

The Australian Industry Group

Industry Development:

Building greater resilience, higher productivity and more diverse opportunities

Post pandemic policy

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About Ai Group

The Australian Industry Group (Ai Group®) is a peak employer organisation representing traditional, innovative and emerging industry sectors. We have been acting on behalf of businesses across Australia for nearly 150 years.

Ai Group is **genuinely representative** of Australian industry. Together with partner organisations we represent the interests of more than 60,000 businesses employing more than 1 million staff. Our members are small and large businesses in sectors including manufacturing, construction, engineering, transport & logistics, labour hire, mining services, the defence industry, civil airlines and ICT.

Our vision is for ***thriving industries and a prosperous community***. We offer our membership strong advocacy and **an effective voice at all levels of government** underpinned by our respected position of policy leadership and political non-partisanship.

With more than 250 staff and networks of relationships that extend beyond borders (domestic and international) we have the **resources and the expertise** to meet the changing needs of our membership. We provide the **practical information, advice and assistance** you need to run your business. Our deep experience of industrial relations and workplace law positions Ai Group as **Australia's leading industrial advocate**. We **listen** and we **support** our members in facing their challenges by remaining at the cutting edge of policy debate and legislative change. We **provide solution-driven** advice to address business opportunities and risks.

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Contents

Executive Summary	5
1. Analysis	6
1.1. Industry Development: What is it and why is important to Australia in 2020?	6
1.2. What roles for government?	6
2. Action	7
2.1. Building Resilience	7
2.2. Developing Business Capabilities	8
2.3. Encouraging High Growth Industries and Businesses	10
2.4. Innovation	10
2.5. Industry Transformation	13

Executive Summary



Australia can put itself in a position to emerge from the COVID-19 crisis more resilient, with higher productivity growth and with a greater ability to extend opportunities for our businesses and our people.

Much of the responsibility for achieving these outcomes rests with Australia's private sector. If we can lift business investment, improve the capabilities of our managers and their workforces and increase the readiness of new and existing businesses to innovate our economy will be well-equipped to grasp domestic and global opportunities and meet future challenges.

Governments and their agencies have critical roles to play in stabilising the macroeconomy; overseeing strong and appropriately prioritised investment in physical and social infrastructure; ensuring our education and training arrangements are first class, making sure our regulatory regimes are well-considered, well run and efficient; and facilitating strong engagement in the international economy.

While getting these settings right is fundamental, governments can also support businesses' efforts to improve their operations and become more innovative. In this Industry Development policy paper we put the case for greater, more linked-up and more coherent efforts to lift business capabilities – particularly those of our small and medium-sized enterprises; further facilitation of the accelerated development of high-growth industries and businesses; and encouraging business innovation. In addition, we emphasise the important roles that governments can play in ameliorating the economic and social costs arising from industry development as existing areas of activity are disrupted in the process of creative destruction.

The COVID-19 experience and the intensification of tensions in the international economy have highlighted vulnerabilities associated with our reliance on global supply chains and has seen an increased interest in building greater resilience to mitigate against these vulnerabilities. Ai Group strongly supports the need to manage these risks and to do so in a way that does not undermine the very strong advantages of our active participation in the global economy. In some areas – including in areas related to defence and health – a greater degree of economic sovereignty makes sense. But not at any cost. We support 'smart sovereignty' over self-reliance and we see the development of strong and competitive domestic industries as fundamental to building greater resilience.

Our policy proposals in the areas of building business capabilities, facilitating the acceleration of high-growth industries and businesses, and encouraging innovation are largely a matter of building on, linking up and giving greater coherence to the wide range of existing initiatives. If these objectives can be pursued with greater inter and intra-government cooperation, all the better and we encourage all governments and the National Cabinet to get on board in a concerted effort to give greater focus on the development of Australian industries.

A handwritten signature in black ink that reads "Innes Willox". The signature is written in a cursive, slightly slanted style. Below the signature is a long, thin horizontal line.

