

Honing our competitive instinct

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Brendan Rynne, Chief Economist at KPMG Australia, discusses this virtuous circle and how Australia can redefine and embrace forms of competition that enhances productivity.

When people ask Brendan Rynne, Chief Economist at KPMG Australia, how important competition is to productivity, he reframes the question to reflect the truth that really needs to be addressed:

"Various Australian businesses are frustrated about their lack of competitiveness or productivity. They don't appreciate one of their key issues is that they're behind their international peers who are operating at the 'global frontier' of knowledge and innovation".

According to Rynne, competition is one of the most important factors driving innovation, and therefore, productivity. And productivity is at the core of improving living standards for our country.

"Australia has traditionally publicly invested in basic research through universities and government bodies like CSIRO; although there has recently been a period of reduced funding from government, with an expectation that the private sector would pick these types of activities up. But basic research is a public good, and it's rare for the private sector to be able to fund these types of breakthrough innovations. Rather, we are much, much better at picking up this basic research, value adding to it through creating new technologies, or even just adopting breakthrough innovations achieved overseas".

Competitive advantage needs an innovative mindset

While innovation has been acknowledged to be a factor fundamental to economic growth since the 1940's¹, it seems that politicians and economists have latched on to it more recently as 'the answer' to current economic woes.

The development of innovative technologies, and diffusion of 'frontier knowledge' generated elsewhere in the world, is absolutely essential to Australia successfully competing in a global marketplace. The problem is that innovation inherently brings with it creative destruction. This phenomenon is being identified under the catch-all phrase 'disruptive technologies', but regardless what we call it, it involves the reduction in value of existing companies that use conventional technologies. Building a disruptive culture, creating safe-to-fail organisations, and allowing our scarce resources to gravitate towards their optimal use are key to advancing our innovation edge.

Calling time on vested interests

In the past, this creative destruction has led to demands on governments for protection, which has effectively enabled a 'losers paradox'² to set government policy. Rather, government should allow individual companies, and even whole industries, to cease operating if they are structurally unprofitable and unable or unwilling to create and/or adopt outcomes that will push them closer to the 'global frontier'. Allowing resources to flow to parts of the economy that will create more value for society is necessary to ensure productivity growth. This is easier said than done, as short term pain associated with job losses due to business closure(s) is often priced politically higher than the economic cost of providing publicly funded financial support.

¹ Schumpeter, J. A. (1943). *Capitalism, Socialism, and Democracy* (6th ed.). Routledge. pp. 81–84.

² Baldwin and Robert-Nicoud note "Declining industries (ie., 'losers') have sunk market-entry costs (e.g., unrecoverable investments in product development, training, and brand name advertising) such that profits in these industries can be raised without attracting entry as long as the level of quasi-rents does not rise above a normal rate of return on the sunk capital...the result is that losers lobby harder, so it is not government policy that picks losers but rather the losers who pick government policies."

"If Australia is to improve its competitiveness, government policy will need to accommodate disruptive technologies".

However, letting resources be utilised in higher productive industries, and providing government support to assist in this transition process, is a much better use of public finances than funding structurally unprofitable businesses or industries. Implicitly incorporated within this action is the implementation of a more flexible labour force policy that facilitates organisational change and innovations as required, while also maintaining fairness for workers involved.

Rynne points out that *"If Australia is to improve its competitiveness, government policy will need to accommodate disruptive technologies, and support industries and businesses to make the transition. That will involve both political parties putting the national interest ahead of their short-term political interests"*.

Public investment in life-long learning for workers is also part of this 'creative destruction' conversation, as funding these types of activities that allow workers to learn new skills and adapt to changing technologies is central in setting the foundations for continued economic growth in an uncertain future.

Rynne also argues that with an ageing population and the use of global value chains in more and more industries, improved competitiveness and productivity is the best way to grow our living standards. We simply have to work smarter with what resources we (will) have available, not necessarily harder.

Opening up to China – or not

Rynne is generally optimistic about the China Australia Free Trade Agreement (ChAFTA) that has just been signed. *"One of the ways a country can improve its productivity is to increase its connections with the rest of the world, be that through increased trade and foreign direct investment, greater involvement in global value chains, or facilitating the mobility of skilled labour"*.

"Free trade agreements help either directly or indirectly with all those elements, and my understanding is that various studies have shown FTAs have generally been growth enhancing for Australia".

Doug Ferguson, KPMG's Head of Asia & International Markets, points out that Australia is seen as an ideal partner to help China develop and ChAFTA is the key mechanism. *"From my observations, the leaders of American, Japanese and Chinese understand that the ChAFTA offers unrivalled access to and benefits in China's markets, and are planning to invest in Australian companies so they can take advantage of them"*.

So are Australian companies ready to take advantage of the ChAFTA and other trade agreements in the same way? *"I think that for many Australian companies, it's largely 'business as usual' without any sense of priority or urgency to understand or act on the huge opportunities that have been placed before them"*. Ferguson points out the KPMG Global CEO Outlook Study showed that 47 percent of global CEOs are planning significant international expansion in 2016, but only 21 percent of Australians are. *"The trade agreement door is open, and I sincerely hope Australian companies can adapt and take advantage,"* Ferguson adds.

Charging up Australia's competitiveness

Australia will strengthen its competitive position if it improves its ability to innovate, combined with being able to rapidly disperse and apply new ideas and thinking. We have to encourage new businesses to enter the competitive marketplace, and foster all businesses to experiment with new technologies and operating models. Simply, more businesses, more innovation, more productivity, better living standards, all create a better Australia.

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