994-95; \$12 million, 1993-94) which is located in the Southbank region of Melbourne.

2.17 The total funds allocated to the Program in 1994-95 of \$138.3 million represented around 60 per cent of the Department's total outlays for the year of \$231 million.

Part 3



Conduct of the audit

AUDIT OBJECTIVES

3.1 The overall objective of the audit was to assess the extent to which strategic and operational policies in place within the Department of Business and Employment for the management of its Industry, Regional and Trade Support Program were conducive to achieving maximum effectiveness in Program delivery and performance.

3.2 Specific attention was directed during the audit to determining whether:

- strategies formulated under the Program were consistent with higher-level government policies and had been implemented to:
 - promote, attract and facilitate investment and industry in Victoria;
 - enhance export performance by Victorian industry; and
 - facilitate the development and expansion of regional industry;
- suitable performance benchmarks had been developed to periodically evaluate the effectiveness of the Program;
- procedures had been established to systematically co-ordinate and control the allocation and monitoring of assistance provided to industry;
- a sound accountability framework was in place for expenditure incurred under the Program;
- the needs of industry had been adequately met; and
- major issues raised in an earlier report of the Auditor-General to the Parliament (*Special Report No. 11, - Financial Assistance to Industry March 1989*) had been addressed by the Department in implementing the Government's industry assistance policies.

AUDIT SCOPE

3.3 The main focus of the audit was on the management of financial and other forms of assistance to industry. The audit did not encompass examination of matters related to the capital cost of construction of the Melbourne Exhibition Centre, for which, as previously mentioned, funding of \$69 million was provided during 1994-95 under the Industry, Regional and Trade Support Program.

Areas of examination

3.4 The following specific areas were examined during the course of the audit:

- principal features of relevant government policy statements;
- Program objectives and strategies;
- procedures for the application, approval and monitoring of financial assistance provided to industry;
- the management of assistance and services, other than of a financial nature, provided under the Program;
- the processes used by the Department to measure the achievements of the Program;
- the needs and expectations of industry;
- the involvement of industry representatives and associations in the development and implementation of the Program; and
- the extent of benefits arising from government funding provided to the Strategic Industry Research Foundation.

Shortcomings in management framework of previous industry assistance programs

3.5 Throughout the 1980s, the then Government operated an industry assistance program as part of its overall economic strategy. Similar to the current Government's industry policy, the broad aim of that program was to assist firms operating in trade-exposed sectors of the manufacturing and tertiary industries to gain access to new markets and to improve their competitiveness.

3.6 Under the previous industry program, assistance was targeted at small to medium-sized firms with growth potential and at highly protected industries with a capacity to improve their growth prospects. In addition, financial assistance, generally in the form of low or no interest loans, was provided to companies where the capital market was deficient in its capacity to provide funds.

3.7 Responsibility for delivery of financial assistance under the program rested primarily with:

- the then Department of Industry, Technology and Resources; and
- the former Victorian Economic Development Corporation (VEDC), which performed a more entrepreneurial role as the principal agency for the provision of loans and equity finance to firms which were not able to attract funds from conventional lending institutions.

3.8 In November 1988, the then Treasurer requested that Mr Fergus Ryan, a prominent chartered accountant, undertake an independent and expert investigation of the operations of the VEDC. The report arising from this investigation, which was tabled in Parliament in December 1988, was highly critical of the management and other aspects of VEDC operations.

3.9 As a result of mounting concern over the financial viability of the VEDC at the time, an audit of the industry segment of the previous Government's economic strategy and the role of certain agencies in implementing this strategy was undertaken by the Victorian Auditor-General. This audit resulted in *Special Report No. 11 - Financial Assistance to Industry* which was tabled in the Parliament in March 1989. Major observations identified in the Report included:

- despite mounting community pressure for greater accountability and effectiveness in the use of public moneys, problems relating to industry assistance previously reported by Auditors-General remained largely unresolved;
- the then Treasurer was not provided with reliable information to gauge the effectiveness of industry assistance because suitable systems, monitoring procedures and performance indicators were not in place;
- financial assistance was provided to firms which, in audit opinion, were ineligible under policy guidelines contained in the Government's economic strategy; and
- control over the provision of assistance was inadequate due to serious weaknesses in the assessment and monitoring processes.

3.10 The existence of these major deficiencies in management control over the provision of assistance placed serious doubt on the achievement of government objectives and resulted in significant losses to the State in the form of non-repayment of loans by assisted firms.

3.11 Given these factors, a major aim of the current audit was to assess the extent to which these shortcomings had been addressed by the Department of Business and Employment in the management of its Industry, Regional and Trade Support Program.

**Use of authority under section 20 of the Audit Act 1994
to liaise with selected private sector recipients of government assistance**

3.12 The opportunity was taken during the audit to utilise, for the first time, the powers of access to documents of assisted private sector entities which were assigned to the Auditor-General by the Parliament under amendments, operative from 1 July 1994, to the State's audit legislation.

3.13 The amended legislation (section 20 of the *Audit Act* 1994) empowers the Auditor-General to examine documents of private or public sector organisations in receipt of funding from any source within the machinery of the State Government. In this regard, 7 companies were selected during the audit for consultation and examination of documentation relating to assistance received under the Industry, Regional and Trade Support Program.

ASSISTANCE PROVIDED TO AUDIT

3.14 The management and staff of the Department of Business and Employment provided significant support and assistance to audit. Assistance was also provided by a range of Victorian and interstate agencies with involvement in the industry and trade sectors.

3.15 Audit wishes to acknowledge the contribution that this assistance made to the preparation of material for this report.

3.16 Appreciation is also expressed to the management of those companies visited by audit in accordance with section 20 of the *Audit Act* 1994 for their assistance and co-operation during the course of audit visits.

Part 4

Characteristics of the Program and of the Department's management approach

OVERVIEW

4.1 Because of the extensive problems identified in the Auditor-General's 1989 Special Report on the State's industry assistance management arrangements, this Part of the Report focuses, to a large extent, on a description of the principal features of the Department's strategic approach to the management of the Industry, Regional and Trade Support Program.

4.2 This course has been followed by audit in order to highlight the Department's initiatives and the intensity of its management efforts to have in place a framework for the Program specifically designed to minimise the risk of recurrence of the State's past problems in this area.

4.3 Part 5 of the Report then examines the departmental framework from an evaluative perspective and includes audit comment on several areas where it is considered that the Department can further build on the positive progress made to date for this important facet of its overall responsibilities.

FEATURES OF THE GOVERNMENT'S INDUSTRY AND REGIONAL DEVELOPMENT POLICIES

4.4 As part of its economic policy direction, the Government has released 2 major policy statements relating to industry and regional development. Details on these 2 policy statements are set out below.

Industry policy statement, September 1993

4.5 The overall purpose of the Government's industry policy statement "*Doing Business in Victoria - Victorian Industry Statement*", as detailed in the Minister's foreword to the document, is:

"... to make doing business in Victoria easier, more productive and, above all, more inviting to prospective investors, both Australian and international. In attracting investment to the State, the Government is mindful of one overarching factor: the generation of wealth and employment growth that will lead to increased living standards for all Victorians".

4.6 The policy statement identifies 4 specific strategies viewed as essential to achievement of this purpose, namely:

- **improving the business environment** by reducing government input costs to business through reform of government business enterprises, a reduction in workers' compensation levies and reform of the labour market to make it more flexible and internationally competitive;
- **reforming bureaucratic procedures** by creating a streamlined and predictable planning and regulatory environment and fast-tracking large investment projects so as to reduce costs and delays to business;
- **facilitating investment and export performance** to create wealth and employment through targeting government assistance and facilitation services to key industry sectors with growth potential; and
- **assisting business to improve competitiveness and productivity and to focus on export opportunities** through joint Commonwealth/State Government initiatives aimed at providing advice, information and subsidies to facilitate strategic planning, total quality management, design and other similar aspects of enterprises' activities.

Regional Development policy statement, December, 1993

4.7 The regional development policy statement *"Investing in Country Victoria: A nine-point plan for investment and employment growth in provincial and rural Victoria"* sets out strategies to achieve the Government's regional development objectives which are outlined in the statement in the following terms:

- **investment attraction** to provide packages of facilitation and financial assistance to enhance the attractiveness of Victoria as an investment location;
- **targeted assistance for country Victoria**, generally in the form of one-off grants rather than ongoing financial assistance, to assist with the relocation, expansion or establishment of firms in regional locations;
- **supporting local development organisations** as economic development is seen as best promoted from the ground up to enable the different regions of the State to fully utilise their existing assets and natural advantages;
- **business advice for regional firms** through the establishment of Regional Development Business Centres to provide local access to all State Government business services and through joint Commonwealth/State Government schemes to assist business to improve the effectiveness and efficiency of their operations;
- **establishment of the Office of Regional Development** within the Department of Business and Employment as the Department's lead unit for economic development across country Victoria;
- **attraction of overseas investment** as a vital element of economic development, particularly where such investment builds on existing competitive strengths;
- **a co-operative approach between government and regional communities** to maximise the use of available resources;
- **building on regional strengths** in order to grow and prosper into the 21st century; and
- **promoting country Victoria** so that interested parties are aware of the particular advantages of doing business in regional centres.

4.8 Viewed collectively, the Government's 2 policy statements constitute the overall framework for the formulation of relevant implementation strategies for the Program by the Department of Business and Employment. As previously mentioned in Part 2 of this Report, the Program is the principal catalyst available to the Department for fulfilling the aims of these 2 policies and has the following major objectives:

- *"promote and facilitate improved Victorian industry and regional performance;*
- *improve the international competitiveness of Victorian enterprises and the Victorian business environment;*
- *enhance the export performance of key Victorian sectors and promote Victoria as an investment and business location; and*
- *provide advice on strategies and policies to improve Victoria's business environment"*.

FEATURES OF THE DEPARTMENT'S MANAGEMENT APPROACH FOR THE PROGRAM

4.9 Given the significance of the Government's industry assistance and regional development policies as key facilitators of the State's economic growth, it was clearly important that the Department developed, at an early stage, an effective management approach to its responsibilities in this area.

4.10 It was pleasing to find that the framework established by the Department for management of the Program had been carefully developed and exhibited several strong features which were aimed at assisting achievement, over time, of the Government's economic policy objectives. These features include:

- emphasis on the provision of financial assistance to projects in those key industry sectors identified by the Department as having strong growth potential;
- implementation of a range of financial assistance and facilitation packages directed at best meeting the Government's objectives and the needs of industry;
- development of detailed guidelines for controlling the assessment, approval and monitoring of assistance provided to individual companies;
- establishment of an organisational structure geared towards strengthening industry and regional development within the State, the attraction of new businesses to the State and the expansion of export levels and markets; and
- integration within the Department's annual business planning processes of the broad objectives of the Program and the strategies devised to meet these objectives.

4.11 **In audit opinion, the information presented in the following paragraphs of this Part of the Report on the above features should give comfort to the Parliament and the community that careful attention has been directed by the Department to ensuring that the lessons of the past in the management of the State's industry assistance arrangements have been heeded.**

Emphasis of the assistance program towards growth-oriented industry sectors

4.12 Under its industry policy statement, the Government makes available assistance packages to companies in key industry sectors as a means of facilitating economic growth in Victoria. The management strategies established by the Department for the Program provide for the availability of these packages to potential recipients to be determined on a case-by-case basis. Projects submitted by applicants are assessed according to the following criteria specifically designed to reinforce the significance of economic benefits expected to accrue to the State:

- the attraction of major **new investment** which otherwise would not occur in Victoria;
- identification of projects offering significant net economic benefits to Victoria, particularly in terms of **export growth, import substitution and increased employment;**
- emphasis to proposed investments in key trade-exposed industry sectors;
- a strict requirement that companies selected for assistance be assessed as financially viable; and
- demonstration by applicants of a commitment to achieving "*world best practice*" in their industry to enhance the likelihood that approved projects will add to the world competitiveness of Victoria's industry base.

4.13 The assistance available to applicants may be in the form of direct grants (no loans are provided under the Program) or non-financial facilitation services such as, assistance with site selection or fast-tracking of regulatory approvals.

4.14 In line with the principles embodied in the Government's industry policy statement, the provision of financial assistance by the Department is designed to attract significant investments in key trade-exposed industries sourced from overseas, interstate or existing Victorian-based companies. Priority in the allocation of assistance is accorded to the following industry sectors:

- manufacturing (including pharmaceutical and heavy engineering);
- processed food;
- downstream minerals, (i.e. value-adding after extraction); and
- high technology.

4.15 These key industry sectors are further elaborated upon in the industry statement as sectors which:

- enjoy a growing share of world trade and form a significant part of Victoria's industrial, educational and research base, namely:
 - pharmaceuticals;
 - information technology;
 - telecommunications;
 - chemicals, plastics and rubber;
 - scientific instruments;
 - aerospace and aviation;
 - waste management and recycling;
 - tourism; and
 - education services.
- add value to Victoria's existing natural resource advantages in agriculture, timber and minerals, comprising:
 - food processing;
 - forest products;
 - textiles, clothing and footwear; and
 - downstream minerals processing.
- are industries in which Victoria has a strong industrial base and which have strong linkages with sectors in the above 2 categories such as the automotive and engineering industries.

4.16 The above framework for the Program established by the Department represents a major change in emphasis from the more entrepreneurial approach adopted under the State's previous industry assistance programs which provided loans to newly-established companies that often were unable to attract finance from conventional lending institutions.