Innes Willox
Chief Executive
Australian Industry Group

1. Analysis

A critical foundation of our future economic and social success is highly productive industries that can compete internationally, provide challenging jobs, underwrite greater resilience; and create more diverse opportunities for Australia and Australians.

1.1. Industry Development: What is it and why is important to Australia in 2020?

Australia's industries supply a wide range of domestic needs; they employ millions of Australians; and they earn income abroad by exporting and investing offshore. Many Australian businesses, whether domestically owned or as part of global groups, operate at the forefront of global technological and organisational developments and they impart key modernising dynamics upon the Australian economy.

Industry development is the movement of more businesses towards the frontiers of global practice and building the number of innovating businesses that push beyond the limits of existing frontiers. As such it has a key part to play in lifting productivity growth and underwriting higher living standards. A faster pace of industry development together with measures that reduce the costs of transition will assist in making the domestic economy more resilient, competitive and dynamic; it will create more highly paid and more challenging employment opportunities; and it will assist in expanding the tax base to help finance the investments and expenditure needed to boost opportunities and address areas of entrenched disadvantage.

Industry development has a particularly important role to play over the next decade.

- The pace of recovery in activity and employment opportunities from the impacts of COVID-19 will be more rapid if underwritten by an acceleration of industry development.
- Weak productivity growth over the past decade has slowed the growth of real incomes and industry development is central to reversing these trends.
- Industry development has a major role to play in Australia's ability to meet the challenges of rapid technological change and the accelerating participation in the global economy by emerging nations.
- Industry development has a major role in underwriting the success and sustainability of efforts to achieve greater resilience.
- Finally, meeting the challenges of climate change and better waste management will require new approaches, new business models and new areas of wealth generation generated by greater industry development.

1.2. What roles for government?

While industry development is delivered by businesses and their workforces, governments and government agencies have critical parts to play in addition to ensuring the basic settings for the private sector to play its role. Many of these settings are covered in other papers in this series. Policy directions to more directly facilitate industry development in Australia include:

- Coordinating the development of the specific industrial capabilities required to achieve desired levels of national resilience;
- Assisting the development of business capabilities, particularly among Australia's small and medium-sized businesses;
- Backing high growth industries and businesses;
- Supporting and promoting business innovation; and
- Helping to reduce the economic and human costs of industry transformation.

2. Action

2.1. Building Resilience

The COVID-19 experience has highlighted areas of economic vulnerability. Many of these vulnerabilities were quickly managed by a combination of coordinated purchasing, substitution of alternative domestic or international sources of supply and switching domestic productive capabilities to areas at risk.

Nevertheless, the shutdown of large parts of China's economy in the opening months of 2020; the broader disruption to international freight movements; and the further shutdowns in other countries have led to a reconsideration of international dependencies, the vulnerabilities of just-in-time delivery and shortcomings in how we manage risks of supply chain disruption. The escalation of geo-political tensions, particularly between the United States and China, has added further dimensions to these issues and has intensified concerns with the degree of interdependence between the Chinese and Australian economies.

Building greater resilience is best achieved by developing more competitive domestic capabilities and by harnessing the benefits of international trade and investment to enhance and complement those capabilities. Greater and more sustainable resilience will not come by insulating Australia from international engagement and competition. International trade opens a world of opportunities and the challenge for the country is how best to reduce the vulnerabilities while maintaining an economy that enjoys the considerable benefits of being open to imports, investment and migration.

There is a wide range of strategies that can be deployed in building greater resilience. One is building greater self-sufficiency. While suitable in some cases, self-sufficiency clearly has its limits.

“Greater resilience is best achieved by developing more competitive domestic capabilities and by harnessing the benefits of international trade and investment to enhance and complement those capabilities.”

Defence capabilities are instructive: we need to have a wide range of in-country expertise and capacity to support and sustain our national defence effort. But insisting on being totally self-sufficient would be extraordinarily and unnecessarily expensive. Instead we need to strike a balance: focus our attention on what we genuinely need to do here; ensure we strive towards excellence in what we do – including by aiming to leverage that excellence through exporting; and supplement self-sufficiency with other strategies that build resilience. In the case of defence these strategies include taking advantage of our international commercial and strategic alliances to the mutual benefit of ourselves and our partners.

