



Investment Attraction



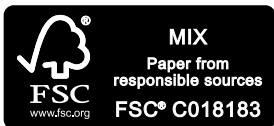
VICTORIA

Victorian
Auditor-General

Investment Attraction

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The Hon. Bruce Atkinson MLC
President
Legislative Council
Parliament House
Melbourne

The Hon. Ken Smith MP
Speaker
Legislative Assembly
Parliament House
Melbourne

Dear Presiding Officers

Under the provisions of section 16AB of the *Audit Act 1994*, I transmit my report on the audit *Investment Attraction*.

Yours faithfully



D D R PEARSON
Auditor-General

15 August 2012

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Audit summary

Background

Governments compete to attract business investment to support the economic growth and stability of their jurisdictions. Attracting new investments and encouraging established businesses to invest further enables governments to stimulate employment and develop the economy.

Governments attract investments primarily by developing a business environment that is attractive to investors, by promoting the attributes of their region as an investment location and by providing financial incentives and other services to individual investors.

The Department of Business and Innovation (DBI) is Victoria's lead economic development agency, however, the operations of other government agencies also affect Victoria's business environment. DBI's primary role is to deliver the government's vision of a dynamic, innovative and sustainable economy in which business is encouraged to grow. Attracting investment is therefore one of DBI's key activities.

Over the past 15 years, Victoria's business environment has been sound. This is evidenced by a number of factors including its ranking as the best of all Australian states and territories based on national benchmarks for competitiveness; its relatively high economic growth; its increased workforce participation; and its supportive pro-business environment. Although Victoria has been an attractive place for businesses to invest for a number of years, maintaining the competitiveness of Victoria's business environment poses significant challenges.

If recent productivity trends continue, they will impact adversely on Victorian living standards. The government's response to the 2011 Victorian Competition and Efficiency Commission's (VCEC) report, *Victorian manufacturing: Meeting the challenges, Inquiry into a more competitive Victorian manufacturing industry*, acknowledged Victoria's low productivity as a problem and agreed that the government should focus on facilitating productivity improvements in the manufacturing industry.

The objective of this audit was to determine whether DBI's investment attraction and facilitation programs are effective and provide value-for-money, including whether DBI:

- adopts a strategic approach to investment attraction
- has facilitated a sound business climate and actively promoted Victoria as an investment destination
- has robust processes for providing financial and non-financial assistance to industry
- has robust, reliable and transparent processes for monitoring, evaluating and reporting on industry assistance initiatives.

Conclusions

Victoria has had a strong and stable economy and an attractive business environment for most of the past 15 years. It is likely that DBI's investment attraction activities have contributed to this outcome, even though it has not undertaken any analysis to demonstrate the influence its activities have had.

DBI's advocacy role appears to be working effectively. Its advocacy processes are assisting businesses to address regulatory and other issues they face. However, it could enhance this function by reviewing its existing arrangements with other regulatory authorities and documenting its advocacy process.

DBI's promotional activities are well planned and organised, and appropriately targeted to priority industries and investment markets.

It is clear that projects that have received government grants have generated benefits for the state in terms of jobs, capital expenditure and exports. However, DBI's investment assistance programs are not focused on achieving a broader range of economic benefits such as productivity and innovation, which have been key features of government policies over the past ten years, and still are. Both independent and interdepartmental reviews over the past four years have criticised DBI's investment assistance criteria for not focusing on key outcomes related to innovation and productivity. As a result, DBI cannot demonstrate that these grants have generated the best outcomes for the state.

DBI does not clearly define objectives for investment attraction and does not have a comprehensive strategic plan governing the various activities it performs to attract investment to Victoria. Without such a strategy, DBI cannot accurately determine whether its actions to attract investment are working in a coordinated way and whether each of its investment attraction activities is contributing appropriately to the achievement of its objectives. DBI has made improvements since 2010, however, more work is needed to demonstrate a cohesive approach to investment attraction.

A lack of effective monitoring and evaluation means that DBI is unable to assess whether its activities are achieving desired outcomes, or to adequately demonstrate the benefits generated from this expenditure.

Findings

Strategy

DBI's corporate plan sets out its priority activities and identifies associated performance measures. However, without a comprehensive investment attraction strategy with specific, clearly defined objectives, there has been no mechanism to:

- focus DBI's investment attraction activities on those that will deliver the best returns for the state
- allocate resources efficiently between investment attraction activities
- monitor, evaluate and report on investment attraction activities.

Without a comprehensive strategic plan and effective evaluation processes, DBI does not have the information it needs to assess the appropriateness of its current resource allocations, nor the ability to reallocate resources between activities to improve the effectiveness of its investment attraction activities.

DBI believes that its corporate plan provides sufficient guidance and direction to its business engagement staff to drive its investment attraction activities and identify suitable projects for financial assistance and/or facilitation services. DBI acknowledges that the corporate plan could more clearly articulate each of these activities and their purpose.

However, VAGO does not believe that the corporate plan is an adequate substitute for a comprehensive investment attraction strategy. The corporate plan is not sufficiently detailed to drive investment attraction activities at an operational level.

Monitoring and reporting

DBI's internal and external reporting is selective and does not provide for a comprehensive understanding of the scale, cost and impact of investment attraction activities.

DBI's information systems capture departmental costs, but relevant costs are not allocated to investment attraction activities or to government assisted projects.

The selected information that is disclosed publicly does not provide a reasonable or sufficient account of the full cost and benefits of DBI's investment attraction activities. Reporting on what funding has been provided to whom, and the outcomes it has generated, is necessary to achieve transparency and maintain public confidence that this use of public funds is benefiting the state.

Evaluation

There have been interdepartmental reviews of DBI's Industry Support Program in 2008 and 2011 and of the Industry Transition Fund in 2010. DBI has also undertaken reviews of a number of its promotional activities. However, DBI has not conducted any other broader evaluations of investment attraction activities. Evaluations that have taken place have not adequately assessed the outcomes of these activities, and consequently DBI does not have a comprehensive understanding of their effectiveness.

Without these evaluations, DBI cannot accurately determine whether the benefits derived from investment attraction activities are greater than their costs, or that it is making the best use of government funding. The recent interdepartmental review of the Industry Support Program also identified the need to determine the impact of projects receiving government assistance.

Business environment

Investment attraction reporting in DBI's annual reports and State Government Budget Papers implies that DBI's investment attraction activities have made a major contribution to the positive trends in Victoria's broad indicators of economic health, such as capital expenditure, jobs and export growth. However, DBI has not undertaken any analysis designed to clearly demonstrate how its specific activities have directly contributed to these, or any other, broader economic outcomes. Consequently, DBI cannot demonstrate the impact of its activities.

VAGO acknowledges the difficulty in linking broad indicators of economic prosperity with investment attraction activities such as promotion, facilitating an attractive business environment, and facilitation services. However, without proper assessment, it is difficult to evaluate the effectiveness of DBI's investment attraction activities.

DBI has ongoing contacts with relevant local, state and Commonwealth Government agencies and makes representations to these agencies on behalf of businesses. While these relationships are important for raising business concerns within government and assisting companies to establish businesses in Victoria, DBI has not reviewed these relationships in the past three years.

DBI's advocacy services were useful in improving Victoria's business environment. However, its advocacy processes are not formally documented and its actions to facilitate regulatory reform are not prioritised or documented.

Promoting Victoria

DBI's promotion and marketing activities are well planned and organised. It has developed clearly defined objectives for its promotion activities which align with its key responsibilities. DBI has also developed a marketing communications plan.

DBI's promotion and marketing strategies reflect detailed research and analysis of Victoria's strengths and weaknesses and they identify the investments, locations, and markets Victoria intends to target. They also outline the communication and advertising mechanisms proposed to engage with the target markets.

Government assistance provided

Over the period from 2008–09 to 2010–11, 336 projects received grants and/or non-financial assistance. Of these, 63 per cent were in the Melbourne metropolitan area and 37 per cent in regional and rural Victoria. According to departmental records, these projects were expected to generate \$8 billion in capital expenditure, create 18 000 full time equivalent jobs and increase exports by \$1.5 billion.

Grants

DBI has established grant assessment and approval processes, including formal selection criteria to align its financial assistance with government industry policy and to establish appropriate governance arrangements. The eligibility criteria for the Investment Support Program and the Industry Transition Fund are reasonable. However, there is a need to provide more guidance on the application of these criteria, particularly those relating to innovation and productivity.

The effectiveness of the assessment process is brought into question as over 50 per cent of the applications examined in this audit received grants despite:

- criteria being assessed as not met
- applications not providing sufficient information to enable all the criteria to be assessed.

Facilitation services

DBI does not have a formal process for assessing and approving access to facilitation services. DBI advised that in selecting projects for facilitation, departmental staff consider such factors as project size and location. Consequently DBI cannot be assured that the services are consistently applied in accordance with government policies and priorities, and are allocated to those projects providing the best return for the state.

Recommendations

Number	Recommendation	Page
	The Department of Business and Innovation should:	
1.	<ul style="list-style-type: none"> • develop an overarching investment attraction strategy for its investment attraction activities with clearly defined objectives • review its internal and external reporting, including the need for greater public disclosure of investment attraction activities • undertake regular evaluations of its investment attraction activities 	18
2.	<ul style="list-style-type: none"> • evaluate the impact of its investment attraction activities on Victoria's business environment • document its advocacy procedures and develop a plan to coordinate actions proposed to improve the state's business environment 	28
3.	<ul style="list-style-type: none"> • limit financial assistance to those projects that meet eligibility criteria, and place greater emphasis on productivity and innovation • adequately justify, support and document assessment decisions • formalise its selection and assessment process for facilitation services. 	46

Submissions and comments received

In addition to progressive engagement during the course of the audit, in accordance with section 16(3) of the *Audit Act 1994*, a copy of this report was provided to the Department of Business and Innovation with a request for submissions or comments.

Agency views have been considered in reaching our audit conclusions and are represented to the extent relevant and warranted in preparing this report. Their full section 16(3) submissions and comments are included in Appendix A.

1 Background

1.1 Introduction

In an increasingly globalised economy, many businesses no longer need to be located close to their markets. Instead, businesses can choose operating locations based on the broader benefits they offer such as infrastructure, the availability of a skilled workforce, the regulatory environment and the cost of establishment.

State and federal governments around the world compete to attract these mobile investments to support the economic growth and stability of their jurisdictions. Attracting new investments and encouraging further investment by established businesses enables governments to stimulate employment and develop the economy.

Governments attract investments primarily by:

- developing a business environment that is attractive to investors
- promoting the attributes of their region as an investment location
- providing information and assisting investors, for example, in selecting sites and acquiring statutory approvals
- providing financial incentives to individual investors.

According to Australian Bureau of Statistics data, during 2010–11 around \$120 billion in new private capital investment was generated in Australia. Of this, \$21 billion or 18 per cent was generated in Victoria.

In the wake of the global financial crisis (GFC), competition for mobile investments has increased as jurisdictions compete for a reduced supply of prospective foreign investments.

1.2 Victoria's business environment

Victoria's attractiveness as an investment destination is dependent on a number of factors including the business environment and quality of life.

Over the past 15 years, Victoria's business environment has been sound. With the exception of Western Australia, which has benefited from the global mining boom, Victoria's economy has performed better than other Australian states and territories and most other developed countries.

Victoria's strong performance over this period is evidenced by:

- its ranking as the best of all Australian states and territories when compared using national benchmarks for competitiveness
- relatively high economic growth, underpinned by strong investment and population growth
- increased workforce participation, offsetting the effects of an ageing population, and sharing the growth in living standards more broadly
- the efficient movement of goods and people, made possible by Victoria's compact size and good infrastructure
- a supportive, pro-business environment
- a good quality of life demonstrated by Melbourne being named 'most liveable city in the world' in 2010.

1.3 Investment attraction in Victoria

The Department of Business and Innovation (DBI) is Victoria's lead economic development agency. Its primary role is to deliver the government's vision of a dynamic, innovative and sustainable economy in which business is encouraged to grow.

DBI's 2009–12 corporate plan identifies investment attraction and facilitation as one of its eight priority activities. Its key investment attraction activities are:

- promoting the state as an investment location to key overseas markets
- facilitating investments by individual businesses
- providing financial incentives to businesses.