4.17 The targeting of industry assistance by the Department to projects and companies that offer significant economic benefits to the State and are clearly financially viable ensures that a sound foundation is in place for subsequent realisation of intended economic benefits from assisted projects.

Range of assistance and facilitation services

4.18 The Department has developed a wide range of financial assistance packages and other facilitation services as part of its implementation strategies for the Program. Table 4A illustrates the diversity of financial assistance and other services available to eligible industry participants.

**TABLE 4A
TYPES OF FINANCIAL ASSISTANCE AND FACILITATION SERVICES**

<i>Area</i>	<i>Type of assistance</i>	<i>Purpose of assistance</i>
Investment recruitment	Financial incentives (by way of grants)	To provide financial incentives to attract new industry investment that may not otherwise be located in Victoria.
Business and industry development	Business assistance	To assist businesses within key industry sectors with potential for rapid growth through export development.
	Industry studies	To facilitate studies aimed at improving the understanding of the Victorian business environment and Victorian enterprises.
	Events and exhibitions	To encourage the staging of events and exhibitions as a means of promoting Victorian products and services.
Regional development	Investment attraction	To assist regional centres in attracting suitable new investment or in expanding existing businesses.
	Regional infrastructure assessments	Joint studies with local government of the infrastructure capabilities of regions to accommodate new investment.
	Regional infrastructure support	Development of the infrastructure required to support potential investment, to establish regional development business centres and to offset the costs of promoting available infrastructure.
	Industry sector opportunity studies	To provide information on new investment opportunities in line with regional strengths.
	Business development	Assistance to regional business and tourism projects to encourage operational improvement through strategic planning, management training, export development and identification of business opportunities.
	Regional development bodies	To subsidise the operation of regional economic development bodies and the costs of employing business development facilitators to provide advice to small business.

TABLE 4A
TYPES OF FINANCIAL ASSISTANCE AND FACILITATION SERVICES - continued

<i>Area</i>	<i>Type of assistance</i>	<i>Purpose of assistance</i>
Trade and investment	Trade fairs and missions	To improve access by Victorian exporters to overseas markets through participation in fairs and missions.
	Export manager assistance	To subsidise the employment of export managers by firms with a commitment to export development.
	Feasibility studies - greenfield projects	To contribute to consultancy costs for studies of greenfield (new development) projects in key sectors.
	Market entry assistance	To facilitate the offshore sale of goods and services through the gathering of information on international markets.
Enterprise improvement	National Industry Extension Service	Joint Commonwealth/State Government scheme to assist businesses to improve the effectiveness and efficiency of their operations including advice and referral services under the AusIndustry initiative.

4.19 It can be seen that the forms of assistance under the Program vary from direct financial and other categories of assistance, geared towards facilitating development within individual companies, through to the organisation and conduct of studies and trade fairs with the broader aim of developing investment and trade opportunities for an industry or region as a whole.

4.20 The Department has consulted widely with representatives of industry and those Commonwealth and State Government agencies involved in industry and regional development both in developing the various forms of assistance under the Program and as a source of expert advice on industry needs. A specific initiative of the Department has been the establishment of a business consultative network that enables key business leaders and participants, through the provision of advice to the Department, to influence Victorian industry policies and strategies. This network involves representation by industry on a Business Advisory Group, which channels broad-based advice to the Minister on industry and business issues, and on several consultative groups which consider developments relating to industry as a whole or specific industry sectors. The Minister chairs both the Business Advisory Group and the individual consultative groups.

4.21 The formulation by the Department of a diversity of assistance categories and a consultative network with industry representatives has been aimed at ensuring that the Program's general direction meets the overall needs of industry and addresses issues of emerging significance to the State's development.

Management control over the provision of assistance

4.22 Given the nature of the Program, it is critical that the Department has in place effective procedures governing applications submitted for assistance, its approval decisions and the subsequent monitoring mechanisms over the direction and use of approved assistance. In fact, these procedures reflect fundamental core elements of the Program which, if not soundly managed, would adversely impact on attainment of the Government's industry and regional development policy objectives.

4.23 The 1989 Special Report by the Auditor-General to the Parliament included major criticism on the manner in which assistance provided under the State's previous industry programs had been managed and controlled. Specific shortcomings identified in that Special Report included:

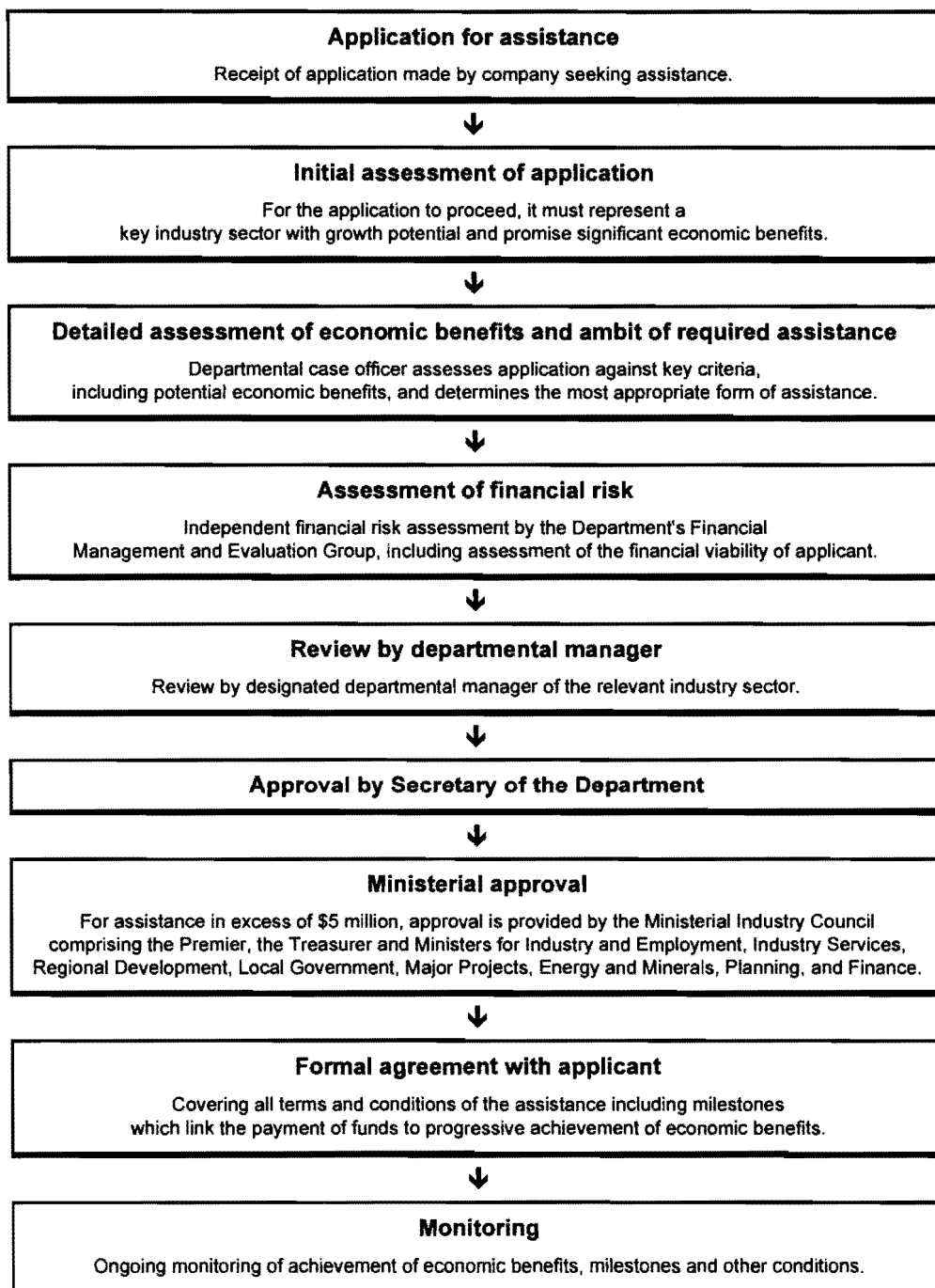
- lack of control over the assessment of applicants for financial assistance, particularly in regard to evaluation of the risk associated with projects to be assisted; and
- failure to regularly monitor the use by companies of financial assistance.

4.24 The Department has directed high priority to the establishment and use of carefully-structured management controls governing the provision of financial assistance. In this regard, it has developed and applied detailed policy guidelines for the management of the various assistance packages available under the Program. The policy guidelines were compiled at an early stage of the formulation of the Program and encompass:

- the previously described criteria for assessment of applications for financial assistance which accentuate the financial viability of applicants and the likelihood of significant economic benefits accruing to the State;
- use of formal agreements, which vary on a case-by-case basis, outlining the terms and conditions of assistance and, in particular, the obligations of recipients;
- scheduling of progressive payments linked to attainment by approved Program participants of agreed milestones covering the realisation of economic benefits; and
- provision for on-going monitoring, including site visits and physical verification of projects, of the extent of actual achievement of economic benefits.

4.25 Chart 4B outlines, in the form of a flow diagram, the key processes implemented by the Department for quality assurance of its management of the assessment, approval and monitoring stages of assistance provided under the Program.

CHART 4B
QUALITY ASSURANCE PROCEDURES FOR FINANCIAL ASSISTANCE



4.26 Audit considered that the Department's control procedures were well-structured, designed to ensure that each key stage of the process was satisfactorily addressed before proceeding to the next stage and, generally, reflected the Department's firm desire of avoiding recurrence of the shortcomings in the previous assistance program. **In summary, the control framework has been designed to minimise risks and maximise the attainment of economic benefits to the State.**

Organisational structure

4.27 Chart 4C outlines the organisational structure established by the Department for its management of the program.

**CHART 4C
ORGANISATIONAL STRUCTURE -
INDUSTRY, REGIONAL AND TRADE SUPPORT PROGRAM**



4.28 In discussions during the audit, the Department indicated that the key features of its organisational structure were:

- establishment of 4 specific organisational units, each with responsibility for achieving a distinct aim of the program, namely:
 - an Industry Development Division with the role of developing existing Victorian industry and facilitating major investment projects;
 - an Office of Regional Development focusing on the attraction of industry to regional areas of the State and liaising with local government agencies on future business opportunities;
 - the Office of Trade and Investment, incorporating Asian, European and North American business units, with the task of promoting export growth by Victorian industry; and
 - an Industry and Business Strategy Division, responsible for monitoring the operations of the Strategic Industry Research Foundation, conduct of industry research and overseeing the development of the Melbourne Exhibition Centre; and

utilisation of the Department's Financial Management and Evaluation Group to provide an arms-length and specialist review of the financial viability of companies prior to the approval of assistance.

4.29 The organisational structure established by the Department complements the other features of its overall management approach for the Program.



Establishment of a new manufacturing plant in the packaging industry.

Business planning

4.30 A further feature of the departmental management setting for the Program is the integration of relevant objectives and strategies within the Department's business planning processes. Drawing on the broad objectives of the Program, the 1994-95 business plan outlines the Program's overall aim as:

"To enhance Victoria's industry and regional performance through the development and support of international competitiveness in Victoria's business environment, key industries, regions and enterprises".

4.31 To support this high-level aim, the business plan incorporates details of relevant strategies, key result areas, outputs and performance measures relating to the Program for the 1994-95 financial year. Examples of this type of information documented in the business plan include:

- program strategies such as:
 - providing specific investment incentives to attract and support major new investments with economic benefits;
 - maximising the impact of research and development support for Victorian industry; and
 - encouraging and assisting investment and export performance in regional areas, particularly in conjunction with regional economic development bodies and local government;

- key result areas covering:
 - improvement in investment recruitment;
 - enhanced export and international performance through export assistance and increased Victorian involvement in key overseas trade fairs and missions; and
 - strategic studies on Victoria's business environment;
- program outputs designed to disclose actual achievements in:
 - announced and prospective major investment projects; and
 - export assistance programs and overseas trade fairs and missions; and
- a series of broad performance indicators for the Program.

4.32 The integration of relevant strategic information on the Program within the Department's business planning processes has provided executive management with the means of overseeing the implementation of the Program's broad aims and objectives as part of the departmental-wide corporate review framework.

Part 5

Effectiveness of services provided to industry

OVERVIEW

5.1 Although the Industry, Regional and Trade Support Program is still in its early stages, economic benefits projected by the Department of Business and Employment to accrue to the State from projects approved to progressively receive assistance from 1994-95 are significantly greater than the equivalent position in 1993-94. In this regard, the Department achieved its target for the year of between \$900 million and \$1.1 billion for anticipated economic benefits in the form of additional investment within the State, with almost \$1 billion expected to materialise from approved assistance.

5.2 However, the Department needs to establish targets for the remaining key categories of economic benefits, namely, export growth, import substitution and increased employment, and develop priorities between industry sectors. Such action would provide the Department with a sounder basis for directing its scarce resources towards those areas with the greatest beneficial impact on the Victorian economy.

5.3 Some additional matters identified by audit concerning provision of assistance which will require attention by the Department were:

- assessing whether its strategic approach to import substitution has been sufficiently targeted to date towards the facilitation of relevant economic activity within the State;
- maintenance of a suitable balance between direct financial assistance and its valuable non-financial facilitation services to industry; and
- through improved cost recording and monitoring, development of an enhanced basis for decisions on the allocation of resources to facilitation services and the cost-effectiveness of such services.