As with defence, so with “economic sovereignty” more generally. It would be extremely foolish to aim for complete sovereignty and to be fair no one is seriously suggesting we should. We need instead to aim for “smart sovereignty”;¹ build our domestic capabilities where it makes sense to do so; leverage these in global markets; and build resilience through diverse trade links backed by focused strategic and diplomatic alliances.

We need a national debate on the degree to which we strive for economic sovereignty as a strategy to build resilience, what policy instruments (including those discussed below) are best suited to achieve the objectives and how we reconcile the resilience imperative with the importance of ensuring we have competitive industries and remain open to international engagement.

To whatever degree it is pursued, the national imperative of building resilience will require more rigorous management of the risk of supply chain disruption in individual businesses as well as coordinated guidance and direction from Australia's

¹ This concept is discussed further in John Blackburn AO, *Submission to the Senate Select Committee on COVID-19* (2020) [here](#).

governments.

2.2. Developing Business Capabilities

A critical means of moving more businesses closer to the frontier of global practice is to improve business awareness of global practice and assist in lifting their capabilities. This policy area is a subset of the broader skills and education agenda but applies specifically to managers, owner-managers and directors of small and medium-sized businesses.

“Building a more coherent approach to business capability development will require intra-and inter-government dialogue and cooperation.”

There is already a wide range of programs at federal, state, territory and local government levels dedicated to building Australia’s business capabilities. Extending the most successful programs and building greater links and coherence across the range of services has the potential to significantly improve outcomes and assist in identifying gaps and opportunities. There is also considerable merit in the more concerted development of accessible case study material through business success stories that highlight the ingredients of successful experiences.

Building a more coherent approach to business capability development will require intra-and inter-government dialogue and cooperation. There is no need for a single national approach and indeed diversity and experimentation in different jurisdictions alongside greater communication and coordination is likely to bring significant benefits. How best to pursue these objectives is fertile ground for the new collaborative structures around the National Cabinet. With local governments also involved in a variety of business capability initiatives, bringing this level of government into the tent would be advantageous.

An initial project in line with the objective of building greater economic resilience could focus on improving the management of supply chain risks among Australia’s small and medium-sized businesses. Governments and their agencies could work with business associations to ensure that advice and case study material is available to managers and boards to help lift the efficient mitigation of supply chain risks.

2.2.1. Business Advisory Initiatives

At the federal level, the Entrepreneurs’ Programme plays an important role in directly assisting transformation of businesses and key sectors. The successes achieved point to the scope to scale up the program and to replicate it in complementary ways to meet business demand and economic opportunity.

“Many of the best advisory services employ benchmarking and diagnostic tools to assess business readiness and guide the business towards its next phase of development.”

The Entrepreneurs’ Programme itself has built up considerable recognition and should retain its current branding. The program has demonstrated considerable agility to assist businesses impacted by the bushfire crisis and COVID-19 to re-build, transform, adapt and strengthen their resilience. The Entrepreneurs’ Programme’s sectoral coverage should stay broad, with construction remaining and the energy sector definition expanded to cover cleantech. Eligibility should include businesses with prospects of successful transition to new fields and those with growth prospects within their current field.

The bDigital service available to program clients is valuable and should persist. To improve capability beyond the scope of clients of the Entrepreneurs’ Programme, the government should build on bDigital with a program targeted to large numbers of SMEs to provide information on successful adoption by businesses of digital technologies as well as advice on options for investments in digital capabilities.

Many of the best advisory services employ benchmarking and diagnostic tools to assess business readiness and guide the

business towards its next phase of development. The Innovative Manufacturing Cooperative Research Centre’s (IMCRC) futuremap® is a great example.²

“futuremap® enables manufacturers, through either one-on-one structured discussions or as part of interactive group workshops, to map their maturity levels and capabilities in the areas of

- Market positioning,
- Leadership, strategy and change management;
- Innovation and use of technology; and
- Digital manufacturing (Industry 4.0).