DBI seeks to influence the decisions made by businesses around where to invest, rather than whether to invest or what to invest in. It also works with other state government agencies and other levels of government as an advocate for business, and to cultivate a business friendly environment in Victoria.

Multiple units within DBI contribute to investment attraction outcomes, including the Trade and Industry Development division, Innovation and Technology division, Investment and Major Projects division, and Tourism and Aviation division.

During the period 2008–09 to 2010–11, DBI facilitated 336 projects. These projects were expected to generate \$8 billion in capital expenditure, create 18 000 full time equivalent jobs and increase exports by \$1.5 billion.

Global financial crisis

The 2008 GFC had a significant impact on global investment flows. Foreign direct investment in Australia halved between 2007 and 2009 (from a peak of \$2 trillion to just over \$1 trillion). This trend was reflected in DBI's number of potential projects falling from 318 in August 2008 to 162 in February 2010.

The changing nature of investment flows as a result of the GFC created a significant challenge for countries trying to win new investment projects. Despite a predicted modest recovery in investment flows, there has been a shift in the landscape characterised by:

- fewer and smaller investment projects
- more intense competition for projects (especially from the developing economies such as China, India and Brazil)
- a reduction in investor appetite for risk
- a shift towards investment decisions being driven by efficiency rather than market growth.

Despite the global downturn, Victoria generally maintained the same level of business investment in 2011 as it did in 2008. This suggests that the state is still an attractive place to invest. The relatively greater impact of the GFC on the business and political environments of many of Victoria's competitors has also improved the attractiveness of Victoria as an investment destination. The Industry Transition Fund which operated from December 2008 to June 2010 to support Victorian business through the GFC may have also contributed to the continued levels of investment.

However, in the current economic climate competition for investment, particularly between Australian states, can be fierce.

Future outlook

Although Victoria's business environment has been sound for a number of years, it faces significant challenges to maintain its competitiveness, both globally and nationally:

- Productivity growth has fallen over the past 10 years. Recent economic growth in Victoria has been stronger than the other states, excluding the mining states of Queensland and Western Australia. This is due in part to strong population growth. However, the state is experiencing falls in productivity and gross domestic product per capita. Many companies are restructuring their business in response to the global economy. Slow productivity growth makes restructuring more difficult and will impact on the survival of some companies.
- The sustained resources boom is supporting a high Australian dollar. This is putting upward pressure on the price of Victorian exports. It threatens the competitiveness of the state's non-resource based industries and reduces the attractiveness of Victoria as a cost competitive location to invest.
- Population growth, urban development and the inability of state governments to maintain and expand the state's critical infrastructure assets, have led to transport issues such as traffic congestion, freight bottlenecks and inefficiencies, and higher energy costs. This is adding to the cost of doing business in Victoria.
- Shifting to a low-carbon economy will place further pressure on some businesses.
- Further deterioration in financial markets would impact both the living standards and the current resources boom.
- Victoria is more reliant than other states on the least efficient taxes, namely stamp duties.

The decline in Victoria's productivity growth is a significant issue facing the state. If the recent productivity trend continues, it will adversely impact on Victorian living standards.

For over 10 years the Victorian Government has recognised the need to improve the state's productivity. This is indirectly reflected in a number of DBI programs that encourage new technology and innovation. These programs are likely to facilitate productivity enhancing activities.

The government's 2011 commitment to develop a comprehensive strategy for boosting productivity, competitiveness and labour force participation also reflects DBI's recognition of facilitating productivity improvements.

1.4 Past audits

VAGO previously audited DBI's investment attraction activities in 2002. The focus of that audit was on targeted government assistance to business. It did not include an assessment of the broader investment attraction activities such as promoting Victoria as a business destination and facilitating improvements to the state's business environment.

The 2002 audit found that there was insufficient public disclosure of the criteria used to provide assistance, and that reporting did not include sufficient information about outcomes to allow the government and Parliament to assess the effectiveness of DBI's investment attraction programs. It further found that DBI did not analyse the outcomes of its assistance, and therefore such analysis could not be used to inform future decisions or program refinements.

The 2002 audit recommended, among other things, that DBI:

- develop and publish explicit criteria for investment facilitation and direct financial assistance
- improve contractual arrangements with businesses receiving assistance
- establish an ongoing program monitoring system capable of assessing program effectiveness
- report annually on assistance provided including expected and actual outcomes.

In 2004 VAGO followed-up recommendations from a number of audits. This follow-up revealed that DBI had implemented key recommendations of the 2002 audit including:

- improving contractual arrangements
- establishing a system to recording the number of new jobs, investment and exports generated from projects receiving assistance
- reporting on the total amount DBI invests in projects, the total number of jobs generated and contractual compliance.

However, it also found that other key recommendations had not been adopted. There continued to be no public disclosure of the criteria for selecting projects to receive investment attraction assistance, and data on the outcomes of investment attraction activities remained insufficient to support evaluation.

1.5 Audit objective, scope and cost

The objective of this audit is to determine whether DBI's investment attraction and facilitation programs are effective and provide value-for-money, including whether DBI:

- adopts a strategic approach to investment attraction
- has facilitated a sound business climate and actively promoted Victoria as an investment destination
- has robust processes for providing financial and non-financial assistance to industry
- has robust, reliable and transparent processes for monitoring, evaluating and reporting on industry assistance initiatives.

To meet the audit objective, we examined DBI's policies and processes for providing financial assistance and facilitation services to companies. This involved:

- examining relevant files and records maintained by DBI and other relevant government material
- interviews and discussions with departmental officers
- selecting and reviewing grant submissions considered by the DBI Investment Committee and the Investment Support Committee of Cabinet
- examining DBI's administration of a selection of grants/initiatives and determining the extent to which these projects generated economic and other benefits.

The audit was performed in accordance with the Australian Auditing and Assurance Standards. The total cost of the audit was \$550 000.

2 Strategy and evaluation

At a glance

Background

A strategic approach to investment attraction is important to achieve activities that are coordinated, appropriately prioritised and work towards achieving clearly defined objectives. An evaluation methodology is necessary to understand whether intended outcomes are achieved, and to facilitate service improvements.

Conclusion

The Department of Business and Innovation (DBI) has not documented a comprehensive investment attraction strategy or an effective monitoring and evaluation process for its investment attraction activities. Without them, DBI cannot be assured that its investment attraction activities are achieving the desired outcomes and providing value-for-money.

Findings

- While DBI has detailed plans for some of its investment attraction activities, it has not developed a comprehensive investment attraction strategy. DBI's corporate plan in its current form is not an adequate substitute for such a strategy.
- Internal and external reporting is selective and does not provide comprehensive information on the scale, cost and benefits of investment attraction activities.
- In the absence of evaluation processes, DBI cannot determine the net economic benefits of its investment attraction activities to the state.

Recommendation

The Department of Business and Innovation should:

- develop an overarching investment attraction strategy for its investment attraction activities with clearly defined objectives
- review its internal and external reporting, including the need for greater public disclosure of investment attraction activities
- undertake regular evaluations of its investment attraction activities.

2.1 Introduction

A strategic approach to investment attraction is important if the Department of Business and Innovation (DBI) is to achieve its corporate objective to attract and facilitate new investment into the state and encourage reinvestment. This should be formally documented, incorporate specific policy objectives, describe the processes and procedures to achieve its desired outcomes, and deliver value-for-money. This provides focus and direction for achieving goals and objectives, and identifying the tasks, milestones and resources needed to realise them.

A comprehensive evaluation methodology is also important to understand whether activities are achieving intended outcomes, and to facilitate service improvements. To assess whether DBI has a strategic approach to investment attraction, we examined whether it has:

- an overarching strategy with defined objectives
- a strategy for engaging with stakeholders
- a systematic process for identifying, analysing and responding to the investment barriers businesses face.

We also examined DBI's monitoring, reporting and evaluation processes to identify whether they are transparent and support the efficient and effective delivery of investment attraction initiatives.

2.2 Conclusion

The broad focus and goals of investment attraction activities are outlined in DBI's corporate plan. However, this does not provide sufficient clarity and direction about each of these activities and their purpose or how they will be effectively evaluated.

Activities that attract investment are undertaken by staff across DBI's divisions. Some of these divisions have plans to drive their investment attraction activities. However, without a comprehensive strategy governing the various activities across the department, DBI cannot be assured these are:

- adequately focused and coordinated to achieve its investment attraction objectives and government policies
- providing value-for-money.

A lack of effective monitoring and evaluation means that DBI is unable to:

- assess whether its activities are achieving desired outcomes
- demonstrate that government assistance provided to public and private organisations generates net benefits for the state.

2.3 Investment attraction strategy

DBI's investment attraction activities are referred to in various plans, including its corporate plan and specific industry plans. However, DBI has not brought these various activities and documents together into a comprehensive investment attraction strategy. Such a strategy would:

- provide the focus and priorities for the department's investment attraction activities
- outline the detailed actions needed to deliver DBI's objectives
- drive policy changes
- efficiently allocate resources between investment attraction activities
- outline monitoring, evaluation and reporting requirements.

DBI's 2009–12 corporate plan includes broad departmental objectives and annual investment attraction targets, and outlines its focus on attracting new investment, jobs and exports. DBI's performance against these targets is reported in its annual reports and budget papers.

The corporate plan also sets out a number of key actions for investment attraction including:

- identifying, facilitating and managing major investment projects across all strategic industry sectors
- implementing investment attraction strategies that target new opportunities in strategically important sectors
- providing support and assistance to investors through the Investment Support Program and the Industry Transition Fund
- implementing marketing and public relations campaigns that promote Victoria's strengths in identified industries
- working closely with the Commonwealth and, where appropriate, other states and territories in collaborative offshore initiatives.

The corporate plan acknowledges that it provides a starting point for policy development and sets out key goals and objectives for each priority activity.

DBI believes that its corporate plan provides sufficient guidance and direction to its business engagement staff to drive its investment attraction activities and identify suitable projects for financial assistance and/or facilitation services. DBI acknowledges that the corporate plan could more clearly articulate each of these activities and their purpose and has indicated that it is willing to provide more information on its investment attraction strategies in its corporate plan.

However, VAGO does not believe that the corporate plan is an adequate substitute for a comprehensive investment attraction strategy. Incorporating detailed strategies for all major departmental activities in the corporate plan would potentially make the plan too unwieldy and unbalanced and it would lose its usefulness.

Without a comprehensive strategic plan and an effective evaluation process, DBI does not have the information it needs to assess the appropriateness of its current resource allocations, or the information to drive decisions on the reallocation of resources between activities to improve their effectiveness.

An effective strategic plan DBI's investment attraction activities would incorporate, at the highest level, the corporate plan that outlines its broad goals, activities and desired outcomes. Underpinning this plan should be detailed strategic plans for each of its major activities, including investment attraction. Plans should then be developed for each investment attraction activity—promotion, improving the business environment, facilitation services and financial assistance. These plans should feed into the plans for department-wide processes such as business engagement, risk management and monitoring and evaluation.

DBI has a high level corporate plan and plans for its major department-wide processes. However, there is no strategic plan for investment attraction and no separate plans for the investment attraction activities of improving the business environment, facilitation services and financial assistance.

Without an investment attraction strategy there is no effective mechanism to:

- direct DBI's investment attraction activities to achieve the governments objectives
- assign responsibility for actions and set time lines
- allocate resources between investment attraction activities
- outline monitoring reporting and evaluation processes.

2.3.1 Other strategies and plans

DBI has plans for some components of its investment attraction work. Though useful for defining aspects of its activities, these strategies have limitations.

Foreign Direct Investment Strategy 2010–2015

In 2010, DBI developed a five-year strategy for attracting foreign investment to Victoria.

It sets out the priority markets and sectors that DBI will target to attract foreign investment, and the key actions it will perform to attract such investment. These actions include marketing, events and financial incentives. This strategy is informed by research DBI commissioned into the post-global financial crisis investment climate and its impact on investment flows into Victoria.

However, the strategy does not outline how it will be implemented or include processes to monitor, review and evaluate its effectiveness.

The strategy is also not reported on and therefore the extent to which DBI is following it, and whether it is having any impact is unclear. The strategy has not been amended since the 2010 change of government.