5.4 The Department's Office of Trade and Investment has generated positive results to date from its overseas trade fairs and missions and its subsidisation program for the engagement of export managers by Victorian companies. The Office is currently in the process of implementing remedial action to strengthen the accountability of the Government's 6 overseas business offices in maximising their contributions to enhancing the State's economic growth.

5.5 In relation to regional development, finalisation of the Department's current strategic evaluation of regional needs will provide it with a more structured framework for pursuit of the Government's objectives in this area. This action needs to be accompanied by the placing of a greater priority on completion of infrastructure studies and assessment of resultant needs for all 5 country regions of the State if Victoria is to be in a position to maximise its share of Australian Government funding for infrastructure works currently available under the national regional development strategy.

5.6 Finally, in line with the Government's focus on improved performance measurement and reporting, the Department is in the preliminary stages of developing a suitable performance measurement framework for the Program. It recognises that substantial attention will need to be directed to the formulation of qualitative performance measures and it expects its recent commissioning of an external consultancy review, aimed at identifying world best practice in this area, to help fill what has been a long-standing gap in the management of the State's industry assistance arrangements.

LEVEL OF INDUSTRY ASSISTANCE TO DATE AND EXPECTED ECONOMIC BENEFITS TO THE STATE

5.7 As pointed out in Part 4 of this Report, the Department has in place a diversity of financial assistance packages and other facilitation services which are available to eligible industry participants.

5.8 During 1993-94 and 1994-95, the Department provided financial assistance and non-financial forms of facilitation services through its Industry, Regional and Trade Support Program to 119 projects.

5.9 In line with the emphasis of the assistance program towards growth-oriented industry sectors, the nature of the economic benefits expected to accrue to the State is determined by the Department and agreed with each applicant as a condition of approval for each project. Table 5A summarises, in aggregate form, financial and non-financial assistance approved by the Department during 1993-94 and 1994-95 for subsequent provision to companies and the related economic benefits expected to be generated by the companies under each type of assistance.

**TABLE 5A
AGGREGATE ASSISTANCE
APPROVED DURING 1993-94 AND 1994-95
AND EXPECTED ECONOMIC BENEFITS TO THE STATE**

<i>Item</i>		<i>1993-94</i>	<i>1994-95</i>
Assistance approved			
Projects assisted -			
Approved financial assistance	(no.)	25	38
Non-financial facilitation services	(no.)	41	15
Total	(no.)	66	53
Financial assistance approved (a)	(\$m)	6.8	42.1
Expected economic benefits			
Additional investment from -			
Approved financial assistance	(\$m)	334	617
Non-financial facilitation services	(\$m)	472	371
Total	(\$m)	806	988
Export growth from -			
Approved financial assistance	(\$m)	112	843
Non-financial facilitation services	(\$m)	358	93
Total	(\$m)	470	936
Increased employment from -			
Approved financial assistance	(no.)	1 794	3 825
Non-financial facilitation services	(no.)	1 911	1 122
Total	(no.)	3 705	4 947

(a) Assistance approved for provision to companies is paid on a periodic basis during the course of the project, subject to satisfactory achievement by companies of expected economic benefits.

5.10 Some key observations which can be drawn from the above table on the level of assistance approved by the Department during 1993-94 and 1994-95 are:

- the magnitude of financial assistance approved to companies investing in Victoria increased 6 fold from \$6.8 million in 1993-94 to \$42.1 million in 1994-95;
- overall economic benefits anticipated to be generated on projects approved during 1994-95 are significantly greater than the equivalent position in 1993-94 in that the:
 - additional investment of \$988 million (\$806 million, 1993-94) represents an expected increase of over 20 per cent;
 - export growth of \$936 million (\$470 million, 1993-94) equates to a projected rise of almost 100 per cent; and
 - increased employment numbers of 4 947 (3 705, 1993-94) constitute an estimated upward movement of 34 per cent;
- all 3 categories of economic benefits represent quantitative projections which involve either huge monetary values or (in the case of employment) a sizeable upward change;
- the number of approvals for projects only receiving non-financial facilitation services has fallen from 41 in 1993-94 to 15 in 1994-95, with an associated reduction in the level of economic benefits expected to be realised from such projects; and
- in terms of improving the State's balance of trade position, emphasis has been directed towards projects with a direct export outcome rather than projects which focus exclusively on import substitution.

5.11 Relevant comment on these key observations is provided in the following paragraphs.

Economic benefits expected to the State from assistance approved to date

5.12 In its 1994-95 business plan, the Department set a targeted value of between \$900 million and \$1.1 billion for anticipated economic benefits, in the form of additional investment, to accrue to the State arising from projects approved during the year. As indicated above, this target was achieved with additional investment of almost \$1 billion expected to materialise within the State from approved assistance in 1994-95.

5.13 The Department did not establish similar targets for the Program's remaining categories of anticipated economic benefits, namely, export growth, import substitution and increased employment. The Department advised audit that such targets were not set because of the difficulty it had experienced in the development of qualitative indicators which could attribute a direct link between a particular form of assistance and the achievement of the Program's broad objectives.

5.14 The setting of specific targets for all of the key categories of economic benefits would place the Department in a stronger position to be satisfied that its management of the Program has contributed, to a maximum degree, to achievement of the Program's major objectives.

□ **RESPONSE** by Secretary to the Department of Business and Employment

The Department notes the position adopted in relation to the setting of specific targets for all key economic benefits. The Department obtains information on economic benefits as part of assessing investments and their impact, and will consider the issue of targets in the light of the consultancy report commissioned by the Department, referred to in paragraph 5.96, on performance indicators of government-funded industry agencies.

Analysis of anticipated economic benefits by industry sector

5.15 Part 4 of this Report indicated that a major criterion used to assess projects submitted by companies for financial and non-financial assistance provided for an emphasis on investments in key trade-exposed industry sectors, with priority accorded to:

- manufacturing (including pharmaceutical and heavy engineering);
- processed food;
- downstream minerals (value-adding after extraction); and
- high technology industries.

5.16 Against this background, audit analysed the economic benefits expected from additional investment, export growth and increased employment in individual industry sectors for projects approved during 1993-94 and 1994-95. Table 5B presents the relevant information.

TABLE 5B
EXPECTED ECONOMIC BENEFITS BY INDUSTRY SECTOR, 1993-94 AND 1994-95

Industry sector	Additional investment		Export growth		Increased employment	
	1993-94	1994-95	1993-94	1994-95	1993-94	1994-95
	(\$m)	(\$m)	(\$m)	(\$m)	(no.)	(no.)
Information technology and telecommunications	15	240	-	15	182	1 630
Processed food	204	221	266	84	882	614
Chemical	8	187	8	4	20	377
Forest	18	98	5	90	114	190
Textiles, clothing and footwear	242	69	137	-	856	615
Services	-	45	-	-	-	260
Automotive	32	37	7	-	334	460
Aerospace	-	31	-	200	-	340
Defence	-	20	-	500	-	80
Heavy engineering	19	19	11	8	202	78
Tourism	145	-	-	-	375	150
Recycling	51	-	-	-	210	-
Pharmaceutical	2	-	-	-	15	-
Downstream minerals	-	-	-	-	-	-
Other industry sectors	70	21	36	35	515	153
Total	806	988	470	936	3 705	4 947
Percentage change (%)	-	+ 23	-	+ 99	-	+ 34

5.17 The information presented in the above table shows, in respect of approved assistance up to 30 June 1995, that:

- significant levels of economic benefits in the form of additional investment, export growth or increased employment are expected in the processed food and the information technology and telecommunications sectors, 2 of the key trade-exposed industry sectors prioritised under the Program for assistance;
- to date, projects within the remaining prioritised sectors of downstream minerals and the pharmaceutical and heavy engineering elements of the manufacturing category have attracted minimal assistance and projected economic benefits; and

- the textiles, clothing and footwear sector expects substantial additional investment of over \$300 million, export growth of \$137 million and an employment increase of 1 471 jobs.

5.18 The Department advised audit that the minimal assistance provided to date for projects in the downstream minerals, pharmaceutical and heavy engineering industry sectors reflected in part the particular economic circumstances facing these sectors (e.g. the global rationalisation in the pharmaceutical sector) and the investment patterns in these sectors.

5.19 Table 5C provides examples of major projects within particular industry sectors approved for assistance under the Program during 1993-94 and 1994-95.

TABLE 5C
EXAMPLES OF MAJOR PROJECTS APPROVED FOR
ASSISTANCE UNDER THE PROGRAM DURING 1993-94 AND 1994-95

<i>Industry sector</i>	<i>Company</i>	<i>Nature of approved project</i>
Information technology and telecommunications	Oracle Corporation	Location in Victoria of an Asia/Pacific support centre in the telecommunications industry encompassing additional investment of \$150 million, potential export growth of \$15 million and increased employment of 310 jobs.
	Foxtel	Establishment of a national customer service centre in Melbourne attracting \$50 million of investment and potential employment of 1 000 jobs.
Processed food	Murray Goulburn Co-op Co. Ltd	Construction of a state-of-the-art central distribution facility with total additional investment of \$7 million, potential export growth of \$230 million.
Textiles, clothing and footwear	Leading Synthetics Pty Ltd	Development of a manufacturing facility for polyester and other products with a total investment of \$116 million, potential export growth of \$40 million and increased employment of 215.
Aerospace	AWA Defence Industries	Expansion of missile manufacturing operations and establishment of international marketing and management location with a \$9 million investment and an anticipated increase in employment of 100 jobs and export growth of \$200 million.
Defence	Thomson Radar Aust. Corporation	A \$20 million investment to expand existing sales, marketing and research and development activities in Melbourne with potential for export growth of \$500 million.

5.20 At 30 June 1995, a total of \$6.2 million had been paid to the companies identified in Table 5C. Progressive payments will be made by the Department in future years up to the level of approved assistance for each company. These progressive payments will be subject to satisfactory achievement by the companies of milestones agreed with the Department relating to realisation of expected economic benefits. At 30 June 1995, the aggregate remaining balance of approved assistance to be paid, subject to satisfactory performance, to the identified companies in future years was \$20.9 million.

5.21 Similar to the point mentioned in paragraph 5.13 on the absence of targets for 3 of the 4 key categories of economic benefits, audit identified that, to date, the Department has not established clear priorities for the allocation of assistance between individual industry sectors or targets for the level of resultant benefits to be achieved in those sectors.

5.22 While recognising the relatively short time since the commencement of the Program, audit considers that the Department should now be in a position to identify those industry sectors with the greatest capacity to contribute to the State's economic growth. In this way, assistance can be more readily focused on the prioritised sectors, with supplementary targets on projected economic benefits established on an industry basis.

5.23 **The development of clear priorities between industry sectors and the establishment of targets for the level of economic benefits on an industry basis would give the Department a sounder basis for directing its scarce resources towards those areas with the greatest beneficial impact on the Victorian economy.**

RESPONSE by Secretary to the Department of Business and Employment

The Department has and will continue to review on a periodic basis, the priority sectors, including the levels of investment and export activity. These reviews, which are linked to the Department's business planning processes, are and will be used to adjust resource allocations.

Method of projection of economic benefits by the Department

5.24 As mentioned in paragraph 5.10, the substantial contributions to the State's economic well-being, likely to materialise in the form of additional investment, export growth and increased employment from assisted projects, represent quantitative projections by the Department of expected incremental outcomes. In some cases, these outcomes are anticipated to materialise over periods of between 2 to 5 years during which changes in domestic and international economic circumstances could impact on the ultimate realisation of benefits.

5.25 It follows therefore that, at this early stage of the Program, the extent of reliance which can be placed on such projections as a measure of likely achievements under assisted projects is necessarily dependent on assessments of the soundness or otherwise of the underlying basis of projections. Accordingly, audit directed some attention to examination of the procedures followed by the Department in the determination of benefits anticipated to accrue to the State from assistance provided under the Program.

5.26 At the initial application stage, companies seeking assistance are required to declare their ability to generate economic benefits in relation to the 4 specified benefit categories. By way of examples, the nature of probable additional investment (supported by estimated benefits) arising from a project may be illustrated by a company within its assistance application as:

- the development of a major new manufacturing facility in one of the manufacturing industries of the State; or
- investment covering acquisition of a site, construction of a building or the purchase of capital equipment for the establishment of a new industry facility.

5.27 As an early means of minimising the risk that anticipated economic benefits will not be achieved or overstated, departmental case officers, with specialist expertise in the relevant industry sector, are responsible for the evaluation of a company's capacity to deliver the stated projected economic benefits. This evaluation is complemented by a stringent analysis of the financial viability of applicant companies by the Department's Financial Management and Evaluation Group. In broad terms, these 2 actions encompass:

- review of the applicant company's financial position, incorporating the furnishing of an opinion by their banker;
- confirmation through independent sources of the bona fides of the company's directors;
- examination of a business information report submitted by an external consultant to the Department in order to provide an independent assessment of the risks associated with supporting the company;
- an extensive evaluation of the company's project proposal;
- analysis of the company's business record; and
- assessment of the company's business planning strategy.

5.28 As a consequence of the above scrutiny processes, the Department is in a sound position to confirm the estimate of projected benefits initially submitted by companies. In this regard, the Department advised audit that, if the projected economic benefits submitted by a company could not be confirmed, it would be highly unlikely that the application would be allowed to proceed.