Industry plans

DBI developed industry action plans for five of the 11 priority industries identified by the previous government—small business, financial services, international education, biotechnology and information communication technologies. It also developed plans for small technologies and manufacturing, which relate to one or more of its 11 priority industries.

These plans highlight key industry development activities for these sectors. However, the majority of the plans are high level marketing documents and do not explicitly cover investment attraction activities. They are, therefore, inadequate to effectively guide investment attraction activities in those sectors.

2.4 Stakeholder engagement

DBI does not have a comprehensive stakeholder engagement strategy that covers all key stakeholders involved in investment attraction. While DBI has a strategic approach to engaging with businesses, it has no defined strategy for engaging with government stakeholders that are critical to investment attraction activities.

Business engagement model

Individual businesses are DBI's key investment attraction stakeholders, and DBI interacts with them according to an engagement model it developed in 2010. DBI established this model so that engagement could be wide reaching and to provide a systematic approach to identifying investment opportunities as well as issues affecting individual businesses and sectors as a whole.

DBI's 2010 model seeks to reach a broader range of businesses and industries, and sets out engagement protocols for businesses of varying size. The model is underpinned by a department-wide information management system intended to transparently document interactions with business, capture opportunities for attracting investment and inform policy development.

This improved engagement process is expected to:

- generate better business intelligence
- improve resource allocation by better targeting government assistance
- focus investment attraction activities on key economy and sector-wide competitiveness issues (such as infrastructure, regulation, skills and red tape reduction).

DBI has advised that the model has recently been deployed across the department and the information management system is fully implemented. This electronic database captures intelligence gathered through engagement to manage and prioritise investment opportunities. Given its recent introduction, it is difficult to evaluate the extent to which it is generating benefits in terms of stakeholder management and information gathering.

Other stakeholders

It is important for DBI to work with other state, local and Commonwealth agencies whose activities impact on investment. As part of this audit we found that DBI:

- has ongoing contact with relevant local, state and Commonwealth Government agencies, and routinely directs companies to the right people within these agencies to addresses their issues. It also makes representations to these agencies on behalf of businesses
- helps companies understand government processes and regulatory requirements and assists in making applications and preparing documents
- works with Austrade and Tourism Victoria to promote the state as an investment destination
- consults with the Victorian Employers Chamber of Commerce and Industry to improve networks between business and government
- assists government organisations like the Productivity Commission and Victorian Competition and Efficiency Commission (VCEC) with their inquiries.

Though maintaining strong intergovernmental relationships is a focus of DBI's work under its 2009–12 corporate plan, the lack of a stakeholder engagement strategy for these activities means that DBI has not established a system to guide this engagement in an effective way.

DBI participates in interdepartmental committees and works with departments to progress specific investment projects. However, both the extent of this work and the resulting outcomes are unclear.

2.5 Identifying and responding to investment barriers

To effectively attract investment to Victoria, DBI needs a thorough understanding of the wider investment climate, the challenges industries are facing, and the barriers these present to new and further investment. Systematically identifying these issues allows DBI to prioritise areas for reform, and direct its efforts to areas that will produce the greatest benefits for the state.

DBI does this through its ongoing engagement with industry to gather intelligence, ongoing monitoring of the investment climate and research projects.

Industry intelligence

DBI's strategic research division analyses the information gathered and provides the results to staff to be used in investment attraction and facilitation activities, marketing and promotion, and industry development.

Before DBI implemented this model, industry intelligence was spread across multiple databases that were not interconnected and not widely accessible by staff. This provided few opportunities or incentives for knowledge exchange and prevented DBI from making the best use of the information gathered.

Research

As part of DBI's 2002 strategic review of Victorian industry, it gathered extensive information on the state's business environment. DBI has also undertaken investment trend analysis and benchmarking studies. The benchmarking studies compare Victoria's competitive position as an attractive destination for investment with other jurisdictions.

More recently, in 2011 DBI prepared its 2011 *Industry Atlas of Victoria* which provides a comprehensive snapshot of Victorian businesses, their location and their condition.

DBI also has ongoing discussions with investment agencies in other jurisdictions to gather information to plan its investment attraction activities. These agencies include Singapore's Economic Development Board, UK Trade and Investment, Scottish Development International and Japan's Ministry of Economy Trade and Industry.

2.6 Monitoring and reporting investment attraction activities

Monitoring and reporting on investment attraction activities, including their costs and the outcomes achieved, allows DBI and the wider public to assess whether DBI is performing effectively.

The success of these activities is ultimately determined by:

- the amount of new investment Victoria receives
- DBI's ability to retain and assist the expansion of existing businesses
- the cost of these activities.

DBI's information systems capture departmental costs, but not all relevant costs are allocated to investment attraction activities or to government assisted projects.

Specifically the costs:

- incurred in promoting Victoria and creating a sound business environment are not monitored and reported either internally or externally
- of DBI's other industry development services that create new investment are not allocated or included in the overall costs of investment attraction activities
- of administering grants programs are not included in the overall cost of financial assistance provided or apportioned to those projects receiving assistance
- of providing facilitation services are not allocated to specific projects.

The benefits to the Victorian community generated by new investment can take many forms including new jobs, capital expenditure, exports, productivity improvements, introduction of innovative processes and an increase in tax revenues. However, the information gathered by DBI on projects it assists is effectively limited to jobs, capital expenditure and exports as reported in the state's Budget Paper No. 3, *Service Delivery*.

Reporting

DBI's internal and external reporting on investment attraction activities is selective and does not provide for a comprehensive understanding of their scale, cost and impact.

During 2008–09 and 2009–10, monthly investment program reports were submitted to DBI's Investment Committee. These reports were limited to the number of jobs created, the value of exports and capital expenditure from the projects receiving government assistance. Similar reports were not provided in 2010–11.

It is unclear if there is any reporting on the progress of promotion activities or actions taken that impact on the state's business environment.

External reporting on investment attraction is limited to the State Budget Papers and DBI's annual report. Budget Papers report on:

- the number of projects being considered for assistance
- the number of jobs and value of capital expenditure and exports expected to be generated from those projects
- the cost of investment attraction.

DBI's annual report includes similar data, as well as the names of the companies receiving financial assistance from some of its grants, and the total value of financial assistance provided for the year.

While this information is useful, it does not provide a transparent account of the full cost and impact of DBI's investment attraction activities. Such transparency is important for all government expenditure, but is particularly important for investment attraction, where significant public funding is provided to private businesses. In this context, reporting on what funding has been provided to whom, and the outcomes it has generated, is necessary to achieve transparency and maintain public confidence that this use of public funds is benefiting the state.

DBI's public reporting could be significantly enhanced by including the:

- amounts of financial and/or other government assistance provided to specific entities
- criteria for assessing government grants
- jobs, exports and capital expenditure generated by the individual projects receiving government assistance
- innovation processes, productivity improvements, skill development and wider value added by these projects
- adverse impacts of government assisted projects on other companies, such as increasing the price of skilled labour in that industry.

Finding the right balance between reporting on government assistance to industry, while maintaining commercial confidentiality is a challenge for DBI. It argues that disclosure of specific grant payments could raise expectations and encourage other businesses to seek assistance, potentially stimulating demand and increasing costs to government.

However, public disclosure is more likely to:

- expose government assistance to greater external scrutiny
- provide a strong incentive for DBI to demonstrate that funds provided are generating the expected economic benefits for the state
- encourage competition for government financial assistance, thereby generating greater benefits for the state for each dollar of assistance.

VAGO's 2002 performance audit on investment attraction recommended that DBI publicly disclose the value of grants provided. However, DBI maintains the view that any benefit would be offset by the potential for such disclosures to undermine its future bargaining position in relation to other jurisdictions.

2.7 Evaluation

Evaluating investment attraction activities is essential for understanding whether they are effective in achieving their intended outcomes. Insights gathered through evaluation are also critical for driving service improvements, and informing future program development.

DBI established an evaluation framework in 2005. It regularly evaluates programs, functions and activities, and works to address significant weakness identified.

There have been interdepartmental reviews conducted of the Industry Support Program in 2008 and 2011 and the Industry Transition Fund in 2010. DBI has also evaluated a number of promotional activities such as trade event sponsorships. However, DBI has not conducted any broader evaluations of its government assistance to businesses or its activities to improve Victoria's business environment. The targeted evaluations that have taken place have not adequately assessed the outcomes of these activities, and consequently DBI does not have a comprehensive understanding of their effectiveness.

What is evaluated?

DBI's evaluations vary considerably. Many are limited to an assessment of whether government policies and broad objectives are being met. With the exception of some industry support programs and promotional activity evaluations, they do not include cost-benefit analyses or value-for-money assessments. There is a lack of information about the outcomes of investment attraction activities and the broader implications for Victoria's economic development.

Without evaluating these elements, DBI cannot accurately determine whether the benefits derived from investment attraction activities are greater than their costs, or that it is making the best use of government funding. The recent interdepartmental review of the Industry Support Program also identified the need to determine the net impact of projects receiving government assistance.

DBI periodically surveys companies receiving government assistance. In August 2008, its survey found that 95 per cent of recipients were happy with the grant or service received. The target level of satisfaction was 80 per cent.

While this is a good result, it is not surprising that the feedback from companies that receive money or free services from DBI is positive.

DBI does not survey companies whose requests for assistance were rejected and there are no other surveys to assess whether companies are aware of its services, such as a broad survey of industries that have not received assistance. This means that DBI does not have sufficient information to understand why companies considering investing in Victoria choose not to. This could provide valuable insight to inform service improvements.

Evaluation of specific assistance provided

In addition to evaluating its broader investment attraction activities, DBI should also evaluate the impact of the specific assistance provided to companies. These evaluations should:

- compare the full costs and benefits derived from the project, including the full costs of its investment incentives and administration of grant programs
- determine whether incentives provided were critical to a recipient company's investment decision
- consider the net economic benefit of the assistance provided by looking at the impact on other businesses
- consider value-for-money. The results of the evaluations should be used to direct public resources towards the activities delivering the highest returns.

Financial assistance

DBI does not review completed projects to determine whether they provided a net economic benefit to the state, or value-for-money.

DBI's financial assistance assessment processes involve evaluating projects before a decision is made to fund them. This process is designed to limit assistance to those projects that meet the selection criteria of the relevant fund.

Criteria for the Industry Support Program and Industry Transition Fund required the economic benefits of each project to exceed the cost of the assistance. However, as government assistance is generally a very small portion of the project expenditure, the value of this expenditure should always exceed that of the government assistance.

DBI's monitoring of deliverables in grant agreements is also designed to provide assurance that the state receives these economic benefits prior to grant milestone payments being made.

These assessments are not a substitute for formal evaluations of completed projects as benefits predicted at the commencement of a project are not always achieved. Evaluations of project performance after the projects are completed would provide greater accountability and valuable information on the return the public is getting from the assistance provided.

Facilitation services

In its engagement with businesses and investors, DBI discusses potential investments in Victoria. It is through these discussions, and the knowledge and experience of its staff, that a decision is made on whether government assistance is warranted.

DBI staff will decide to facilitate the investment where it considers the indicative benefits likely to be derived from the project will exceed the cost of the services provided.

However, there is no formal evaluation of DBI's facilitation services to determine if they generated the expected net benefits to the state, or provided value-for-money. It is also not possible to determine whether the provision of these services resulted in the investment coming to Victoria.

Reviews of Department of Business and Innovation investment attraction activities

A number of reviews have looked at the government assistance provided to industry in the past three years.

2008 Industry Support Program review

This interdepartmental review found that the program's criteria had remained unchanged despite the economic environment being very different to the early 1990s when the fund was first established. The report suggested that the criteria were inappropriate to the current government objectives of productivity and innovation.

2011 Industry Support Program review

DBI and the Department of Premier and Cabinet recommended the program continue under a refined set of arrangements that ensures value-for-money for the state. The Department of Treasury and Finance did not support the continuation of the program beyond the existing commitments. The Interdepartmental Committee recommended among other things:

- the Victorian Government recommence discussions with other jurisdictions to introduce informal cooperation mechanisms
- all criteria should have to be met and the wording of some criterion, namely, sustainability, productivity, alignment with government policy, and the project not proceeding without government support, should be amended
- an increased focus on productivity
- additional information on the contribution of the project to its proposed location, risk factors and job displacements likely to result from the project.