5.29 Following examination of the above procedures established by the Department and of the manner in which these procedures were applied to several projects, **audit is of the view that the Department's projections of economic benefits expected to flow to the State from projects approved for assistance as at 30 June 1995 have been developed on a sound basis and reflect all known conditions at that date.**

Reduced focus on projects only receiving non-financial assistance

5.30 Table 5A, presented earlier in this Part, and an accompanying explanatory paragraph indicated that the number of projects approved to receive only non-financial facilitation services has fallen from 41 in 1993-94 to 15 in 1994-95, with an associated reduction in the level of economic benefits expected to be realised from such projects. This position contrasted with a 50 per cent increase in the number of projects approved to receive direct financial assistance in 1994-95.

5.31 Audit was advised by the Department that the greater concentration on financial assistance during 1994-95 mainly reflected the current intensity of international and interstate competition between governments for attracting business investment. In such an environment, there is a greater expectation by industry participants for financial incentives and, spurred by the competitive forces, the amount of financial assistance offered by governments tends to escalate. Relevant to these circumstances is the fact that most governments direct efforts to luring capital investment to their areas as a means of fostering economic growth. It is also in the interests of industry participants to canvass all available offers to maximise the level of funding they can derive from government sources in the process of determining where to locate their investments. While, in many cases, the amount of financial assistance offered by government may represent a relatively minor proportion of the aggregate costs to be incurred by a company on an investment project, the extent of such assistance may well be an important influencing factor in the company's ultimate decision on the project's location.

5.32 The above circumstances create a dilemma for governments and, in the Victorian context, the Department in attracting major investments through financial assistance while at the same time maintaining adequate attention to the provision of non-financial facilitation services. In this regard, the Department is aware of the important role of facilitation services in expediting investment activity in the State and, even in the short time since the Program has been underway, there have been several examples where valuable facilitation services have been provided to support major investment projects. Two good illustrations of this position were:

- assistance with project planning, the selection of an appropriate site and gaining the necessary development approvals for the construction of a processing plant in the forestry industry; and
- the attraction of a Japanese processing company in the food industry through facilitating the location of the processing plant and assisting to establish communication lines with local primary producers.

5.33 The Department also advised that the provision of financial assistance to companies is invariably accompanied by non-financial assistance.

5.34 The value of non-financial facilitation services was clearly reinforced by industry representatives to audit during visits to a number of companies in receipt of assistance under the Program (the industry perspective on this matter and other aspects of the Program are presented in Part 6 of this Report).

5.35 The Department has indicated to audit that it intends to keep this element of the Program under regular scrutiny with the aim of avoiding any potential for erosion over time of the level and quality of facilitation services made available to support industry activity within the State. It also advised that, in addition to the provision of non-financial assistance to individual companies, resources have been directed towards activities aimed at improving the business environment as a whole. In this regard, in November 1993 the Department commissioned KPMG Consulting to undertake a benchmarking study of the costs of doing business in Victoria as a means of identifying for industry the benefits and costs of the State as a location for new investment. The study focused on the competitive position of Melbourne relative to Brisbane, Sydney and a selection of overseas cities and found that, overall, Victoria provides a cost-competitive environment for the location of industry.

5.36 An important feature of the Department's management of the Program, in terms of maximising new business investment within the State, will be the maintenance of a suitable balance over time between direct financial assistance to industry and the valuable non-financial services available to augment industry activity.

RESPONSE by Secretary to the Department of Business and Employment

As outlined in the Report, the Department provides a wide range of facilitation, information and service assistance to industry and enterprises, as well as financial assistance. The balance will be influenced by government policy and the developments elsewhere in relation to industry and enterprise policies and programs.

Limited emphasis on projects dealing exclusively with import substitution

5.37 A specific feature of the criteria formulated under the Program for the evaluation of applicants is the focus on projects offering significant benefits to the State's balance of trade position through either export growth or import substitution. As indicated in the earlier commentary on Table 5A, during 1993-94 and 1994-95 emphasis has been directed towards projects with a direct export outcome rather than projects which focus exclusively on import substitution.

5.38 Import substitution essentially refers to the replacement of imports through the manufacture of domestically-produced goods. As local industry operating in a trade-exposed environment increases its ability to produce goods that meet local demand and effectively replace the purchase of imports, benefits will accrue to the State generally in the form of increased production, employment growth and, because of the import replacement, an improved balance of trade position.

5.39 Because of the economic significance attached to import substitution and the fact that it is a prioritised category under the Program, audit raised with the Department the rationale for the limited focus on projects which deal exclusively with import substitution.

5.40 In discussions with audit on this matter, the Department advised that the trend in industry policy generally in Australia and elsewhere is not to focus exclusively on import substitution but to adopt the philosophy that a company which can successfully export is more internationally competitive and self-sustaining than one which can only compete at home. It also indicated that the Department's Industrial Supplies Office has a responsibility of identifying and facilitating projects with potential for import substitution.

5.41 Given the priority attached to import substitution within the Government's industry policy statement and the Program's assistance criteria, there would be merit in the Department assessing whether its strategic approach to import substitution has been sufficiently targeted to date towards the facilitation of relevant economic activity within the State.

RESPONSE by Secretary to the Department of Business and Employment

The Department's funding of the Industrial Supplies Office, which has been increased as from 1 July 1995, and the use of net exports in assessing the economic benefits of investment projects, illustrates the strategic focus placed on import substitution by the Department.

Scope for improved recording and monitoring of costs of facilitation services

5.42 Operating costs incurred by the Department during 1994-95 in relation to the Program totalled \$35 million. This figure incorporates the costs associated with the provision of facilitation services.

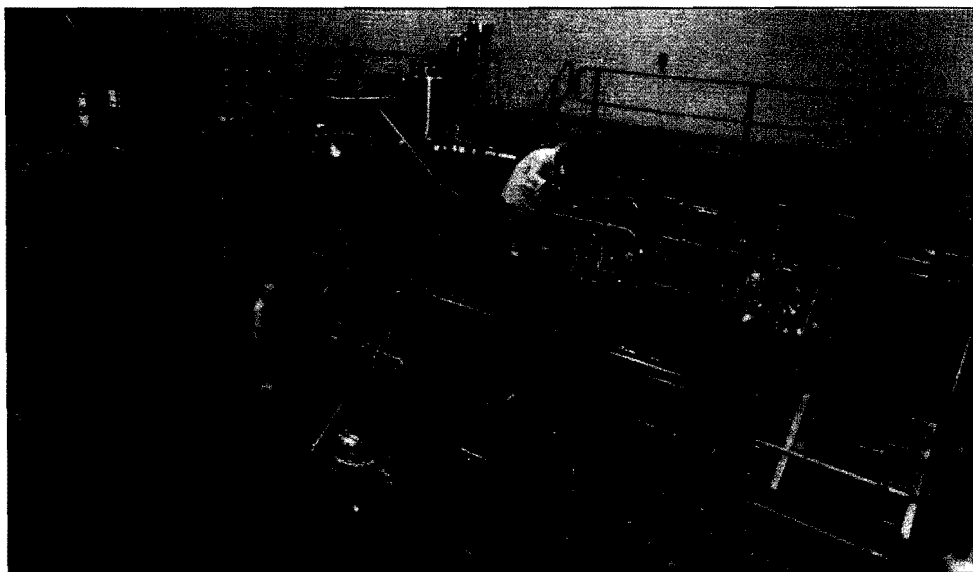
5.43 The Department does not separately record salaries and related costs connected with the provision of facilitation services. As a consequence, it is not in a position to determine the cost-effectiveness of all facilitation services provided under the Program from both an aggregate viewpoint and in terms of the various types of services. In other words, it has not been able to undertake periodic monitoring of the level of costs incurred in the provision of particular types of services or to ascertain whether costs have been warranted, or even excessive, relative to the resultant benefits or whether sufficient resources have been directed to those services offering the greatest benefit to industry.

5.44 The above position contrasts sharply with the careful recording by the Department of all direct financial assistance approved for projects under the Program.

5.45 The Department should take action to implement a management information system which enables the separate recording and monitoring of costs incurred in the provision of facilitation services. The availability and use of such information would enhance the Department's decision-making processes and the cost-effectiveness of resource management for this aspect of the Program.

RESPONSE by Secretary to the Department of Business and Employment

As part of the improved financial planning and reporting initiatives in 1995-96, the Department will introduce a pilot activity-based costing system.



Advanced food processing production facilities.

OFFICE OF TRADE AND INVESTMENT

5.46 As mentioned in Part 4 of this Report, the Office of Trade and Investment is the key organisational unit within the Department responsible for the promotion of export growth by Victorian industry. The Office incorporates business offices in London, Tokyo, Frankfurt, Hong Kong, Seoul and Jakarta.

5.47 The role of the Office encompasses:

- providing financial assistance and facilitation services for major projects with a specific emphasis on export growth;
- strengthening of Victoria's overseas representation, particularly in South-East Asia, and facilitating access to international markets by Victorian exporters, primarily through organising trade fairs and missions;
- subsidising the engagement of export managers by Victorian companies to enhance export performance; and
- managing the 6 overseas business offices.

Assistance provided to major projects

5.48 While the level of expected export growth arising from approved projects during the 2 years was quite substantial (\$470 million in 1993-94 and \$936 million in 1994-95), to date, the contribution by the Office of Trade and Investment in terms of facilitating such projects has been relatively limited. Table 5D shows the number of projects approved for assistance by the Office over the last 2 financial years and the associated future economic benefits expected to accrue to the State.

TABLE 5D
PROJECTS APPROVED FOR ASSISTANCE BY THE OFFICE OF TRADE AND INVESTMENT AND EXPECTED ECONOMIC BENEFITS, 1993-94 AND 1994-95

Industry sector	Projects assisted		Investment generated		Increased exports		Employment growth	
	93-94	94-95	93-94	94-95	93-94	94-95	93-94	94-95
	(no.)	(no.)	(\$m)	(\$m)	(\$m)	(\$m)	(no.)	(no.)
Textiles, clothing and footwear	1	-	20	-	28	-	45	-
Food	5	1	38	25	-	-	60	-
Engineering	3	-	9	-	-	-	82	-
Information technology and telecommunications	1	-	-	-	-	-	2	-
Science and medical instruments	-	1	-	8	-	35	-	45
Recycling	1	-	1	-	-	-	6	-
Leisure	1	-	-	-	33	-	25	-
Tourism	1	-	80	-	-	-	-	-
Total	13	2	148	33	81	35	220	45
State aggregate	66	53	806	988	470	936	3 705	4 947
Per cent of total program (%)	20	4	18	3	13	4	6	1

5.49 Given the importance to Victoria of a strong balance of trade position, the Department should ascertain whether greater priority needs to be given by the Office of Trade and Investment to its role of assisting major projects in the Victorian export industry.

□ **RESPONSE** by Secretary to the Department of Business and Employment

The Department adopts a project approach to investment recruitment and facilitation using the resources of staff, as appropriate, from the Industry Development Division, Office of Regional Development and Office of Trade and Investment. The statistics in Table 5D do not reflect the total involvement of the Office of Trade and Investment in investment recruitment activities since they only relate to the projects where the Office is assigned lead responsibility for management purposes.

Trade fairs and missions

5.50 The organisation of trade fairs and missions is a major function undertaken by the Office to make overseas markets more accessible to Victorian exporters and to strengthen Victoria's overseas representation, particularly in the South-East Asian area.

5.51 During 1993-94 and 1994-95, 17 overseas trade fairs and missions were organised by the Office at a total cost of \$810 000. Over 200 Victorian businesses were involved in these events and received departmental funding of up to \$5 000 to subsidise the costs of their participation.

5.52 The documentation held by the Office relating to these trade fairs and missions indicated that such activities encompassed a wide coverage of Victorian industries. Events were organised for the information technology, construction, processed food and automotive industry sectors, and focused on targeted export-growth regions in South-East Asia including Indonesia, Vietnam, China and Hong Kong.

5.53 To its credit, the Office has undertaken a survey of companies participating in its overseas trade fairs and missions held between July 1994 and March 1995. The survey was aimed at determining the impact of these services and the associated level of client satisfaction. Significant matters conveyed by participants in their responses to the survey were:

- their resultant establishment of valuable overseas contacts, including retail, distribution and agency relationships;
- actual export sales of \$21.6 million identified as attributable to contacts or information arising from the trade fairs and missions; and
- potential for export sales of in excess of \$500 million over the next 5 years.

5.54 In terms of client satisfaction, the majority of participants rated the trade fairs and missions organised by the Office to be either of an excellent or a satisfactory standard in enhancing their export development capacity. Table 5E summarises the views of respondents on this matter.

TABLE 5E
RESULTS OF CLIENT SATISFACTION SURVEY
CONDUCTED BY THE OFFICE OF TRADE AND INVESTMENT
(per cent)

Activity surveyed	Rating		
	Excellent	Satisfactory	Unsatisfactory
Trade fairs -			
Importance to export growth	20	59	21
Objectives of company met	28	55	17
Trade missions -			
Importance to export growth	42	29	29
Objectives of company met	47	41	12

5.55 The Office indicated to audit that it intends to conduct similar surveys on a periodic basis.

5.56 The Office of Trade and Investment should be commended for the very positive results achieved to date from its overseas trade fairs and missions, as perceived by industry participants.

Subsidising engagement of export managers

5.57 Under an initiative introduced by the Department in November 1993, the Office of Trade and Investment subsidises the engagement of export managers by Victorian companies with the objective of enhancing the State's export performance.