The committee's recommendations have been accepted by government.

2010 Industry Transition Fund review

This review was undertaken by the government's Economic and Sustainability Development Committee following the completion of the Industry Transition Fund. The purpose of the review was to identify the details of the commitments outstanding and the outcomes achieved by the fund. The key performance measures discussed in the report were capital expenditure and jobs. There were no recommendations.

2011 VCEC *Victorian manufacturing: Meeting the challenges*

The scope of the review included the changing nature of manufacturing in Victoria; the economic cost of decline in the sector; drivers of future growth; actions to improve competitiveness and productivity; and the regulatory burden imposed on the sector.

The review recommended that financial assistance to attract footloose investments that are able to relocate to Victoria in response to changing economic conditions, should be provided only when there are demonstrable spillovers to other firms from the introduction of new technology and only after strict conditions have been met.

2011 Review of Victorian Government industry assistance

In 2011, DBI commissioned a consultant to undertake a comprehensive review of government industry assistance programs. A final report was presented to DBI on 29 February 2012. While this review was conducted from a whole-of-government perspective, it includes comments relevant to DBI's investment attraction activities.

Recommendation

1. The Department of Business and Innovation should:
 - develop an overarching investment attraction strategy for its investment attraction activities with clearly defined objectives
 - review its internal and external reporting, including the need for greater public disclosure of investment attraction activities
 - undertake regular evaluations of its investment attraction activities.
-

3 Business environment and promotion

At a glance

Background

Investment agencies around the world recognise that creating a sound business environment is critical to attracting investment. Investment destinations need to have good quality and efficient infrastructure, and investment agencies need to work with government to reduce the barriers created by business regulation, and respond to investor concerns where appropriate. These agencies also need to effectively promote the merits of their investment location.

The Department of Business and Innovation (DBI) is Victoria's lead agency for investment attraction.

Conclusion

It is likely that DBI's advocacy role and promotional activities have contributed to Victoria's strong and stable business environment. However, the extent of its contribution is difficult to judge because DBI has not undertaken any analysis to demonstrate the influence its activities have had on this outcome.

Findings

- DBI engages with industry, gathers useful information on issues facing Victorian businesses and advocates for reform. However, its advocacy processes are not formally documented and its actions to facilitate regulatory reform are not prioritised and documented in a strategy or plan.
- DBI has appropriately planned its promotional activities and has developed a marketing communications plan.

Recommendation

The Department of Business and Innovation should:

- evaluate the impact of its activities on Victoria's business environment
- document its advocacy procedures and develop a plan to coordinate actions proposed to improve the state's business environment.

3.1 Background

A sound business environment is critical to attracting investment. The role of governments in this process is to:

- reduce the barriers created by business regulation and its complexity
- make economic infrastructure as accessible, affordable and effective as possible
- attract and build key capabilities as a catalyst for investment.

Having a good business environment is necessary but is not enough to attract investment. The merits of the investment location also need to be promoted.

The extent of foreign investment in Victoria depends on many factors largely beyond the control of government. These include the state's geographic location, access to nearby markets, its natural and human resources, global and national economic growth and actions by leading investment nations. However, one factor that can be influenced by government is the quality of Victoria's investment and business environment.

The Organisation for Economic Cooperation and Development and the Productivity Commission have indicated that establishing a sound business climate is the most effective way of attracting investment.

3.1.1 The Department of Business and Innovation's role

To improve the Victorian business environment, promote the state as an attractive place to invest and facilitate new investment, there need to be processes that enable the government to engage with industry and potential investors.

The Department of Business and Innovation (DBI) plays a key role in fostering and promoting industries in Victoria and provides the interface between government and the business community. As stated in its 2009–12 corporate plan, DBI's mission, is to 'work with business and the community to boost productivity, exports, investments and jobs'.

As Victoria's lead agency for investment attraction, DBI is well placed to:

- engage with industry and their representative bodies to identify practical problems faced by companies doing business in Victoria and any adverse perceptions about the state's business climate
- be an advocate for investors within government, facilitating changes to laws and regulations or seeking development approvals
- establish ongoing relationships with government agencies whose operations impact on Victorian businesses and new investment in the state
- work within government to streamline administrative procedures impacting on the establishment of a business.

3.2 Conclusion

Victoria has had a strong and stable economy and a sound business environment for most of the past 15 years. DBI has concentrated its investment attraction activities on facilitating private sector projects that generated jobs, capital expenditure and exports. DBI's advocacy and promotional role is likely to have contributed to this outcome, however, the extent to which this is the case is unknown.

DBI works with relevant government agencies to streamline the regulatory impact on investment and to facilitate reform to assist industry. This advocacy role appears to be working effectively. However, reviewing DBI's existing arrangements with other agencies and documenting its advocacy process would further enhance this function.

DBI's promotional activities are well planned and organised.

3.3 DBI's contribution to establishing a sound business environment

DBI has identified and raised with government issues affecting business and investment in Victoria. However, DBI was not able to demonstrate its contribution to improving Victoria's business environment over the past 15 years.

DBI's industry policy framework recognises that the Victorian Government can play a key role in supporting the ongoing competitiveness of industries by advocating and driving efficiencies in the areas of infrastructure, labour and skills, regulation, collective action between government agencies, and Commonwealth-state reform.

An important way to improve Victoria's business environment is to identify issues faced by companies operating in, or considering locating in the state, and facilitating changes to address them.

Recent changes to DBI's engagement model have resulted in broader interaction with Victorian businesses and this should result in a greater focus on investment projects providing productivity improvements.

Our audit of DBI's role in advocating regulatory and other reform has revealed that:

- actions to facilitate regulatory reform are not documented in a strategy or plan
- the priority assigned to actions is not formally documented
- while there is a business engagement strategy and relevant stakeholders have been identified in DBI's divisional business plans, there is no stakeholder management strategy
- the advocacy role of DBI is not formally evaluated.

3.3.1 Identifying impediments to investment

DBI undertakes strategic research, analysis and industry scanning to identify priority sectors and high-level issues affecting industry, and to develop relationships with industry and industry representative groups.

DBI uses this, and other information obtained from discussions between its business development managers and industry, to identify infrastructure, regulatory and other issues impacting on investors generally and those affecting strategic sectors.

This information is recorded in DBI's customer/client relationship management information system. Intelligence extracted from this system is used to identify systemic issues that may inform policy change. These issues are referred to DBI's policy division for assessment and action.

Examples of issues identified by DBI that impact on business and the resulting actions are outlined in Figure 3A.

Figure 3A
Issues impacting on business and actions taken

Issue	Nature of concern	Action taken by policy	Response
High electricity connection costs to businesses.	Distributors interpretation of connection guidelines.	Representations made to the Essential Services Commission and subsequently to the Australian Energy Regulator (AER).	The AER made a determination addressing the interpretation of the guidelines consistent with DBI's advocacy.
Commonwealth Government proposal to replace research and development tax concession with a tax credit.	Companies and industry associations concerned about impact. Some small and medium enterprises confused by changes.	Modelling undertaken to determine impact on Victorian business.	Results provided to Commonwealth Government, industry and business development managers. Results indicated a positive impact on Victorian small and medium sizes companies.
Commonwealth Government proposal to change the Pharmaceutical Benefits Scheme arrangements impacting on generic drug providers.	Pharmaceutical manufacturers concerned about negative impact on industry.	Research undertaken to establish industry wide impact.	DBI report back to industry.
Commonwealth Government changes to employee shareholding on fringe benefits impacting on research and development start-up companies.	Industry concern that changes may impact on ability to continue to recruit skilled and specialist staff to start ups.	Advice provided on impacts of the scheme.	Information provided to industry to enable it to seek appropriate advice to maximise the tax benefits to employees in setting up such scheme.

Source: Victorian Auditor-General's Office based on data provided by the Department of Business and Innovation.

3.3.2 Reducing the administrative burden

Through its industry engagement and advocacy role, DBI attempts to facilitate changes to administrative requirements to improve the investment climate. Its success in doing this is dependent on its ability to influence other departments, regulators and governments.

DBI facilitates regulatory and other reform through a number of mechanisms. This includes direct representations to ministers, departments, agencies and regulators, and its participation in the National Investment Advisory Board and a number of interdepartmental committees.

DBI also raises issues impacting on business with a range of agencies that can result directly or indirectly in regulatory reform. For example, DBI has:

- provided business intelligence to Victorian Competition and Efficiency Commission inquiries
- analysed vocational education and training issues, including apprenticeship and traineeship regulation, to facilitate changes to state training requirements
- undertaken work on land use and employment to assist the development of planning policy
- undertaken targeted consultation with businesses and other government agencies to inform the Commonwealth Government's food labelling review.

DBI is also represented on the Project Control Board for the state government's Red Tape Reduction Strategy, which achieved a 25 per cent reduction in the cost of regulation over the five-year period from July 2006 to June 2011.

3.3.3 Establishing relationships with relevant government agencies

DBI can assist Victorian companies to set up or expand their businesses in the state by establishing arrangements with other public and private sector agencies whose activities directly or indirectly impact on the business environment, promote Victoria, or provide assistance to industry.

DBI works with local, state and Commonwealth government agencies including Austrade, Tourism Victoria, the Victorian Chamber of Commerce and Industry, the Productivity Commission and the Victorian Competition and Efficiency Commission.

This audit found that these relationships were important for raising business concerns within government and assisting companies to establish businesses in Victoria.

Involvement in the recent (Commonwealth) Blewett Food Labelling Review is an example of where DBI's targeted consultation with businesses and other government agencies has resulted in positive outcomes for business.

At the request of the Council of Australian Governments, the Australia and New Zealand Food Regulation Ministerial Council commissioned the food labelling review. DBI was a member of a state-level interdepartmental committee—which included the departments of Health and Primary Industries—that consulted with the food and beverage manufacturing sector and made a submission to the Ministerial Council review.

In responding to recommendations made in the Blewett review team's *Labelling Logic* report, the Commonwealth Government agreed to amend the *Food Standards Australia New Zealand Act 1991* and food standards.

To establish effective working relationships, DBI needs to have a clear strategy for intergovernmental communication and:

- determine which activities are best undertaken in conjunction with other agencies
- define the types of arrangements that should be established
- outline reporting and evaluation requirements and funding arrangements.

DBI indicated that the effectiveness of its relationships with associated agencies is demonstrated through the continuing demand for facilitation services and the ongoing willingness of those agencies to work with DBI to achieve the best outcome for the state. While these relationships are managed on an ongoing basis, having a plan to coordinate these activities would provide a more structured approach to DBI's reviews of these relationships.

3.3.4 Streamlining administrative procedures

A major factor affecting investment decisions is the time taken to establish businesses in new locations, and government administrative and regulatory requirements have a significant impact on set up times. Reducing or streamlining government processes enables new investments to be established more quickly and reduces investor costs.

A common approach adopted in other jurisdictions is to establish a 'one-stop shop' to give investors access to the information they need to set up their business and to assist them to meet regulatory requirements.

In 2005, DBI established Invest Victoria, which acts as an investment promotion agency and a one-stop shop for potential investors. Invest Victoria has longstanding relationships with other departments and agencies and delivers the following services:

- assisting companies to gather market information and make contact with relevant Victorian Government agencies
- providing information on the companies' market potential, including details of existing companies, research and development capabilities, available skills and costs
- identifying a range of available sites for particular businesses and assisting with planning approvals and access to utilities
- putting companies in touch with suitable local suppliers, service providers and partners
- assisting companies to access government services including government grants and support programs.

This audit found that DBI's advocacy services were useful in improving Victoria's business environment.

3.4 Promoting Victoria as an investment destination

If Victoria is to attract investment, the state's attributes as an attractive investment destination need to be effectively promoted. If investors have a poor perception of Victoria or know little about the benefits Victoria provides to business, the government's efforts to generate investment will be less effective.

DBI's promotion and marketing activities are well planned and organised.

3.4.1 Victoria's competitive advantage

Promoting Victoria as an attractive investment destination involves a number of components. The first is to develop a picture of where Victoria stands as an investment destination. This involves understanding the demand and supply market for investment funds and the state's competitive position in this market.

To do this DBI needs to identify and understand:

- what Victoria is trying to achieve by attracting foreign investment—promotional objectives
- what types of investment will best serve the state's needs
- how the current foreign direct investment trends affect Victoria's ability to attract investment
- Victoria's strengths and weaknesses as an investment site
- the environment of Victoria's competitors and how Victoria compares to them.

Promotional objectives

Clearly defined objectives are required to guide investment promotion activities and allocate resources. DBI's promotional objectives are to:

- highlight to the international business community the resilience of the Victorian economy and its long-term stability
- strategically target investment in sectors and markets that have high growth potential and match Victoria's industry capabilities
- raise the profile of Victoria as an international business location
- maximise opportunities for synergies with other investment attraction stakeholders within Victoria—such as Tourism Victoria and Melbourne Convention and Visitors Bureau—and for leveraging off 'Team Australia' in global markets.

These objectives are aligned with DBI's key responsibilities.

Determining the right sectors and markets for investor targeting

In response to falling foreign investment in 2009, DBI engaged a consultant to review investment flows and identify businesses with high potential to succeed.

The review looked at foreign direct investment flows for the period 2003–08 and analysed past market trends in investment activity in Victoria, Australia, Oceania, and the world to forecast future trends.

The review identified Victoria's strengths and weaknesses as an investment destination and compared them with those of its main competitors.

Using the information gathered on the relative strengths and weaknesses of Victoria and its competitors, and the supply market for investment dollars, the report identified the biotechnology, software development, automotive and aerospace sectors as high-priority sectors in the medium term.

Invest Victoria added advanced food processing, knowledge process outsourcing, and carbon market services to the consultant's list of high priority sectors. The combined list was included in DBI's 2010 *Foreign Investment Attraction Strategy 2010–2015*.

The consultancy also identified potential sources of investment funding for the key Victorian sectors identified. Priority markets identified were the US, UK, Japan and Germany. India and China were regarded as the most important priority investment funding sources among the developing countries.

Identifying investor perceptions

After establishing what Victoria has to offer and how it compares to its competitors, it is necessary to identify what potential investors think about Victoria.

This information can be used to identify what needs to be done to bridge the gap between how the target market sees Victoria and how the government would like the location to be perceived.

In 2009, Invest Victoria also engaged a consultant to interview corporate executives working in priority sectors and markets to gauge their perception of Victoria as a potential investment destination. The consultant found that many of the executives interviewed were not familiar with Victoria or did not see the state as a potential investment destination. This highlighted the need for better targeting of DBI's marketing and promotional efforts.

DBI has not undertaken follow-up interviews with corporate executives, but it believes that the lessons from the consultant's report have been incorporated into its sales manual and marketing strategies.

3.4.2 Developing a marketing theme

Once investors' perceptions of Victoria are determined, a promotional campaign with a central marketing theme needs to be developed. This theme is used to improve Victoria's image, within the general investment community and the priority markets. To be effective it must:

- reflect what the investor is looking for
- demonstrate how Victoria can help the investor to meet this need—for example, a marketing theme might stress Victoria's cost-efficient yet highly skilled labour, rather than simply proclaiming that it is a wonderful place to live
- clearly identify and position Victoria as a unique investment opportunity, to distinguish it in the eyes of investors.

DBI identified five key promotional campaign themes to attract prospective investors.

These were Victoria's:

- competitive and dynamic business environment
- skilled and innovative workforce
- world-class infrastructure
- enviable lifestyle
- supportive government.

These themes focus on the state's strengths as a potential investment destination and reflect the investment location drivers identified in DBI's research.

3.4.3 Promotional planning

DBI has outlined its promotion and marketing strategies in its *Foreign Investment Attraction Strategy 2010–2015*. It has also developed a marketing communications strategy in 2009–10 and a trade and investment international networks strategy in 2011.

DBI's promotion and marketing strategies reflect its detailed research and analysis of Victoria's strengths and weaknesses, and identify the investments, locations and target markets. The strategies also outline DBI's communication and advertising mechanisms to engage with the target markets.

3.4.4 Selection of marketing tools

DBI uses a number of marketing tools, including:

- sector specialist visits
- public relations and media
- visiting journalists programs
- events and sponsorships
- social media
- direct mail.

These tools were selected following a 2010 consultant's study, which identified the preferred communication channels of key decision-makers and intermediaries in each of the priority sectors and markets identified by DBI.

DBI also promotes Victoria:

- internationally through its established network of 13 overseas Victorian Government Business Offices
- through its established national networks, such as the Chambers of Commerce, industry groups, and the Commonwealth Government's investment agency, Austrade
- through the Invest Victoria website. The site provides potential investors with a large range of information on Victoria and its attractiveness as an investment and a quality of life destination. The site also acts as a portal for potential investors to obtain more detailed information on particular areas of interest and provides contact details for follow-up enquiries.

While these tools are useful in terms of selling the state's message, their effectiveness is ultimately determined by the way in which they have been implemented.

In August 2010 DBI engaged a consultant to review its promotional activities. DBI agreed with most of the consultant's recommendations and although it has taken action to address them, it has not yet assessed their effectiveness.

Recommendation

2. The Department of Business and Innovation should:
 - evaluate the impact of its investment attraction activities on Victoria's business environment
 - document its advocacy procedures and develop a plan to coordinate actions proposed to improve the state's business environment.
-

4

Government assistance

At a glance

Background

The Department of Business and Innovation (DBI) provides companies with financial and non-financial facilitation services to assist them to establish or expand their business in Victoria. To maximise the benefits to the state, DBI needs a comprehensive and robust process to allocate these grants and services.

Conclusion

Projects that have received government assistance have generated benefits for the state. However, DBI's investment assistance programs are not focused on achieving a broad range of economic benefits and are not consistently evaluated. As a result, the department cannot effectively demonstrate that assistance is provided consistently with government policies and priorities, and allocated to the projects providing the best return for the state.

Findings

- During the period 2008–09 to 2010–11, DBI facilitated 336 projects. These projects were expected to generate \$8 billion in capital expenditure, create 18 000 full time equivalent jobs and increase exports by \$1.5 billion.
- There is a need to further refine the financial assistance criteria by placing greater emphasis on innovation and productivity and providing more guidance on the application of the criteria.
- Grants were approved despite not meeting criteria or not having sufficient documentation to demonstrate that they met the criteria.
- A formal process for providing facilitation services to industry has not been established.

Recommendation

The Department of Business and Innovation should:

- limit financial assistance to those projects that meet eligibility criteria, and place greater emphasis on productivity and innovation
- adequately justify, support and document assessment decisions
- formalise its selection and assessment process for facilitation services.

4.1 Introduction

The state government has a portfolio of industry assistance programs managed by seven government departments. In 2010–11, these programs provided \$412 million in government assistance, with the Department of Business and Innovation (DBI) responsible for \$170 million, or 41 per cent, of that amount. This assistance is provided for a range of purposes including industry development, investment attraction, innovation and technology, and regional development.

DBI's investment assistance takes the form of:

- grants to assist business investment in Victoria
- non-financial assistance to help companies understand Victoria's regulatory requirements and establish or expand their businesses.

While many of DBI's programs facilitate investment in the state, the main mechanisms used to attract investment to Victoria have been the:

- Industry Support Program (ISP)
- Industry Transition Fund (ITF).

Money from the ISP and ITF was occasionally used by DBI for other purposes and other departmental funds were used to attract investment to Victoria.

As part of its industry engagement process, DBI has ongoing dialogue with companies on their investment needs. Where a proposed investment may benefit from the department's assistance, DBI works with the company to apply for financial assistance or support the project in other ways. Companies can also approach DBI directly for assistance.

The overall objective of investment assistance programs is to provide benefits to the state in the form of economic development, jobs and economic wellbeing. To achieve the desired outcomes, these programs need to be sufficiently robust and include:

- clear objectives and priorities to focus the assistance
- measurable, relevant and transparent selection criteria
- rigorous assessment and approval processes
- effective monitoring and evaluation of the project outcomes.

Leading authorities on economic development such as the Organisation for Economic Cooperation and Development, the Productivity Commission and the Victorian Competition and Efficiency Commission believe that there is limited economic justification for targeted assistance.

Such assistance also creates potential risks for government as it involves seeking and selecting some companies, but not others, to receive assistance. Companies have an incentive to try to maximise the assistance granted by overstating the projects importance and the likely benefits flowing from the project in terms of growth, employment and exports.

DBI's view is that Victoria's main competition for business investment comes from other developed countries and Australian states that generally have sound investment environments and offer financial and other incentives to attract investment. Therefore DBI believes that Victoria's good business environment and its promotional activities alone are not enough to attract investment. In 2011, the state government committed to continue targeted investment assistance.

4.2 Conclusions

Projects that have received government assistance have generated benefits for the state. However, DBI's investment assistance programs are not focused on achieving a broad range of economic benefits and are not consistently evaluated. As a result, DBI cannot effectively demonstrate that assistance is provided consistently with government policies and priorities, and allocated to the projects providing the best return for the state.

Grants

DBI has established grant assessment and approval processes, including formal selection criteria, to align its financial assistance with government industry policy and appropriate governance arrangements. The eligibility criteria for ISP and ITF are reasonable. However, there is a need to further refine the criteria by providing greater emphasis on innovation and productivity, and to provide more guidance on the application of the criteria.

The effectiveness of the assessment process is brought into question by the large number of applications that received grants where the:

- criteria were assessed as not met
- application did not provide sufficient information to enable all the criteria to be assessed.

Recent reviews of ISP and ITF raised concerns about the overemphasis on capital expenditure and job creation when allocating grant funding, noting that projects that contribute little to productivity are unlikely to offer a net economic benefit to Victoria. Despite DBI changing its criteria to include productivity and innovation, the main focus in determining eligibility for assistance has remained capital expenditure and job creation through the criterion 'net economic benefit to the state'.

A focus on innovative projects that increase productivity would likely have provided better outcomes for the state.

Facilitation services

Processes used by DBI to identify projects that would benefit from its facilitation services are limited and there are no established criteria to inform the decision to provide these services.

4.3 Assistance provided

Over the period from 2008–09 to 2010–11, 336 projects received grants and/or non-financial assistance. Of these, 63 per cent were in the Melbourne metropolitan area and 37 per cent in regional and rural Victoria.

According to departmental records, these projects were expected to generate \$8 billion in capital expenditure, create 18 000 full time equivalent jobs, and increase exports by \$1.5 billion. The relevant details for each year are provided in Figure 4A.

Figure 4A
Projects assisted and projected outcomes for the period 2008–09 to 2010–11

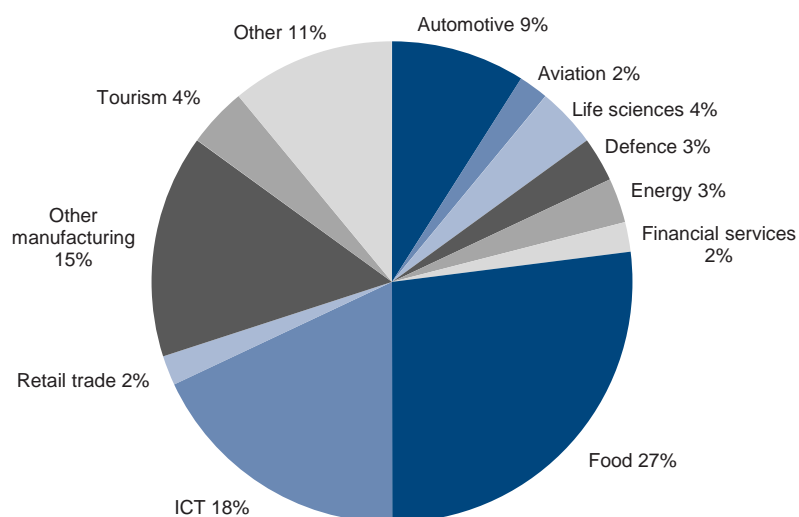
Year	Projects assisted (number)	Capital expenditure (\$mil)	Jobs facilitated (number)	Exports facilitated (\$mil)
2008–09	107	3 069.9	3 808	144.8
2009–10	114	2 113.2	8 094	542.8
2010–11	115	2 790.4	6 142	851.9
Total	336	7 973.5	18 044	1 539.5

Source: Victorian Auditor-General's Office based on data provided by the Department of Business and Innovation.