5.58 During 1993-94 and 1994-95, 59 firms within key industry growth sectors received assistance totalling \$1.7 million from the Office under these arrangements.

5.59 The Office has also conducted a survey of companies assisted in this area during 1993-94. This survey encompassed the views of subsidised companies on the benefits arising from employment of an export manager and identification of the level of export sales achieved by the companies. The main results of this survey were:

- the employment of an export manager had the positive effect of facilitating:
 - the appointment of export agents and distributors;
 - establishment of joint ventures;
 - the opening of new export markets; and
 - expansion of existing production facilities.
- the majority of subsidised companies (70 per cent) were targeting the Asian region; and
- export sales of \$67.5 million in 1992-93, \$160 million in 1993-94 and \$230 million between July 1994 and March 1995 had been achieved by the companies.

5.60 While the Office recognises that the identified levels of export sales cannot be directly attributable to the subsidised employment of export managers, the survey results do indicate that, in its relatively short period of operation, this initiative has made a positive contribution to the enhancement of export development by the participating companies.

Victorian Government business offices

5.61 The Office is responsible for the management of the Government's 6 overseas business offices located in London, Tokyo, Frankfurt, Hong Kong, Seoul and Jakarta. The purpose of these offices is to provide a source of knowledge of the various markets as a means of facilitating export growth from Victoria and fostering investment in Victorian enterprises.

5.62 In total, 26 staff are employed in the business offices and the costs of operation incurred in 1993-94 and 1994-95 were \$3.9 million and \$4.1 million, respectively.

5.63 The Office has recently completed an internal review of the staffing, operating costs and processes for reporting of achievements of the Government's overseas offices. This review identified that:

- deficiencies in the quality of reports forwarded to the Department by the offices have caused the Department to doubt the accuracy of performance information contained in those reports;
- the reports forwarded to the Department varied considerably in reporting style and there was a lack of detail regarding activities undertaken making it difficult for the Department to assess the significance of the achievements of the offices;
- there was a general tendency for the offices to report on activities rather than outcomes; and
- the Department believes that there have been many instances where successful investment cases have not been adequately monitored and the full extent of economic benefits has not been reported.

5.64 Drawing on the results of its review, the Office has recently initiated remedial action which provides for the introduction of a standardised format for reporting of performance by the overseas offices, the formulation by offices of specific performance targets and, generally, a requirement for offices to place a greater focus on progressive monitoring and reporting on outcomes of investment and export activities.

5.65 As a consequence of its recent initiatives in this area, the Office should be in a stronger position to:

- assess the effectiveness of the contribution of the overseas offices to enhancing the State's economic growth; and
- determine the optimum allocation of resources between offices having regard to the extent of their individual performance.

MANAGEMENT OF REGIONAL DEVELOPMENT

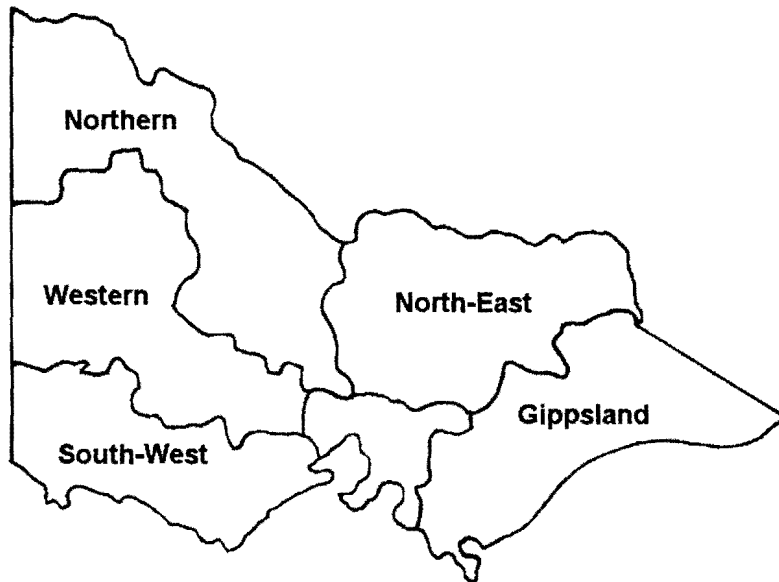
5.66 As mentioned in Part 4 of this Report, the Government's regional development policy statement sets out strategies designed to achieve its regional development objectives in terms of attracting investment to country Victoria, supporting regional development organisations, attracting overseas investment to regional areas and, generally, building on regional strengths and promoting regional locations.

5.67 The Department has documented in its 1994-95 business plan that the aim of its regional development activities under the Program is to generate long-term sustainable growth and investment in Victorian regional centres by:

- the attraction of new investment projects to country areas through the provision of financial assistance, facilitation services and strategic information;
- delivery of enterprise improvement programs designed to make regional firms internationally competitive through enhanced business and strategic planning;
- working together with those regional development bodies and local government organisations which have an intimate knowledge of local firms, conditions and opportunities for development and growth;
- fast-tracking major investment projects by providing regional investors with a direct and speedy resolution to regulatory and planning requirements; and
- the funding of regional infrastructure studies to facilitate further infrastructure investment in regional areas.

5.68 The Office of Regional Development is the major unit within the Department with responsibility for achievement of the above aim through delivery of financial assistance and facilitation services to regional Victoria. The boundaries of regional areas assisted by the Office are illustrated in Chart 5F.

**CHART 5F
REGIONAL AREAS ASSISTED BY THE OFFICE OF REGIONAL DEVELOPMENT**



Level of regional assistance and expected economic growth

5.69 As a means of identifying the level of economic growth expected across regional Victoria from assistance approved under the Program during 1993-94 and 1994-95, audit analysed such assistance according to individual country regions. Table 5G shows the portion of aggregate approved financial assistance and expected economic benefits directed at regional development projects during the 2 financial years and the allocation of such assistance on a regional basis.

TABLE 5G
APPROVED ASSISTANCE AND EXPECTED ECONOMIC BENEFITS
RELATING TO REGIONAL AREAS, 1993-94 AND 1994-95

Region	Financial assistance approved (\$m)		Additional investment (\$m)		Export growth (\$m)		Increased employment (no.)	
	93-94	94-95	93-94	94-95	93-94	94-95	93-94	94-95
Northern	0.7	0.3	191	49	11	-	1 015	450
North-East	0.1	1.1	42	230	30	169	366	528
Gippsland	0.1	2.4	22	24	230	5	520	220
South-West	0.4	6.9	55	79	26	4	308	948
Western	0.3	0.2	32	37	4	-	162	190
Total	1.6	10.9	342	419	301	178	2 371	2 336
State aggregate	6.8	42.1	806	988	470	936	3 705	4 947
Percentage of State aggregate (%)	24	26	42	42	64	19	64	47

5.70 The main features of the information shown in the above table are:

- the greatest level of additional regional investment arising from projects approved for financial assistance in 1994-95 is expected to be generated in the North-East region of Victoria (\$230 million or 55 per cent of total investment), with virtually all of anticipated export growth also to occur in that region;
- around 63 per cent of financial assistance approved in 1994-95 was allocated to the South-West region which is expected to give rise to 948 additional jobs, a major employment boost for the region compared with 308 additional jobs in the previous year; and
- for assistance approved in 1993-94, around 44 per cent of additional investment is earmarked to occur in the Northern region while the bulk of expected export growth is associated with the Gippsland region.

5.71 The above analysis illustrates that, to date, there has been no discernible pattern in assistance approved under the Program for regional development projects, however, significant economic benefits are projected for certain regions. It also shows that the amount of assistance often constitutes a very small proportion of additional investments committed by companies and that assistance to labour-intensive projects (as reflected in the South-West region) sometimes demands a relatively higher level of government funding.

5.72 The Department is currently in the process of identifying the strengths and development needs of the State's individual regions. This process is expected to provide the basis for formulation of priorities between regions and provide greater assurance to the Department that regional assistance under the Program has been directed to those areas of the State with the greatest potential for economic growth.

5.73 Finalisation of the Department's strategic evaluation of regional needs should provide it with a more structured framework for pursuit of the Government's objectives covering regional development within the State.

Co-ordination with the Australian Government's regional development strategy

5.74 In July 1994, the Australian Government released details of its regional development strategy within a document entitled "*Guidelines for the Regional Development program*". The purpose of this strategy is to stimulate economic development in regional areas of Australia.

5.75 Under its strategy, the Australian Government is encouraging the formation of *regional development organisations* to assume responsibility for overseeing regional development within broad geographic regions which may transcend across State boundaries. The Australian Government's strategy provides for the allocation to the States of a total of around \$150 million over the 4 year period July 1994 to June 1998 to fund sustainable economic development in regions, of which about \$70 million is earmarked for new strategic infrastructure development or improvements to existing infrastructure.

5.76 Under the published guidelines, regional development organisations will need to satisfy the following conditions in order to qualify for financial assistance:

- *"have a primary focus on economic development, business growth, economic growth and a global focus;*
- *comprise a core group of business, union, local government and educational and training representatives;*
- *facilitate representation of other interest and community groups;*
- *integrate economic and social development; and*
- *be incorporated".*

5.77 The geographic regions designated for economic development are expected to take a lead role in shaping their own future and to be pro-active in identifying and maximising opportunities for development.

5.78 The guidelines also outline the role of State Governments in providing advice and assistance in the setting up of the strategy's implementation framework for regions which cover areas within their jurisdictions. In this regard, the main task undertaken by the Department's Office of Regional Development to date has involved assisting the Australian Government to identify (from a Victorian perspective) logical segments of country Victoria that would fit into the broad geographic regions proposed under the national guidelines.

5.79 Following discussions by audit with representatives of the Australian Government, the Office of Regional Development and a number of local government bodies, action in 4 key areas would seem to be needed in order to achieve effective implementation of the strategy within Victoria. These 4 key areas relate to:

- finalisation of the substantial amount of work still required for the development of profiles identifying the economic strengths and needs of each region;
- a need to clarify the functions of regional development organisations in order to facilitate co-ordination with existing structures and to avoid an excessively bureaucratic environment in regions for industry;
- avoidance of unnecessary duplication of services at the Federal and State levels; and
- alleviation of the existing uncertainty over the future of regional development organisations beyond their current funding term which expires in June 1997 (although the strategy encompasses overall funding for 4 years, the provision of financial assistance to regional development organisations is stipulated to cover only 3 years).

5.80 A proactive approach by the Department to satisfactory resolution of the above issues, in its liaison with the Australian Government, will be important in achieving maximum benefit to the State from the national regional development strategy.

□ **RESPONSE** by Secretary to the Department of Business and Employment

The Department agrees that there is a need to resolve the issues outlined above, in particular the clarification of the functions of regional development organisations, and the avoidance of unnecessary duplication of services at the Federal and State levels. The Department has adopted a pro-active approach to these issues, and has consistently opposed, with some success, the tendency of the Australian Government's regional programs to duplicate the services and initiatives contained within the State's programs.

The Department has provided, and will continue to offer assistance to regions to develop strategies identifying their economic strengths and needs. The Department has welcomed the entry of the Australian Government into the regional development field, but does not accept that it can do a great deal more to assist with the administration of the national program.

Need for greater focus on regional infrastructure studies

5.81 As mentioned in paragraph 5.67, the aim of the Department's regional development activities, as documented in its 1994-95 business plan, provides for the funding of regional infrastructure studies to facilitate further infrastructure investment in regional areas.

5.82 With the focus of the Australian Government's strategy on the development of infrastructure projects at the regional level, the Department indicated to audit that it has sought to provide technical support for the drafting of local submissions by co-ordinating the responses of the various State infrastructure agencies so that a "whole of government" response can be made by the State.

5.83 Over the last 2 financial years, only 2 infrastructure studies have been carried out by the Department, namely, a Statewide study of infrastructure needs pertaining to road construction and a study of infrastructure requirements in the Western region. The costs of these surveys totalled \$29 000. At the time of the audit, a resultant assessment of the potential economic growth from infrastructure development had **not** been undertaken in each case.

5.84 This partial state of regional infrastructure studies is of some concern as these studies are designed to identify existing impediments to future investment and to formulate remedial action plans.

5.85 The significance of regional infrastructure studies has been reinforced by the earlier-mentioned allocation of \$70 million by the Australian Government for infrastructure purposes.

5.86 If Victoria is to be in a position to maximise its share of available Australian Government funding, action should be taken to identify, in conjunction with local government, those regions requiring urgent infrastructure works that will enhance economic growth and to establish priorities for the funding of such works through the national regional development strategy.

□ **RESPONSE** by Secretary to the Department of Business and Employment

The Department agrees that there is a need to identify infrastructure works that will enhance economic development, and a regional perspective will be placed on infrastructure priorities where appropriate.

There are difficulties with the Australian Government's regional infrastructure program, from the perspective of its potential effect on State infrastructure priorities. The requirement that infrastructure priorities are established at a regional level has often resulted in inadequate cost/benefit analysis and decisions taken in isolation from State priorities, despite the requirement for matching State funding. The Department has sought to offset these difficulties by providing technical support for the drafting of local submissions and by co-ordinating the responses of the various State infrastructure agencies so that a "whole of government" response can be made by the State.

IMPORTANCE OF PERFORMANCE MEASUREMENT AND REPORTING FOR THE PROGRAM

5.87 The soundness of performance measurement and reporting procedures within the Victorian public sector is a key element of the Government's resource management strategies.