In recent years, assistance has been prioritised and given to companies operating in sectors identified by the government as having strategic significance for Victoria. These sectors include food, information communication technology (ICT), financial services, manufacturing, automotive industries and life sciences.

Figure 4B provides a breakdown by industry of the projects receiving assistance over the three-year period to 2010–11.

Figure 4B
Facilitated projects by industry sector, 2008–09 to 2010–11



Source: Victorian Auditor-General's Office based on data provided by the Department of Business and Innovation.

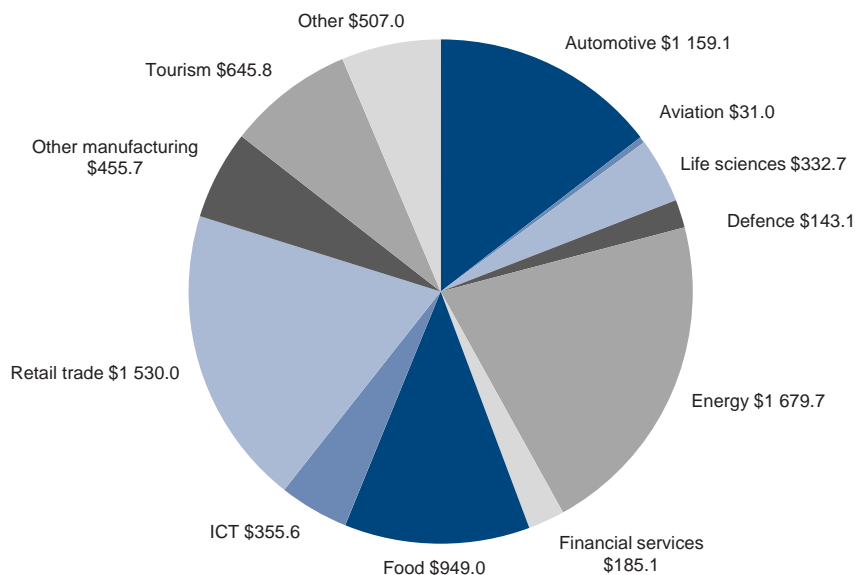
As Figure 4B illustrates, the food industry has received significant assistance in terms of the projects facilitated. DBI has facilitated a total of 92 projects in this priority sector, representing 27 per cent of all assistance provided over the past three years. ICT has also received a significant share of assistance.

These assisted projects were expected to generate around 18 000 jobs in the following priority industry sectors:

- **retail trade**—3 880 full time equivalent (FTE) jobs or 21 per cent of all jobs created were attributed to eight facilitated projects (2 per cent of all projects facilitated)
- **ICT**—3 465 FTE jobs or 19 per cent of all jobs created from 61 facilitated projects
- **food**—1 971 FTE jobs or 11 per cent from 92 facilitated projects.

Figure 4C details the expected capital expenditure from DBI's attraction and facilitation services.

Figure 4C
Expected capital expenditure from all facilitated projects
by industry sector for the period 2008–09 to 2010–11 (millions)



Source: Victorian Auditor-General's Office based on data provided by the Department of Business and Innovation.

DBI's records suggest that the energy sector will generate almost \$1.7 billion in capital expenditure from a total of 11 facilitated projects, representing 21 per cent of the total capital expenditure. Other major contributions to capital expenditure are:

- retail trade, which is expected to generate \$1.5 billion or 14 per cent of the total amount from eight projects facilitated
- \$1.1 billion from the automotive industry from 29 projects
- almost \$1 billion from the food industry.

4.3.1 Investment attraction grant programs

The vast majority of DBI investment attraction grant assistance comes from ISP and ITF. Over the past three years to 30 June 2011, the government has committed around \$230 million in grants from ISP and ITF for 46 projects. This amounts to 14 per cent of total projects assisted over that period. Grants from ISP and ITF ranged from \$170 000 to \$40 million.

Investment Support Program

ISP is the primary source of funding for DBI investment attraction grants. The fund was established in 1993. The ISP guidelines state that its purpose is 'to assist Victoria to secure footloose businesses and/or investments that offer a significant net economic benefit to the state, and align with the government's policy objectives'.

Between 1993 and July 2011, ISP provided around \$568 million in grants for 186 projects. Of these, 161 were completed by 30 June 2011 and the remaining projects were still in progress.

Over the past three years, DBI has agreed to provide \$190 million in ISP grants to 22 projects. These projects are expected to generate around \$920 million in capital expenditure and generate 4 640 new jobs. Details of these projects, grant commitments and project outcomes are outlined in Figure 4D.

Figure 4D
Investment Support Program commitments and interim outcomes,
2008–09 to 2010–11

Year	Projects facilitated no.	Contracted outcomes			Interim outcomes		
		Amount committed \$mil	Capital expenditure \$mil	New jobs no.	Amounts paid \$mil	Capital expenditure \$mil	New jobs no.
2008–09	4	45.2	70.2	1 328	37.8	71.1	885
2009–10	5	23.1	114.9	1 064	15.6	98.0	673
2010–11	13	121.1	734.3	2 248	41.9	130.3	1 300
Total	22	189.4	919.4	4 640	95.3	299.4	2 858

Source: Victorian Auditor-General's Office based on data provided by the Department of Business and Innovation.

As Figure 4D shows, these projects have so far generated 2 858 new jobs, achieving 66 per cent of the target outcome, and generated \$300 million, or 33 per cent, of the overall expected capital expenditure. These outcomes appear reasonable, given that to June 2011 only 50 per cent of the total amounts committed have been paid. DBI advised that the remaining amounts committed are allocated to future years.

Industry Transition Fund

The ITF operated from December 2008 to June 2010. It was established to provide businesses with temporary support during the global financial crisis and provide assistance to firms with the potential to move into new and emerging industries, as well as those that underpin the state's baseline capabilities. During that time, 31 of the 70 companies applying for assistance were successful. Of these, seven did not take up the funding offer, resulting in 24 companies receiving assistance. These companies received \$39.1 million in grants, with payments ranging from \$173 000 to \$10 million.

At 30 June 2011, \$24.3 million in grant payments had been made. The remaining grant payments are scheduled to be paid through to 2015–16. Details of the ITF grants approved by DBI and associated outcomes are outlined in Figure 4E.

Figure 4E
Industry Transition Fund commitments and achievements, 2008–11

No. of projects	Contracted outcomes				Interim outcomes			
	Amount committed \$mil	Capital expenditure \$mil	New jobs no.	Retained jobs	Amounts paid \$mil	Capital expenditure \$mil	New jobs no.	Retained jobs
24	39.1	293.0	898	3 496	24.3	120.1	335	2 001

Source: Victorian Auditor-General's Office based on data provided by the Department of Business and Innovation.

Process for providing grants to industry

DBI has established grant assessment and approval processes, including formal selection criteria, to align its financial assistance with government industry policy and appropriate governance arrangements. However its processes are not sufficiently robust to provide the best outcomes for the state from the financial assistance provided.

There is a need to further refine the criteria by placing greater emphasis on innovation and productivity and providing more guidance on the application of the criteria.

As demand for government assistance will always exceed the assistance available, there needs to be a sound and transparent process for determining which projects are assisted.

This audit examined whether DBI:

- has objective and comprehensive grant selection criteria that are consistent with government policy objectives
- has a robust grant assessment process
- has mechanisms to protect the probity and propriety of the allocation process
- is verifying compliance with requirements established in grant agreements
- grant payments are within the program budget
- grants obtain the best returns for the state.

Grant application processes

DBI does not maintain records on how grant applications originated. However, discussions with departmental staff indicate that most are generated through DBI's ongoing industry engagement process. During this process, companies either ask for financial assistance or DBI informs them of the availability of government grants.

DBI has a grant management manual that:

- outlines grant application, assessment and approval processes
- lists the criteria for each fund and provides guidance on the application of the criteria
- outlines staff responsibilities.

Key steps in the process for assessing and approving ISP applications are:

- A designated DBI client manager prepares a 'proof of concept' in the prescribed form.
- DBI's investment committee reviews the documentation and evaluates the merits of the application using the relevant criteria. Economic modelling is sometimes used to quantify the expected impacts the assistance would have on the Victorian economy.
- If the financial assistance is endorsed by the DBI investment committee, a formal proposal, incorporating a detailed financial risk assessment, is prepared and submitted to the DBI investment committee.
- The proposal is endorsed by the DBI investment committee.
- The departments of Premier and Cabinet (DPC) and Treasury and Finance (DTF) can also analyse and brief their ministers on proposals submitted for consideration.
- All final funding decisions under ISP are made by a cabinet committee.

A similar selection process is followed for grants provided from ITF. The ITF guidelines set out funding principles which include that:

- there will be a cap on financial assistance to any one firm—a firm may only make one successful application for a grant under ITF
- only in exceptional circumstances will the government consider financial assistance in excess of \$2 million—of the total grants committed from the ITF, two were approved over this threshold amount, one for \$10 million and another for \$2.4 million.

ITF assistance under \$500 000 requires the approval of the portfolio minister. Amounts over \$500 000 require the approval of the relevant committee of cabinet.

Selection criteria for grant eligibility

Grant criteria are not being consistently applied. This is due in part to uncertainty regarding the status of the selection criteria and insufficient guidance on their application.

To provide assurance that grants meet government policy objectives and are allocated consistently and fairly:

- the status of each criterion needs to be clearly outlined, i.e. which criterion need to be met in order to receive a grant
- selection criteria need to be objective and measurable
- selection criteria should be periodically reviewed and revised to meet changes in conditions and government policy direction.

Figure 4F outlines the threshold selection criteria for ISP and ITF assistance during the period covered by this audit—2008–11.

Figure 4F
Selection criteria for the Investment Support Program Fund
and the Industry Transition Fund

Threshold criteria	ISP	ITF
The investment is footloose	✓	
The project will not proceed without the grant	✓	
The proposed investment aligns with government policy	✓	
The project is sustainable	✓	*
The project makes a significant contribution to productivity	✓	✓
There is a demonstrated net economic benefit to the state	✓	✓
The grant is affordable within the budget	✓	
The grant requires a co-contribution of \$2 for each \$1 of funding		✓
The company has sought funding from alternative government programs		✓
Purchase of new plant and equipment or technology, or upgrade of existing infrastructure		✓
Assists a merger or acquisition that creates sustainable, growth-oriented entities		✓
Supports skills and capabilities that may not otherwise survive the economic downturn		✓
Ensures jobs in industries considered to have long-term viability are retained in the short term		✓
Assists the ongoing viability of industry in local communities and regional areas		✓

*Financial risk assessment were undertaken for each project considered under ITF.

Source: Victorian Auditor-General's Office based information from the Department of Business and Innovation's investment attraction manual.

Status of criteria

The DBI grant manual does not indicate whether ISP and ITF criteria are mandatory. It is also unclear from the words used in some of the criterion whether applicants must satisfy all of the criteria to be eligible for financial assistance. However, DBI asserts that three of the ISP criteria are mandatory—projects are required to be footloose; provide a net benefit to the state; and would not proceed without government assistance—and that productivity and innovation benefits are considered as part of the assessment process.

Objective and measurable

The grant manual states that applications for grants should be assessed in an objective, fair and consistent manner. However, it is often hard to assess compliance with some criterion objectively, such as the requirement for projects to be footloose and innovative.

The lack of sufficient guidance on how these criteria are to be applied and measured is likely to be one of the main reasons for differences of opinion between DBI, DTF and DPC in applying the criteria.

Criteria adapted to meet changes in conditions and policy

Over the past ten years, DBI has reviewed and revised the selection criteria for ISP. However, changes in policy have not always resulted in changes to the type of projects receiving grants.

In the early 1990s Victoria was experiencing depressed economic conditions and had an unemployment rate of 11 per cent. To stimulate economic growth and create jobs, the government established ISP. At that time, the criteria for grant funding focused on projects that created jobs, involved significant new capital expenditure and increased exports.

The current government's 2012 Industry Policy places a greater focus on innovation and improving competitiveness, as did the previous government's *Growing Victoria Together* statement, 2000, and 2002 Innovation Economy Policy. In 2008, a productivity-focused criterion for ISP was introduced to better align projects receiving financial assistance with the government objective of developing an innovative economy.

However, despite the previous and current governments' policies and the introduction of a productivity criterion, capital expenditure and job creation have remained the main focus in determining a project's eligibility for funding through the criterion 'net economic benefit to the state'. In more than half of the ISP grant submissions reviewed as part of this audit, the supporting documentation did not contain sufficient information to demonstrate that the proposal would make a significant contribution to innovation or productivity. To achieve its policy objectives, DBI needs to place greater focus on productivity and innovation.

VAGO acknowledges the difficulties inherent in assessing productivity and innovation during the consideration of the eligibility of projects for assistance. However, the importance of doing so was identified in several recent reports, namely:

- the 2008 and 2011 interdepartmental reviews of the Industry Support Program
- the December 2011 Victorian Competition and Efficiency Commission (VCEC) report, *Victorian manufacturing: Meeting the challenges, Inquiry into a more competitive Victorian manufacturing industry*.

These reports criticised DBI's investment criteria for not focusing on key outcomes related to innovation and productivity. They recommended a focus on innovation and productivity and provided useful guidance on how these criteria could be measured. The VCEC report noted the government's support, in principle, for the recommendation. The government's response also stated that its current practice was to assess assistance proposals against set criteria that included ensuring that any investment delivered productivity enhancements, was sustainable and demonstrated a net economic benefit to the Victorian economy.

Grant assessment process

The ISP and ITF grant assessment processes are inadequate. Grants were approved where criteria were not met and where the information provided in applications was insufficient for an assessment against the criteria to be made.

This audit selected and reviewed 50 grant submissions, 32 ISP submissions from the period 2003–11 and 18 ITF submissions from 2008–10.

VAGO found that assessment criteria were not met:

- All submissions were approved even though most of the project proposals did not meet all of the criteria. The ISP criteria limit funding to those projects that will not proceed without the grant. This is in contrast to a 2011 VCEC review of major manufacturing in Australia which found that obtaining government financial assistance was not a deciding factor in attracting the investment in four of five cases reviewed.
- It was not always clear which criteria were used to assess the project, which criteria had been met and which had not.

VAGO also found poor quality of information:

- Most submissions lacked sufficient detail and analysis to allow them to be properly assessed against the selection criteria.
- In the majority of submissions, DPC and/or DTF indicated that they did not assess project proposals against all the criteria, or were unclear on whether a criterion had been met, mainly due to a lack of information about the proposal.
- Six submissions approved by the relevant government committee were not supported by DPC or DTF. The Interdepartmental Committee report on ISP in July 2011 acknowledged difficulties in how the criteria are interpreted and assessed, and noted that efforts should be taken to minimise differences of opinion between DBI, DPC and DTF about whether a proposal meets the ISP criteria. The report recommended changes to the submission template for assessing selection criteria. DBI is reviewing its template.
- The DBI grants manual requires that reasons for recommending grants that do not fully meet the selection criteria must be documented and included in the approval document. In most cases, reasons were not documented.

DBI's investment committee does not have members from outside the department. Representation of independent parties on the committee would improve the independence and objectivity of the grant assessment and approval process.

Probity and propriety of the allocation process

As grants give significant amounts of money to private sector entities, there is always the risk of bias and corruption. To address this risk, DBI needs to make sure that specific probity controls are applied to the management of ISP and ITF.

Monitoring the deliverables established in grant agreements

Once the grant is approved, payments are tied to the achievement of the milestones included in the grant agreements. The milestones usually relate to the existing outcome measure of capital expenditure and employment targets. To receive the grant payment, companies must provide the information required by the agreement at each designated milestone.

This audit found that grant recipients generally provided the deliverables outlined in the funding agreements prior to receiving milestone payments. However, there were instances where deliverables, such as project reports, company annual reports and audit certificates were not provided or not provided in a timely manner.

In several other cases the deliverable was considered to be satisfied following an assurance from the recipient that the required action had been performed, rather than departmental verification or other evidence that it had. While information and assurances from recipients may be sufficient to satisfy some requirements outlined in the grant agreements, DBI did not exercise its right under the terms of the grant agreement to independently verify the achievement of milestones.

Grant payments within the program budget

Grant programs are funded by periodic Parliamentary appropriations. The ISP guidelines state that grants cannot be approved unless there is sufficient money available in the fund.

This audit identified eight instances where ISP grants had been approved even though there was insufficient money in the ISP budget to fund the grants in the year the grant was approved. Funding was later obtained from another DBI fund, a Treasurer's Advance or by deferring the payment to the next financial year.

Committing the government to expenditure that has not been approved by the Parliament is not financially prudent. This practise can also lead to applications for funding being paid from a different fund without being assessed against that fund's assessment criteria.

Net benefit for the state from financial assistance

Companies and other entities received ISP and ITF grants without demonstrating that their project would provide a net benefit for the state. DBI cannot demonstrate that its grant expenditure provides the best return for the state.

Providing a net benefit for the state

The ISP and ITF criteria require applicants to provide information to enable the DBI to determine if a project provides a net benefit for the state.

Project benefits can include new jobs, capital investment, exports, skills development and innovation and productivity improvements. Costs include grant payments and administration and indirect costs.

Indirect costs are the broader impacts on the industry and economy created by a project. For example, if the project is in an industry where skilled staff are in short supply, the additional demand for staff created by the project is likely to lead to staff shortages and higher salary costs. As a result, it will have an adverse impact on competing businesses.

For the grants reviewed by VAGO, DBI primarily used capital expenditure, jobs created and exports to demonstrate that the net economic benefit to the state criterion had been met. There was generally no quantification of:

- skills development, innovation or productivity increases created by the project
- indirect costs associated with the project.

Without identifying and quantifying the broader impacts of projects, DBI is not able to demonstrate the true extent of any benefit for the state.

In 2008, DBI introduced a modified input/output model to assess the industry-wide effects of each proposed investment. The aim of this model is to identify the direct and indirect costs of each project, so that the net benefit to the state can be measured.

To demonstrate that projects provide net economic benefits, DBI's assessment process compares the broad impacts from projects—such as increased jobs and capital expenditure—with the cost of the assistance. For this assessment to be meaningful, DBI needs to link the benefits to Victoria to the assistance provided. That is, DBI needs to demonstrate that the government assistance is necessary for the project to proceed. If this were not the case there is no economic justification for the government to financially support the project. Such a demonstration is required to get ISP funding.

However, this approach makes it difficult to determine whether the assistance is critical to the investment decision. As noted above, despite this being a prerequisite for financial assistance under ISP, it is not always a deciding factor in investment decisions made by the private sector.

Value-for-money

Getting value-for-money involves generating the greatest return for the Victorian community from each dollar spent on investment attraction. To achieve this, grant funding for investment assistance should be allocated to companies whose projects generate the greatest returns. Industry scanning, analysis and engagement should be used to identify such projects.

DBI undertakes industry scanning and strategic analysis. However, for the three years to 2011 the link between these planning processes and the allocation of grants was weak.

DBI has ongoing relationships with industry groups, consultants, statutory bodies involved in regulating industry, real estate agents, etc. DBI believes that this engagement is effectively used by its staff to:

- identify projects in the pipeline that will provide the greatest returns for the state
- encourage companies to apply for financial assistance where they need it.

However, DBI is only involved with a small number of the investment projects being considered each year, and its past focus has been on engaging with larger companies in priority sectors. Therefore, it is unlikely that its engagement with industry is broad and sophisticated enough to achieve value-for-money.

DBI assessment processes do not compare funding applications to see which ones provide the best value-for-money and the assessment process does not specify the outcomes required to get funding. For example, the assessment criterion relating to jobs does not:

- require a specific number of additional jobs to be created in order for the project to receive assistance
- differentiate between the skills associated with the additional jobs created.

ISP and ITF also have criteria dealing with spillover benefits. These benefits include innovation and productivity improvements. Again, no specific targets are required for companies to get assistance.

As a result, projects providing jobs and capital expenditure but no productivity improvements or innovation may be given preference over smaller dollar value projects providing greater value in terms of productivity or innovation but fewer jobs. This is counter to DBI's own policy of focusing on innovation and productivity.

Without a more strategic approach to allocating financial assistance and making value-for-money assessments, it is unlikely that the assistance being granted is providing value-for-money.

4.3.2 Non-financial assistance – facilitation services

In addition to grants, DBI provides a range of non-financial facilitation services:

- to attract new investment projects to the state
- as part of ongoing services provided to companies operating in the state.

Companies wishing to access DBI's facilitation services need to demonstrate a commitment to improving performance and achieving international competitiveness, and the investment needs to add to Victoria's productive capacity. However, as there are no formally established criteria or approval processes for the provision of these services, DBI cannot be assured that the services are consistently applied in accordance with government policies and priorities, and are allocated to those projects providing the best return for the state.

DBI's Investment Facilitation Group provides a range of specialist services for around 200 projects annually. These services fall into one of two categories:

- **General information and services**—provide and/or subsidise the cost of information and services to companies, to help them make their business decisions. This includes information and analysis on local labour market skills, access to markets, regulatory environments, strategic industry sectors and their competitive strengths, wage structures and industrial relations.
- **Facilitation services**—tailored to company needs are provided where a company approaches DBI for assistance or DBI identifies a company that may benefit through its industry engagement process. Departmental client managers respond to and actively seek out new investment projects, particularly in companies demonstrating growth potential. Tailored services to meet specific needs include:
 - providing specialist advice on Victoria's development approvals process and licence and permit requirements
 - coordinating a range of state, Commonwealth and local government approvals associated with planning, development, the environment, health and safety and other regulatory controls
 - identifying greenfield or existing site options based on specific business requirements
 - advising on the costs, and access to business infrastructure such as electricity, gas, water and transport services
 - advocating to government and external parties on various issues, such as development approvals policies and environmental regulations.

Appropriate facilitation services provided

DBI's policy is to facilitate, in some way, any new investment project that seeks support. Its facilitation services are targeted at companies in its designated priority sectors that are considering investing in Victoria or looking to expand their existing business.

The government's industry policy priorities form the basis of DBI's broad investment attraction criteria. DBI believes that these priorities are reflected in its internal structures and resource allocations.

Facilitation services are provided by investment facilitation teams working within the various divisions of DBI. Once a company approaches DBI and indicates its intention to invest in Victoria, a team is assembled from staff across the department, and sometimes from other departments, to assist the company build or expand its operations. These teams are led by industry sector client managers who are responsible for maintaining a relationship with each company.

DBI also has a small investment facilitation group that delivers services on behalf of investment attraction teams across the department. This group predominantly provides services relating to site location and specialist advice on development approvals and infrastructure.

The services to be provided are determined by the DBI team through the investment attraction consultation with the company. This investment facilitation group undertakes analysis of the services it provides and produces internal reports.

The group has an annual budget of around \$2 million. DBI was not able to provide an estimate of the cost of this group's facilitation services.

Assessment and approval processes

This audit examined DBI's processes for determining which companies are provided with facilitation services and found that:

- DBI does not have a formal process for assessing and approving access to facilitation services. Rather, the nature and amount of assistance to be provided is informally determined by DBI staff, on a case by-case basis, with a view to securing the investment at least cost to the state.
- DBI does not have eligibility criteria for facilitation services. It advised that in selecting projects for facilitation, departmental staff have regard to the industry sector priority, project size, location, alignment with government policy, strategic importance and readiness to commence. However, this process is not documented.
- Decisions on who gets assistance and the amount of the assistance are determined by DBI staff and there is no approval process for the provision of these services.
- The provision of services is not considered or approved by either the DBI investment committee or the Investment Support Committee of Cabinet. These two committees receive information on facilitation services only if the project is also applying for a grant.

Value-for-money

DBI informed VAGO that the type and scope of facilitation services offered and provided have been developed and refined over 25 years to better reflect industry needs, government policy and departmental objectives. DBI also advised that it uses its business engagement processes to determine the mix of facilitation services it provides and that these services have not changed significantly in recent years.