5.88 In today's environment, effective performance measurement and reporting practices are fast becoming vital pre-requisites for a soundly-based strategic management framework within both public and private sector organisations. The extra accountability pressures associated with the public sector impose a greater responsibility on public sector managers to ensure that high-quality performance measurement and reporting processes are in place which satisfy, not only management's needs, but also those of the Parliament and taxpayers.

5.89 Given the significance of the Industry, Regional and Trade Support Program, the audit encompassed an assessment of the approach followed by the Department for measuring and reporting on the Program's effectiveness. Also relevant to this area was the fact that the 1989 Special Report by the Auditor-General on the earlier industry assistance program highlighted the lack of suitable performance indicators in place to measure the outcomes and effectiveness of that program.

Current approach by the Department to measurement of Program performance

5.90 Because of the many variables which can impact on the Program's performance, such as changes in prevailing economic conditions, the development of effectiveness measures for the Program, particularly those of a qualitative nature, is not a straightforward task.

5.91 During discussions with the Department, audit was advised that its work in this area is still in the preliminary stages and it acknowledged that there was a need to improve the quality of performance measures and to have in place a measurement framework which adequately encompasses the Program as a whole. The Department also mentioned the difficulty involved in attributing a direct link between the level of assistance provided to companies and the achievement of the Program's objectives of enhancing the State's economic growth.

5.92 The early work by the Department in the development of performance measures and targets for the Program is documented in the Department's 1994-95 business plan in the manner shown in Table 5H.

TABLE 5H
PERFORMANCE MEASURES AND TARGETS FOR 1994-95

<i>Program area</i>	<i>Examples of performance measures</i>	<i>Target, 1994-95</i>
Investment recruitment and facilitation	1. Value of new investments facilitated and announced during 1994-95.	\$900 million to \$1.1 billion
	2. International and national investment promotions of Victoria supported or facilitated.	Not yet developed
Enterprise and industry development	1. Number of enterprise improvement program grants.	800 small grants
	2. Investment and export outcome for enterprises assisted through enterprise improvement plans.	Not yet developed
	3. Distribution of enterprise improvement grants by enterprise and key sectors.	" "
	4. New significant enterprise and business development activities or projects in key industry sectors.	" "
	5. Number of industry-based research and development initiatives facilitated and assisted.	" "
Export assistance and business migration	1. Number of export assistance packages and export sales generated.	175
	2. Proportion of business migration to Victoria.	Not yet developed
	3. Enterprise participation in trade fairs and missions.	" "
	4. Investment enquiries and export facilitation provided by overseas offices.	" "
Regional development	1. New investments in country Victoria.	Not yet developed
	2. New business developments in country Victoria.	" "
Business environment	1. Implementation proposals developed on strategic study findings.	Not yet developed
	2. Number and significance of industry events attracted.	" "

5.93 While the development of the above performance information represents an important initial step, the Department recognises, as mentioned above, that significant enhancements are necessary. In this regard, it can be seen that the early performance indicators are directed more towards measuring the quantity of services provided than the quality of Program achievements.

5.94 In considering the work undertaken to date by the Department in this area, audit determined to develop a suggested framework for qualitative performance measures which examined the Program from a top-down perspective beginning with the Program's 4 specified objectives. The audit suggestions are presented in Table 5I.

**TABLE 51
TOP-DOWN FRAMEWORK FOR
QUALITATIVE PERFORMANCE MEASUREMENT, AS SUGGESTED BY AUDIT**

<i>Major program objectives</i>	<i>Possible action for development of performance measures</i>
Promote and facilitate improved Victorian industry and regional performance.	<ol style="list-style-type: none"> 1. Define what constitutes the key characteristics of improved industry and regional performance. 2. Determine the main impediments to improved industry and regional performance, strategies necessary to overcome impediments and monitor the resultant improvement in actual industry and regional performance.
Improve the international competitiveness of Victorian enterprises and the Victorian business environment.	<ol style="list-style-type: none"> 1. Gain industry views on the effectiveness of initiatives to improve the competitiveness of Victoria's business environment. 2. Compare the costs of Victorian transport, ports, employment and other charges against the State's international trading competitors.
Enhance the export performance of key Victorian sectors and promote Victoria as an investment and business location.	<ol style="list-style-type: none"> 1. Prioritise those key Victorian industry sectors with the greatest potential to increase export growth. 2. Identify desired locations for export market penetration by each industry sector. 3. Determine the principal impediments faced by existing and potential exporters, and design strategies to eliminate these impediments. 4. Identify the main factors influencing decisions by overseas companies to invest in Victoria and devise avenues for facilitating new investment.
Provide advice on strategies and policies to improve Victoria's business environment.	<ol style="list-style-type: none"> 1. Develop, through ongoing liaison with employer and industry associations, strategies to improve Victoria's business environment.

5.95 Audit considered that the above approach would provide a useful foundation for the Department in its formulation of performance measures in the specific areas of the Program.

□ RESPONSE by Secretary to the Department of Business and Employment

The Department notes the suggestion by audit. A number of studies and activities suggested by audit have been undertaken including, for example, the international benchmarking of business costs referred to in paragraph 5.35 and impediments to existing and potential exporters.

Consultancy to develop performance measures

5.96 In an important recent initiative, the Department has commissioned an external consultancy review to identify *world best practice* measures in the development of performance indicators for government-funded industry agencies. Specifically, the Department has requested the consultants to:

- *"undertake a survey which samples Asian, North American and European industry agencies, identifying the agencies, their responsibilities and the associated measures;*
- *include in its survey Australian States, Federal Government agencies, parliamentary bodies and economic agencies;*
- *identify relevant best practice indicators (and target levels/rates of return) having full regard to the activities of the Industry, Regional and Trade Support Program;*
- *identify target levels which will enable the Department to establish the overall cost-effective use of resources; and*
- *clearly identify the methodology underpinning the development of the world best performance measures".*

5.97 The Department expects the results of the consultancy to be available by October 1995.

5.98 The Department's initiative in commissioning this consultancy is clearly a positive move. Hopefully, as a consequence of the consultants' work, the long-standing gap in performance measurement of the State's industry assistance arrangements (which was evident as far back as 1989 from comments in the earlier audit report) can be speedily addressed.

RESPONSE by Secretary to the Department of Business and Employment

As outlined elsewhere in the Report, the Department has introduced, for example, in the investment recruitment and export assistance areas, information systems to assess the impact of the various activities. The consultancy report is aimed at providing a framework for future activity.

Reporting of Program performance

5.99 The Department's *Annual Report* is the primary catalyst for the channelling of information to the Parliament on its management of the Program.

5.100 *Annual Reports* of the Department in recent years have included the following Program information:

- the objectives, strategies and activities of the Program;
- an outline of major projects facilitated;
- the names of companies in receipt of financial assistance; and
- aggregate payments under the Program.

5.101 Given the importance of adequately informing the Parliament and the community of the manner in which the Program has been managed, future *Annual Reports* should disclose actual performance against all performance targets set for the reporting period. Audit also considers that the Department's accountability to the Parliament and the community would be strengthened by annual reporting of the amount and type of financial assistance provided to each company assisted under the Program.

□ **RESPONSE** by Secretary to the Department of Business and Employment

The Department notes the Report's comments. Actual performance information along with performance targets for the forthcoming year are contained in the annual Budget papers.

On the provision of financial information, the Department currently lists in its Annual Report, the enterprises which have received financial assistance during the preceding year and information on the total assistance paid to enterprises. The provision of additional information is not envisaged given the competitive position referred to in paragraph 5.31 and the approach taken by other governments.

Part 6

Industry perspectives on the Program

OVERVIEW

6.1 The audit incorporated visits to 7 companies, approved to progressively receive financial assistance under the Industry, Regional and Trade Support Program and associated with a cross-section of projects in terms of both size and nature.

6.2 This Part of the Report documents relevant matters arising from the audit visits and includes the views of senior company representatives on the nature of the Program and its overall effectiveness.

6.3 The results of audit visits to the companies also provided added assurance that financial assistance has been appropriately applied to projects that are contributing to the economic growth of the State.

COMPANY VISITS RELATING TO THE PROGRAM

6.4 Given the characteristics of the Program, the opportunity was taken during the audit to utilise, for the first time, the powers of access to documents of private or public sector recipients of government assistance which were assigned to the Auditor-General by the Parliament under July 1994 amendments to the State's audit legislation.

6.5 The amended legislation (section 20 of the *Audit Act* 1994) empowers the Auditor-General to examine documents of private or public sector organisations in receipt of funding from any source within the machinery of the State Government for the purpose of evaluating the performance of government programs.

6.6 Because this audit involved the inaugural use of the legislative authority, there was a need to carefully develop an overall audit approach which required the assistance of both the Department and company representatives. The level of co-operation and assistance received by audit from both areas was of a high standard.

6.7 Visits were made by audit to 7 companies, approved to progressively receive financial assistance under the Program and representing a cross-section of Program participants, for consultation and examination of documentation relating to their projects.

6.8 The principal purpose of the company visits was to gather information to assist audit in forming an opinion on the overall effectiveness of the Program. As part of the process, each company was asked to produce, for audit examination, documentation which:

- confirmed the receipt of financial assistance;
- showed the purpose of the assistance;
- illustrated the manner of application; and
- disclosed the extent to which the specified purpose had been fulfilled.

6.9 An important element of the audit visits was the seeking of the views of senior company management on the effectiveness of the Program, the appropriateness of the Program's overall direction and the extent to which the Program had satisfactorily met the needs of their company.

Review of company documentation

6.10 The 7 companies selected for audit visits are associated with projects of varying sizes approved to receive aggregate financial assistance of \$5.4 million. Their projects relate principally to the development, expansion or relocation of manufacturing facilities including investments in advanced technology. Industry sectors represented by these companies encompassed the automotive, engineering, packaging, recycling, telecommunications, and the textiles, clothing and footwear sectors.

6.11 It is pleasing to report that the results of the audit visits were very satisfactory. In each case, the extent of government financial assistance received to date had been clearly recorded and extensive documentation was available to describe the key features of the approved project, the progress of its development and the benefits expected to accrue to the company and, in turn, to the State.

6.12 It was also encouraging to hear from company representatives that the departmental case officers associated with their projects had maintained regular dialogue with them on the progress of projects and had frequently visited project sites to confirm that actual development was in line with the agreed terms of the assistance.

6.13 The results of the section 20 visits to companies by audit provide added assurance that financial assistance received under the Program has been appropriately applied to projects that are contributing to the economic growth of the State.



A state-of-the-art environmental test chamber which provides a climatic evaluation of automotive components.

Company perspectives on the Program

6.14 As part of the visits, audit sought the views of company representatives on the Program in the following 5 areas:

- how the company became aware of the Program;
- rationale for the company's decision to invest in Victoria;
- assessment of the effectiveness of the Program;
- avenues with potential for enhancing Victoria's capacity to attract investment; and
- the intensity of interstate competition for new business investment.

6.15 As a summary comment, audit found the feedback from company representatives to be extremely interesting and thought-provoking. The Department has signalled to audit that it shares this view and expects the insight of the various companies to be quite valuable in formulating future strategies for the Program.

6.16 The following paragraphs summarise the views expressed to audit by company management.

How companies became aware of the program

6.17 The Department uses various means to publicise the services available under the Program with particular emphasis on the regular distribution of brochures to companies, business associations and financial institutions. In addition, departmental case officers play a key role in promoting the Program by visiting companies to further explain the various types of available assistance.

6.18 Management of visited companies advised that they had become aware of the Program through a range of sources including:

- direct approach by departmental staff to discuss development opportunities within their industries;
- business contacts who had previously utilised the Department's assistance and facilitation services; and
- referral to the Department by regional development organisations.

6.19 Some companies suggested to audit that attaching greater public visibility to the achievements of the Program would serve to increase the general awareness of services provided by the Department. These views indicate that there may be merit in the Department assessing the effectiveness of its current promotional techniques and complementing such techniques with regular surveys of Program participants. This latter action would help to identify major development projects assisted under the Program, the details of which could be used in promotional campaigns.

Rationale for company decisions to invest in Victoria

6.20 On this point, the rationale cited by the visited companies for their decision to invest in Victoria covered a range of factors including:

- a desire to develop, expand or relocate manufacturing facilities;
- the degree of assistance offered by the Department, both of a direct financial nature and in the form of facilitation services;
- the company's desire to maintain its Victorian employment base;

- the competitive cost of electricity;
- a well-established industrial and manufacturing culture within the State; and
- the existence of appropriate infrastructure facilities such as energy, transport and distribution links.

6.21 It is significant to mention that one of the visited companies represented an overseas investment in Victoria worth in the vicinity of \$100 million and emphasised to audit that a major factor influencing its decision to locate in the State was the professionalism of the Department in the provision of facilitation services.

6.22 In essence, the views expressed by the companies tended to generally confirm perceptions about Victoria's capacity to attract investment through its well-established infrastructure facilities and its existing manufacturing culture.

6.23 Some reservations were expressed by companies in terms of the overall State environment for investment proposals including:

- delays experienced in negotiations on electricity tariffs and uncertainty over future pricing levels in the early stages of the restructuring of the State's electricity industry;
- a need for greater deregulation of the labour market; and
- some difficulties experienced in obtaining clear title for land developments.