A formal review or evaluation of its facilitation services has never occurred. In the absence of such an evaluation, DBI does not know whether its mix of services is providing the best outcomes for either the state or businesses.

DBI does not capture and allocate the costs and benefits associated with the provision of facilitation services to specific projects. In the absence of this information and with no evaluation of its facilitation services, it is not possible for DBI to know whether:

- the benefits to the state exceeded the cost to the taxpayer
- departmental expenditure on facilitation services to Victoria is being wisely spent and is providing value-for-money.

Recommendation

3. The Department of Business and Innovation should:
 - limit financial assistance to those projects that meet eligibility criteria, and place greater emphasis on productivity and innovation
 - adequately justify, support and document assessment decisions
 - formalise its selection and assessment process for facilitation services.
-

Appendix A.

Audit Act 1994 section 16— submissions and comments

Introduction

In accordance with section 16(3) of the *Audit Act 1994* a copy of this report was provided to the Department of Business and Innovation with a request for submissions or comments.

The submission and comments provided are not subject to audit nor the evidentiary standards required to reach an audit conclusion. Responsibility for the accuracy, fairness and balance of those comments rests solely with the agency head.

Responses were received as follows:

Department of Business and Innovation48

Further audit comment:

Auditor-General's response to the Department of Business and Innovation.....54

RESPONSE provided by the Secretary, Department of Business and Innovation



Department of Business and Innovation

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Mr Des Pearson
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Victorian Auditor-General's Office
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MELBOURNE VIC 3000



Dear Mr Pearson

Performance Audit – Investment Attraction

VAGO has provided the Department of Business and Innovation (DBI) with its proposed audit report on investment attraction (the Report). Under its final audit specification, VAGO sought to determine whether DBI's investment attraction and facilitation programs are effective and provide value for money.

The Report does not accurately reflect on the objective of investment attraction and facilitation, the policy that underpins it, and the role that assessment criteria play in the process.

The Report recommends that DBI 'develop an overarching strategy for investment attraction'. DBI rejects this recommendation and maintains that it has an overarching strategy for investment attraction. VAGO concludes that DBI's corporate plan is 'an inadequate substitute for a comprehensive investment attraction strategy'. DBI contends, however, that strategy enunciated in the corporate plan, supported by other corporate documents such as the Business Engagement Model and International Engagement Strategy, does provide the necessary focus and priorities for the Department's investment attraction activities and aligns investment attraction with the Department's complementary business and economic development activities.

The objective of investment attraction and facilitation

DBI's investment attraction and facilitation services are aimed at market-driven activity with the purpose of promoting Victoria as a location for investment by the private sector, and attracting it to Victoria through DBI's investment attraction and facilitation services.

RESPONSE provided by the Secretary, Department of Business and Innovation – continued

As acknowledged in the Report, DBI's investment attraction activities are not seeking to influence the decision of a private firm to make an investment, or the decision as to what the private firm should invest in, but rather a firm's decision on where to invest. To this end, DBI markets Victoria and its competitive advantages.

DBI focuses on productive capacity investments in goods and services, which generate employment and, where possible, exports to expand market capacity.

Factors that assist in productive investment in the economy include:

- a strong robust local economic environment;
- a tax framework that is supportive of investment;
- incentives from Government supporting the investment environment; and
- a professional approach to each investment proposal.

To support this activity Victorian Government Business Offices (VGBO) are located across Victoria and in critical international markets, for example in China and India.

To better understand private sector business activity and to support investment attraction, amongst other things, DBI has developed and implemented the Business Engagement Model. The Business Engagement Model is comprised of an expanded and strengthened VGBO network with skilled Business Development Managers located closer to businesses across the State. Both the onshore and offshore VGBOs are supported by the Global Engagement Management System (GEMS), a key technological enabler, providing a central repository for all the business engagement information including investment opportunities and business issues.

The Model primarily targets 50 per cent of businesses employing between 20-199 employees and 100 per cent employing more than 200 resulting in direct in-depth engagement with an estimated 12,000 businesses per year.

The network of offshore VGBOs undertakes a critical role in investment attraction and facilitation including maintaining relationships with existing investors, encouraging reinvestment into Victoria, and undertaking lead-generation exercises to bring new investment into the State as well as supporting government-to-government and government-to-business exchanges.

This network is complemented by the work of Invest Victoria which promotes Victoria as an investment destination and facilitates and delivers investment projects. It identifies investment opportunities and provides end-to-end management directly or indirectly of complex investment opportunities. It also develops and manages priority investments, business engagement plans and the investment pipeline for the Department.

RESPONSE provided by the Secretary, Department of Business and Innovation – continued

The policy

The Government outlined its policy approach to investment attraction in its response to recommendation 10.4 contained in the Victorian Competition and Efficiency Commission's 2011 report *Victorian manufacturing: meeting the challenges* (VCEC Manufacturing Inquiry). The recommendation suggested that the objective and criteria for attracting investment be changed to emphasise technology and innovation spill-overs.

The Government did not accept the recommendation because it might exclude some projects that have a net benefit to Victoria.

The objective of investment attraction and facilitation and the policy is clear – to attract investment to Victoria where there is a net benefit to Victoria.

An investment attraction strategy

VAGO recommends that the Department develop an overarching investment attraction strategy for its investment attraction activities with clearly defined objectives.

This recommendation illustrates the different views held by VAGO and DBI over the role of investment attraction and, in particular, how it relates to the other policy objectives of government.

Following a request from DBI, VAGO provided more detail as to what the contents of the proposed strategy might look like. It states:

A specific strategy for investment attraction would:

- *Provide the focus and priorities for the department's investment attraction activities*
- *Outline the detailed actions to deliver DBI's objectives*
- *Drive policy changes*
- *Efficiently allocate resources between investment attraction activities*
- *Outline monitoring, evaluation and reporting requirements.*

VAGO, p.9

Implementation of VAGO's recommendation would require the Government to prioritise specific investments from all of those that may be available so that these selected investments become the focus of activities. Such a strategy would involve forming a view on what investment opportunities exist at any given time across the world, which ones might consider Victoria as an option, and which offer the 'best' opportunities based on the potential net value to the State. This seems unlikely to be the intent of the recommendation because it is clearly impractical and involves 'picking winners'.

RESPONSE provided by the Secretary, Department of Business and Innovation – continued

A strategy that seeks to ‘pick winners’ fundamentally misunderstands the nature of the very active global market for footloose investments. Victoria is essentially a buyer in this market, not a seller, and much of the Report suggests this is not understood.

For this same reason, DBI does not accept the recommendation that selection criteria for investment facilitation services be formalised.

Further public disclosure of investment activity

As outlined in the Government’s response to the VCEC Manufacturing Inquiry, DBI supports the transparent provision of information on assistance for individual projects. DBI currently reports on the companies that have received financial assistance in its Annual Report, but does not identify specific details of the grants awarded. Assistance is only provided once agreed targets have been reached. DBI does not report on those projects where agreed assistance has not been provided, either because targets were not achieved or the project did not proceed.

DBI does report on the aggregate capital expenditure invested, additional jobs created and additional export potential attributable to facilitation and support programs.

The details of recipients of the vast majority of industry assistance programs are disclosed in the Department’s Annual Report. The funding for these programs is competitive and recipients are aware of the assessment criteria and funding available at the application stage.

DBI does not accept VAGO’s contention that there is a need for greater public disclosure of its investment attraction activities (such as the Investment Support Program). Under such programs, the Victorian Government is the competitor against other jurisdictions to attract investment projects. VAGO has failed to identify how the benefits of disclosure would outweigh the adverse impact on Victoria’s ability to attract investment at least cost to the State. DBI contends that such disclosure is likely to increase the amount of financial assistance necessary to attract the same quantum of investment.

There are constraints on the Government’s ability to divulge commercial information and Government decision-making processes in relation to individual companies. In addition, details of individual grants are not made public in order to avoid inflating future expectation of assistance.

RESPONSE provided by the Secretary, Department of Business and Innovation – continued

Evaluation of investment attraction activities

DBI contends that the Government investment attraction activities have been regularly and appropriately reviewed.

VAGO suggests in recommendation 2 that these activities should be evaluated against the impact on the overall business environment in Victoria. As stated earlier the objective of investment attraction and facilitation and the policy are clear – to attract footloose investment to Victoria where there is a net benefit to the state. Given the projects that we successfully attract represent a small percentage of overall business investment activity in the State, it can be reasonably assumed that the impact on the macroeconomic environment would be small and difficult to measure.

Companies that receive financial assistance do so once they have achieved specific, pre-established milestone targets. In most cases, companies are also required to provide reports to demonstrate a range of qualitative benefits that their projects have resulted in for Victoria. In instances where these reports were not received, this occurred following the final payment for the project and did not affect the expected deliverables for the assistance.

DBI notes VAGO's comment that the information it gathers on projects it assists is limited to jobs, capital expenditure and exports. This does not acknowledge the vast range of qualitative information that is received which guides further development of our investment attraction strategies.

The role of eligibility criteria and assessment

VAGO's recommendation 3 is for Government to connect attraction and facilitation activities more strongly to other policy objectives of government, for example, sectoral strategies or the pursuit of more innovation and higher productivity growth.

From time to time, governments do adopt sectoral policies or place greater emphasis on matters such as productivity. Recent examples are the manufacturing strategy, the food and fibre strategy, and the boating industry strategy, which is an election commitment. The notable point is that investment attraction and facilitation already exist alongside these strategies, and bolster them where this is appropriate.

These strategies and policy objectives are considered as criteria to be used to assess potential investments for consideration by Government. These criteria can and do change over time in line with government policy – as they should – and are not the core objective of investment attraction activities. In every case, DBI has applied the criteria operating at the time in determining eligibility for assistance.

DBI's current programs include both attracting footloose investment to Victoria as well as encouraging investment in activities most likely to lead to growth in productivity, including regulation reform and public infrastructure.

RESPONSE provided by the Secretary, Department of Business and Innovation – continued

DBI seeks to encourage investment in productivity-enhancing activities such as new technology, innovation and research and development. In most instances these activities are supported through competitive-based grants programs that are structured to seek the greatest value for the state from the available options.

An overall investment facilitation strategic plan, as proposed by VAGO, could lead to confusion between these different objectives and, potentially, poor program design.

Stakeholder Engagement

DBI does not accept the recommendation that it should document its advocacy procedures and develop a plan to coordinate actions proposed to improve the state's business environment. As Victoria's lead economic development agency, DBI's professional relationship with other agencies is based on years of positive interaction and beneficial outcomes for industry.

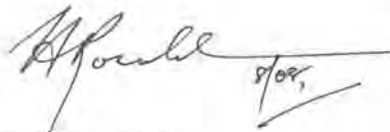
In summary

DBI has a clear and overarching strategy for investment attraction, albeit not in the form preferred by VAGO. DBI does not support the development of a stand-alone strategy for investment attraction and facilitation, or for it to be used to deliver other objectives of government, and supports the continued use of criteria to assist Government in making investment attraction decisions.

DBI has an overarching Corporate Plan that includes references to all the relevant elements of investment, being capital equipment, building and structures, innovation and technology and research and development. In addition, together with other Departmental documents including the Business Engagement Model and the International Engagement Strategy, it canvasses the full range of complementary activities in which the Department is engaged which all form part of DBI's economic development activities.

DBI believes that the Corporate Plan is a better option for setting out the Department's investment activities where programs contribute to different departmental objectives. However, DBI acknowledges that the Corporate Plan could more clearly articulate each of these activities and their purpose.

Yours sincerely



HOWARD RONALDSON
Secretary

Auditor-General's response to the Department of Business and Innovation

The department's views have been extensively discussed and exhaustively considered during the course of the audit. We remain of the opinion that the department's inability to reliably monitor and demonstrate the extent to which its investment attraction activities are effective will continue until it implements a comprehensive investment attraction strategy, robust evaluations of investment attraction activities and more rigorous assessment of projects that receive government assistance. Consequently, it is surprising that the department holds the view that adopting these disciplines could lead to confusion and poor program design. We also confirm that these practical recommendations were never intended to suggest the need to pick winners.

Auditor-General's reports

Reports tabled during 2012–13

Report title	Date tabled
Carer Support Programs (2012–13:1)	August 2012

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