Assessments of the effectiveness of the Program

6.24 The main points raised by the companies during the audit visits regarding the effectiveness of the Program were:

- unanimous high praise for the dedication and commitment of departmental case officers in assisting firms to develop and expand their business activities;
- the Department's facilitation services were deemed to be extremely valuable in establishing contacts with key government agencies and fast-tracking investment projects;
- the Office of Regional Development was considered a vital element within the Program because of its knowledge of regional Victoria, its links with local government and regional development bodies and its accessibility for country-based firms; and
- the provision of financial and facilitative assistance served to improve the timing of projects and went some way towards reducing risks to business associated with major new developments.

Avenues with potential for enhancing Victoria's capacity to attract investment

6.25 The Government's industry statement establishes that its initiatives and policies for industry development are designed to make doing business in Victoria easier, more productive and, above all, more inviting to prospective investors, both Australian and international.

6.26 Each company raised with audit a number of issues which they considered would contribute to improving Victoria's capacity to attract additional investment. Many of these observations relate directly to the operation of the Program by the Department, while other matters have a wider relevance to the overall economic strategies implemented by the Government. The main issues raised by company representatives to enhance Victoria's capacity to attract investment were:

Financial assistance

- Larger grants should be made available for genuine *footloose* projects (new investments in productive facilities) as a means of attracting new industry to the State.
- The method of calculation by the Department of the amount of financial assistance to be provided to individual companies effectively provides for inclusion of concessional rebates covering land and payroll tax payable by companies. This element of the assistance package may not constitute a significant incentive for technology-driven companies where the level of such taxes is often of minimal value.

Departmental services

- Services available under the Program should be clearly visible to companies to make them aware of the nature and level of assistance available, particularly the Department's facilitation services and the capacity to fast-track investment projects through the planning and regulatory processes.

Availability of land

- For projects involving site locations and the provision of assistance by way of the availability of public land, the assessment of the sale price to be paid by the assisted company should take into consideration the need to achieve a balance between a fair commercial price and the benefits to be gained by commercial development of the land, such as the creation of employment and increased production and export earnings. This issue was seen by companies as particularly relevant in view of the fact that some other Australian States were viewed to be quite aggressive in attracting new investment by providing free or heavily-subsidised land and, in some cases, assistance to build new manufacturing facilities.

Taxes

- The majority of companies expressed the view that the levels of indirect taxes and State charges, particularly payroll tax, were a heavy cost burden on their businesses and a major impediment to attracting new investment and improving the cost-competitiveness of products manufactured in the State. A suggestion put forward by companies was provision of payroll tax relief for those companies with potential for increasing export sales and generating employment growth.

Improving links between industry and government

- The Department's external Business Advisory Group was seen by company management as an effective means by which industry can have its views made known to government.
- Further improvements to communication between industry and government could be achieved by the establishment of a secretariat within the Department that deals directly with industry.

Technology

- Companies emphasised the need for further assistance to enhance research and development capabilities and the level of investment in computer technology and training as a means of improving the global competitiveness of Victorian manufacturing firms.

Education

- The education system, particularly at the TAFE level, needed to be more closely linked to industry as a means of ensuring that the future employment and skill needs of industry were satisfactorily met.

The intensity of interstate competition for new business investment

6.27 The companies broadly viewed the current quality and level of assistance and facilitation services as adequate, but drew attention to the competitive nature of the environment particularly in terms of some aggressive strategies adopted by other States to lure investment activity. These strategies have included:

- direct approaches made by government to companies to relocate interstate;
- the willingness of some States to provide larger financial incentives;
- the provision of free or highly-subsidised land; and
- assistance with the building of new production facilities.

6.28 Companies also expressed the view that the degree of competition between the States can lessen the common commitment between States to achieve economic benefits on a national level.

Part 7

Strategic Industry Research Foundation

OVERVIEW

7.1 Since 1990-91, substantial levels of government funding have been provided to the Strategic Industry Research Foundation (formerly the Strategic Research Foundation established by the previous Government) and, through it, to 3 associated research institutes for industry research projects. By 30 June 1996, the end of the current triennial funding agreement, government financial assistance totalling \$48.6 million will have been allocated to the Foundation and its institutes.

7.2 Following an external consultancy review of the Foundation commissioned by the Government and completed in March 1993, the focus of the Government's policy on research support to the Foundation moved from a long-term speculative approach to one which involved close collaborative arrangements with industry. Under this new framework, *roundtable* dialogue with industry has become the main catalyst for the Foundation in identifying and facilitating directions for innovative research.

7.3 During the current triennium, the Government has continued to fund 2 of the 3 research institutes associated with the Foundation, namely the Biomolecular Research Institute and Ceramic Fuel Cells Limited. These institutes are involved in research activities which have long-term time horizons with very uncertain, but potentially significant, returns. If the Government determines to maintain existing funding levels to the 2 bodies from 1 July 1996, the Department will need to regularly monitor their ongoing research performance.

7.4 With regard to the third research institute, the Australian Computing and Communications Institute, some disturbing circumstances relating to its financial viability became evident in recent years and an amount of \$8.1 million advanced by the previous Government to the Institute to fund the leasing of computer equipment is still fully outstanding and unlikely to be repaid. The likely loss of taxpayers' funds in this instance supports the Government's current move towards facilitating industry-driven collaborative research rather than direct funding of proposals cited by particular private sector parties as offering a commercial return.

7.5 There is clear scope for substantial upgrading of the quality of information channelled annually by the Foundation to the Department on its research activities. The importance of a strengthening of the Department's management review framework governing the functions of the Foundation is reinforced by the fact that a contingent liability of up to \$5 million may accrue to the Government if, in the event of a winding-up decision, the Foundation is not in a position to meet its financial obligations.

7.6 Also, the line of accountability to the Parliament and the community would be considerably enhanced if the operations of the Foundation were subject to annual audit by the Auditor-General. Such action should occur if the level of Government funding to the Foundation remains significant.

NATURE AND ROLE OF THE FOUNDATION

7.7 In 1988, the previous Government established the Strategic Research Foundation as part of a strategy to develop and strengthen the State's research base. The key role assigned to the Foundation was to participate in research projects in conjunction with industry through the funding, under 3 year agreements commencing in 1990-91, of the following 3 research institutes:

- Australian Computing and Communications Institute - to investigate new technology in the computing and communications fields;
- Biomolecular Research Institute - to discover and develop new treatments for medical diseases; and
- Ceramic Fuel Cells Limited - as a focus for research and development of ceramic fuel cell technology (the conversion of chemical energy directly to electricity with high efficiency and minimal pollution).

7.8 The government funding arrangements also provided for the Foundation to receive direct financial assistance for its interface with industry on research activities.

7.9 In 1992, the newly-elected Government commissioned an external consultancy review of the performance of the Foundation and one outworking of this review was the change in name of the organisation to the Strategic Industry Research Foundation. The Government also introduced a second 3 year funding period for the Foundation commencing in 1993-94, with funding to be provided under the Industry, Regional and Trade Support Program.

7.10 The Foundation is an incorporated company limited by guarantee which operates on a day-to-day basis at arms-length to the Government. However, it is required to submit a 3 yearly strategic plan for approval of the Minister, provide quarterly reports to the Department on progress in its research programs and furnish annually to the Minister a report summarising its achievements.

7.11 The Foundation and its related research institutes are not subject to audit by the Auditor-General.

EXTENT OF GOVERNMENT FUNDING TO THE FOUNDATION

7.12 Up to 30 June 1995, government funding to the Foundation and, through the Foundation to its related research institutes, has totalled \$36 million under the 3 year funding agreements, with a further \$4.5 million earmarked for 1995-96, the final year of the current funding agreement.

7.13 In addition, the previous Government provided a direct advance of \$8.1 million to the Australian Computing and Communications Institute in 1991 which means that **by 30 June 1996, aggregate financial assistance by government of \$48.6 million will have been provided to the Foundation and the research institutes.** Table 7A provides relevant details of the government funding.

TABLE 7A
GOVERNMENT FUNDING OF THE FOUNDATION AND RELATED INSTITUTES
 (\$million)

<i>Organisation</i>	<i>First triennium to 30 June 1993</i>	<i>Second triennium to 30 June 1996 (a)</i>	<i>Total funding</i>
Strategic Industry Research Foundation	7.4	7.0	14.4
Australian Computing and Communications Institute (b)	13.9	0.7	14.6
Biomolecular Research Institute	9.8	6.8	16.6
Ceramic Fuel Cells Limited	1.0	2.0	3.0
Total	32.1	16.5	48.6

(a) Incorporates funding of \$4.5 million earmarked for 1995-96.

(b) Includes an advance of \$8.1 million for lease of a computer system.

7.14 The above table illustrates the quite sharp reduction in the level of triennial financial assistance provided by the Government to the Foundation and research institutes under the current agreement (falling from \$32.1 million, including the advance of \$8.1 million, during the initial period to the current figure of \$16.5 million).

7.15 The table also shows that virtually all of the impact of the reduced level of government funding has been directed towards the Australian Computing and Communications Institute.

RESULTS OF GOVERNMENT REVIEW OF THE FOUNDATION

7.16 An early action by the current Government in connection with the Foundation was the commissioning in 1992 of an external consultancy review to examine the Foundation's operations and performance. This review was undertaken by Sir Russel Madigan, a legal specialist with expertise in the minerals industry and the international trade sector.

7.17 At the time of the review, the Government had signalled its intention to restructure the Foundation and it envisaged that the results of the review would provide a strong basis for the direction of the restructure.

7.18 Sir Russel reported to the Minister on the results of his review in March 1993. His major conclusions were:

- *"The key underlying assumption and logic upon which the Foundation's creation and original charter were based in 1988 are no longer appropriate to the needs and conditions prevailing in Victoria in 1993 and beyond;*
- *"Despite its historical background, the Foundation has, particularly over the last 12 months, taken significant advantage of the lessons available from its experience to date, introducing some successful innovations in terms of its operating approach;*
- *"Based on this, the Foundation has a unique and valuable role to play within the context of the Government's overall industry development and job creation objectives;*

- *"The Foundation was (initially) directed towards the establishment of research institutes in nominated areas of technology seen as of strategic importance. This was all the old ivory tower long-term stuff, easy to prescribe, which Australia recognises as the core of scientific research but with very little relevance or consequence for the development of technology and products required for the growth of competitive industries;*
- *"There now exists a more exciting and valuable asset base which the Foundation has managed to establish, particularly during the latter part of its existence. Specifically this is represented by the unique range of networks and project creation know-how which it now sustains and manages. The outworkings of this asset are most visibly displayed through the Industry Roundtable operating model which systematically brings together executives from companies with a potentially common set of innovation needs;*
- *"The importance of this (roundtable) approach cannot be understated because it is driven by the practical innovation needs of industry and has the active participation of senior management from companies. This is, in turn, the best guarantee that subsequent research and development activities will be truly focused towards commercial outcomes and a guaranteed market."*

7.19 Sir Russel went on to form the view that if the *roundtable model* of communicating with industry was to represent an effective method of identifying relevant commercially-driven research and development, a new charter should be developed for the Foundation and incorporate the following major aims:

- stimulating business to identify opportunities to become more competitive through innovation; and
- facilitating business access to the research and development needed to take advantage of innovation.

7.20 In terms of the Foundation's restructure, Sir Russel suggested that it needed to more critically address its activities towards companies within key industry sectors, organise companies into purpose-driven groups and explore cost-effective means of funding research and development.

7.21 Drawing on Sir Russel's conclusions on the Foundation's past performance and suggestions for its future direction, the Government's industry policy statement issued in September 1993 articulated its position on the future role and functions of the Foundation in the following terms:

"... the Government has decided to totally restructure the role of the Foundation to strengthen links between industry requirements and research. The focus of the revamped body will be industry-driven research. The Government will commit \$16.5 million to fund industry research and development over the 3 year period 1993-94 to 1995-96".

7.22 The above position was subsequently used by the Foundation as the basis of its strategic plan covering the 3 year period to 1995-96. This strategic plan, which has been approved by the Minister, outlines the Foundation's mission as:

"... to contribute to improved performance of industry and the development of new industries in Victoria and Australia, by facilitating market driven collaborative research and development".

7.23 To meet this mission, the objectives of the Foundation are to:

- assist industry to identify opportunities for research and development and innovation;
- identify and develop sources of funding for industry-driven research and development and innovation; and
- contribute to the scientific, technical and commercial success of those longer-term strategic research ventures in which the Foundation has an established commitment.

7.24 In summary, the Government's consultancy review and its associated restructuring of the Foundation have been designed to stimulate industry competitiveness by facilitating an expanded participation by industry in the identification and pursuit of innovative research.

ACTIVITIES OF THE RESEARCH INSTITUTES

7.25 A major function of the Foundation, as outlined in earlier paragraphs, has been the funding of research activities undertaken by its 3 commercial research institutes.

7.26 Structurally, the research institutes operate independently as companies limited by guarantee, however, the managing director of the Foundation acts as a representative on the institutes' boards of management.

7.27 Audit concluded from the examination of material relating to the activities of the Foundation and its associated research institutes that, because of the inherent nature of the research environment, it is very difficult to be conclusive at this stage on the likelihood of major benefits to the State from the sizeable investment made to date.

Australian Computing and Communications Institute

7.28 The Australian Computing and Communications Institute was established in May 1991 to investigate new technology in the computing and communications fields. Founding members of the Institute were the Foundation, Computer Power Pty Ltd, IBM Australia Ltd, Digital Equipment Corporation (Australia) Pty Ltd and Siemens Ltd. The latter 2 companies have since withdrawn from membership of the Institute.

7.29 As presented in the earlier Table 7A, the Institute received government funding of \$13.9 million in the period up to 30 June 1993. Under the current 3 year funding agreement to 30 June 1996, the Institute is scheduled to receive only \$700 000. This total funding of \$14.6 million comprises \$6.5 million from the Foundation for the Institute's specific research activities and an amount of \$8.1 million received directly from government over the period May 1991 to January 1993 for the lease of an IBM computer system.

7.30 The direct government funding of \$8.1 million relating to the lease of an IBM computer system was the subject of a specific funding agreement in May 1991 between the Foundation (at the time of the agreement, the Institute had not been incorporated) and the then Minister. The agreement provided for the funding of the lease of the computer system over the period May 1991 to June 1993 and specified that the Institute was obliged to make annual repayments of the total government funding by December 1997. These repayments by the Institute were envisaged, under the funding agreement, to be financed from commercial leasing of the computer system. In this regard, some of the potential uses of the computer, as cited in the agreement, included:

- research and development projects consistent with the objectives of the Institute which have applications in at least 2 key areas such as agriculture, mining, manufacturing, the wholesale and retail trade, transportation or communications; and
- strategic research and development projects in areas in which the corporate members of the Institute are seeking to develop products for the international market.

7.31 **Audit was advised by the Department that no repayments of the amount of \$8.1 million advanced to the Institute had been received to date and it did not expect to receive any repayments in the future.** The Department attributed this position to the failure of the Institute to attract sufficient clients to achieve a profitable outcome from commercial sub-leasing of the computer.

7.32 In an August 1993 report to the Minister, the Department identified that some major occurrences since 30 June 1993 had placed the future viability of the Institute in significant doubt and, in particular, withdrawal of 2 of the founding members of the Institute, namely, Digital Equipment Corporation (Australia) Pty Ltd and Siemens Ltd, following their assessment that the research and development projects in which they were to participate were not financially viable.

7.33 In response to discussions on the disturbing circumstances relating to the Institute, the Department advised audit that:

"Following a review of the Institute's cash requirements early in 1994, the Foundation has transferred \$500 000 to the Institute, and advanced an interest-free loan of \$250 000 in the form of bridging finance which was repaid before June 1995. These payments were made in the expectation that a research and development syndication proposal would be approved by the Australian Taxation Office. Subsequently, an \$8 million research and development syndicate to enhance the Institute's telemedical imaging capabilities was approved. This and the forgiving by IBM of the Institute's outstanding lease commitments regarding its super-computer have enhanced the Institute's long-term viability".

7.34 **The highly-probable loss of a significant level of taxpayers' funds in this instance supports the Government's current move towards facilitating industry-driven collaborative research rather than direct funding of proposals cited by particular private sector parties as offering a commercial return.**

□ **RESPONSE** by Secretary to the Department of Business and Employment

In relation to the lease of the IBM computer system, the Department would add that the decision taken in April 1991 to fund the project was based on expert consultancy advice that forecast considerable commercial usage. This proved not to be the case.

Further, steps to limit the exposure to the Institute were taken as soon as the implications were clear of the Institute's failure to attract sufficient clients to achieve a profitable outcome from commercial sub-leasing of the high-performance computer and the withdrawal of 2 of the founding members in mid-1993. In addition, the Foundation acted quickly to ensure the financial viability of the Institute.

Biomolecular Research Institute

7.35 The Biomolecular Research Institute was established in October 1991 under a partnership between the Foundation and the Commonwealth Scientific and Industrial Research Organisation (CSIRO). The mission of the Institute is:

"To discover, synthesise and develop novel therapeutic compounds of commercial value in the treatment of important medical diseases for the economic benefit of Australia".

7.36 Up to 30 June 1995, the Institute has received total government funding from the Foundation of \$14.6 million, with a further \$2 million earmarked to be provided during 1995-96.

7.37 Sir Russel Madigan, in his earlier-described review of the Foundation, commented on the Institute's research environment in the following terms:

"The Institute has been the major beneficiary of the funds so far deployed. In terms of future benefits, again it is really too early to tell. The creation of the Institute was partly in response to a recognition that the "Parkville Strip" enjoys, in scientific research terms, a world class reputation. Yet this important resource has yet to give rise to any major downstream commercial benefits within Australia. Will the Institute help change this pattern? Given the product development lead times inherent to the pharmaceutical industry, the answer is inevitably still a long time coming. Subject to an in depth analysis of the research progress achieved to date and - just as important - likely subsequent development and commercialisation scenarios, I am unable to pass judgement on the value of the asset so far established."

7.38 In addition, an independent review of the Institute undertaken on behalf of the 2 partners by a panel of recognised experts in the medical and pharmaceutical fields, reported in April 1993 that:

- the 2 funding partners should recognise the long-term nature of research relating to drug design and continue to substantially fund the Institute;
- most medium-term projects are highly speculative and most will fail in terms of drug development;
- funding and servicing of long-term projects will probably require additional sources of finance to those currently provided; and
- the success of the Institute and the economic impact of its activities can only be measured retrospectively.

7.39 In discussions with audit on the activities of the Institute, the Department also emphasised that pharmaceutical research and development involves a relatively long time horizon with 7 to 10 years between the commencement of research and possible discovery of a marketable pharmaceutical product. Nevertheless, the Department mentioned that any successful commercialisation in this field would bring substantial returns to the parties involved. It considered that the cost of continuing to support the Institute, of approximately \$2 million each year, is not substantial compared with the estimated potential benefits to the State, both in financial terms and in enhancing medical research and supporting the local pharmaceutical industry.

7.40 **The long-term nature of the Institute's research activities will necessitate periodic assessment by the Department of the feasibility of ongoing direct funding in this field compared with the emerging alternative focus by the Government on facilitating industry research and development.**

□ **RESPONSE** by Secretary to the Department of Business and Employment

The current review of the Foundation is part of an ongoing assessment by the Department of the funding of the Institutes. The previous review which was similarly thorough took place in 1993. One of the terms of reference of the current review is to examine the progress of the institutes in terms of the result of the research undertaken and progress with establishment of commercial collaboration agreements.

Ceramic Fuel Cells Limited

7.41 Ceramic Fuel Cells Limited was established in July 1992 under an agreement between the Foundation, the CSIRO, the Australian Government's Energy Research and Development Corporation, the Broken Hill Proprietary Company Limited and the Electricity Commission of New South Wales. Up to 30 June 1995, government funding of \$3 million, which represents the Foundation's full commitment under the agreement, has been provided to the company.

7.42 Ceramic fuel cell technology can be broadly described as the conversion of chemical energy directly to electricity with high efficiency and minimal pollution.

7.43 The mission of the company is:

"To provide the Australian focus for research and development of ceramic fuel cell technology to commercialisation stage to support an Australian manufacturing industry".

7.44 Sir Russel Madigan viewed the activities of the company as, inter alia, *"Launched just over a year ago, the project has so far brought together a number of commercial partners with an interest in electricity generation. Again, it is really too early to place a value on the asset so far created, except to say that the underlying science appears to be soundly based".*

7.45 The Department advised audit that the company is now 3 years into a 5 year program and is meeting pre-agreed technical milestones. The Department also indicated that the company is on track to develop the targeted research area, namely, prototype fuel cell units, by June 1997, is actively seeking additional commercial involvement to strengthen its financial viability and is currently working to prove the technology's commercialisation capabilities on a large-scale basis.

7.46 **Because the activities of the company essentially involve a long-term speculative research project with, if successful, substantial commercial potential, it will be some time before the outcome of the Government's limited investment in this area can be determined.**

FRAMEWORK FOR MONITORING FOUNDATION OPERATIONS

7.47 The Foundation is an incorporated company limited by guarantee which operates on a day-to-day basis at arms-length to the Government. It is required to submit a 3 yearly strategic plan for approval of the Minister, provide quarterly progress reports to the Department and furnish annually to the Minister a report summarising its achievements.

7.48 The preceding paragraphs illustrate that extensive levels of government funding have been channelled to the Foundation and, through it, to its related research institutes. In addition to this aspect of the Government's relationship with the Foundation, **the triennial funding agreement stipulates that a contingent liability of up to \$5 million may accrue to the Government if, in the event of a winding-up decision, the Foundation is not in a position to meet its financial obligations.**

7.49 Given the above circumstances, it is clearly important that the Department has in place sound procedures for monitoring the ongoing actions of the funding recipients and for ensuring that the Government's interests are adequately protected.

7.50 In an earlier outline paragraph on the Foundation, the following 3 key features of the Department's monitoring framework were mentioned:

- submission by the Foundation of a 3 yearly strategic plan for approval of the Minister;
- provision of quarterly reports to the Department on progress in the Foundation's research programs; and
- annual reporting to the Minister on overall research achievements.

7.51 While the requirement for clearance of the 3 yearly strategic plan represented an important element of the Department's review framework, audit examination of the quarterly and annual reports prepared by the Foundation found that such reports conveyed information of limited value to the Department in forming meaningful judgements on the progress of research activities against the strategic plan or on the effectiveness of the Foundation's operations. In particular, the material documented in the annual reports reflected only a broad assessment of research activities, with little or no specific data on individual projects or on the extent of definitive progress achieved to date against the agreed performance targets set out in the strategic plan.

7.52 In summary, audit considered that the quality of information channelled annually by the Foundation to the Department fell far short of the purpose of the annual reports, as set out in the funding agreements, which is to demonstrate how the Foundation's initiatives have or are expected to contribute to:

- *"... improving productivity and/or competitiveness of Victorian and Australian enterprises and industries;*
- *increasing Victoria's share of value-added products and services in domestic markets and increasing Australian exports of value-added products and services;*
- *maintaining and creating jobs in advanced technology enterprises; and*
- *establishing effective, commercially-driven consortia that combine research/organisations, investors and industrial firms to create and utilise intellectual property".*

7.53 In discussions with the Department, audit indicated that its management review framework governing the functions of the Foundation would be strengthened by a requirement that the Foundation's annual reports incorporate the following details:

- research contributions expected from *roundtable* forums between the Foundation and industry groups;
- the extent to which *roundtable* forums have addressed industry needs;
- the current financial position of the Foundation and its 3 related research institutes and progress towards ensuring the institutes' long-term financial viability;
- timelines for the commercialisation of the various research activities;
- potential economic benefits expected to accrue to Victoria and Australia through research and development activities in terms of additional investment, export growth, import substitution and increased employment; and
- the success of efforts to generate additional sources of revenue to supplement its funding base.

7.54 There is clear potential for the Department's overseeing of the operations of the Foundation to be significantly enhanced through improvement in the quality of the Foundation's annual reporting.

RESPONSE by Secretary to the Department of Business and Employment

The Revised Strategic Plan of the Foundation contains performance indicators which represent an improvement in the quality of the Foundation's annual reporting, including a number of the areas identified in this Report. The Government's Funding Agreement with the Foundation contains a requirement that the organisation prepare and submit to the Minister an annual performance statement against its Strategic Plan. The first such statement covering the period July 1994 to June 1995 provides a full assessment of the Foundation's performance against all of the performance indicators.

The review currently being undertaken will also address the issue of the nature and quality of the Foundation's reporting on its operations to Government.

TRIENNIAL REVIEW OF FOUNDATION OPERATIONS

7.55 The current funding agreement, covering the period to 30 June 1996, provides for the Foundation and the Minister to reach agreement on the appointment of an independent panel to review the progress of Foundation initiatives and report to the Minister by 15 November 1995. Detailed terms of reference for the review are documented within the agreement.

7.56 At the time of preparation of this Report, the Department had advised audit that the Foundation and the Minister had reached agreement on the review process and it expected that the assignment would be completed by the end of September 1995.

7.57 The results of the triennial review will assist the Government in determining the nature of its future involvement with the Foundation and the level of associated funding to be provided to the body.

ACCOUNTABILITY TO THE PARLIAMENT AND THE COMMUNITY

7.58 As a company limited by guarantee, the Foundation's reporting responsibilities are governed by the Corporations Law and its financial statements are subject to an annual audit by an auditor appointed under the terms of that legislation.

7.59 Because the Foundation is not a public body, it is not required to report annually to the Parliament under the *Financial Management Act* 1994 on its operations and its financial position. In addition, the activities of the Foundation are not subject to audit by the Auditor-General.

7.60 To date, the Department has included quite brief information on its relationship with the Foundation in its annual report to the Parliament. In discussions with the Department, audit conveyed the view that the level of reporting to the Parliament should be substantially upgraded to reflect the magnitude of government funding to the Foundation.

7.61 Audit also suggested that, if the level of future government funding to the Foundation continues to be significant (actual level in 1993-94 was 84 per cent of the Foundation's total operating revenue), it would be desirable for the Government to prescribe, under the terms of the *Audit Act* 1994, the Foundation as a body subject to annual audit by the Auditor-General. **Such action would enable the Parliament and the community to be regularly informed, from an independent source, on the nature of the Government's interests in relation to the Foundation and the manner in which those interests have been addressed and protected.**

□ **RESPONSE** by Secretary to the Department of Business and Employment

As a company registered under the Corporations Law, the Foundation is required to lodge an annual return in accordance with the provisions of that legislation. This return is a public document. The current review will also address the issue of the protection and reporting of the Government's interests in the Foundation.

Availability of reports

Copies of all Reports issued by the Victorian Auditor-General's Office are available from:

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