As each manufacturer checks its position against 13 key areas of industrial and manufacturing competitiveness, futuremap® produces a point-in-time self-assessment and report that identifies both immediate, and medium-term, opportunities for growth and potential investment.

As well as receiving a point-in-time self-assessment and report, futuremap® also connects Australian manufacturing SMEs with further educational materials and access to a broad eco-system of supporting organisations and programs.”

2.2.2. Digital Capabilities

Key opportunities for modernisation of existing business practices and models are available through greater digitisation of operations, supply chains and distribution. There are many commendable initiatives that have been developed by various levels of governments and by different agencies. Greater coordination, linking and coherence could be achieved through greater intra- and inter-government dialogue and cooperation. There are also opportunities for governments to help spur business digital maturity through further collaboration with industry and other organisations.

One such initiative is the Industry 4.0 Advanced Manufacturing Forum (I4AMF), which brings together stakeholders from industry, academia, unions and key institutions including the Advanced Manufacturing Growth Centre and the IMCRC. The I4AMF and the associated ecosystem is the sort of initiative that, if extended and/or replicated in a complementary way for other industries, would accelerate the take up of digital opportunities by a broader cross-section of Australian businesses.

2.2.3. Cyber Security

Digitalised businesses and increased telework redouble the importance of cyber security against a plethora of evolving and growing cyber threats. Existing initiatives such as AustCyber and the Australian Cyber Security Centre (ACSC) are positive but concerns about the security of public and private digital platforms highlight the importance of coordinating overall policy through the Australian Government’s National Cyber Security Strategy. The latest version of the Strategy includes many positive and well-funded initiatives, but successful implementation will hinge on close industry consultation.

It is essential that the government’s own actions do not inadvertently undermine wider cyber security. For instance, Ai Group and many others have been concerned at flaws in the recent Assistance and Access legislation, which empowers law enforcement seeking access to secure digital systems to require cooperation from related suppliers and service providers. The ambit of the legislation is very broad, potentially affecting confidence in the cyber security of many digitalised businesses. The Independent National Security Legislation Monitor (INSLM) recently recommended a raft of improvements that would

² See <https://www.imcrc.org/futuremap/>

substantially alleviate these concerns and should be adopted in full.³ Future legislation in this space should be informed by INSLM assessment prior to passage.

2.2.4. Industry Capability Networks

The Industry Capability Networks operating in each state are important resources and would benefit from stronger national coordination driven by the objectives of generating greater value. This could include through the integration with digital platforms and consistent linking with private sector and government initiatives including their procurement policies and industry development strategies.

2.2.5. Trade and International Engagement

There is also a range of important programs most prominently through Austrade that are aimed at building export capabilities and facilitating the development of new markets. The new client-focus of Austrade holds considerable promise and has the potential to tailor information and support to the circumstances of businesses. Ai Group’s separate policy paper on Trade looks more closely at the potential for improving and expanding the current reach of programs in this area.

2.3. Encouraging High Growth Industries and Businesses

Many policy initiatives aimed at encouraging new areas of opportunity start from an identification of favoured industries including specific “industries of the future” and set about developing industry plans and approaches to the development of those industries. This approach has had some successes with a variety of state, territory and federal initiatives including the Growth Centres.

“A more concerted and coherent focus on businesses exhibiting strong firm-specific capabilities would complement the industry-focus applied in the Growth Centres and other initiatives.”

The industry-wide approach also has weaknesses. Identification of potential opportunities can be coloured by the latest fads and by the interests, experiences and expectations of those involved. Political and interest group input can divert concentration away from areas of inherent merit towards areas with fewer genuine prospects. Perhaps more importantly, identifying specific industries does not fit well with the serendipitous nature of business success deriving from firm-specific advantages evident in a wide variety of, often unexpected, industries.

A more concerted and coherent focus on businesses exhibiting strong firm-specific capabilities would complement the industry-focus applied in the Growth Centres and other initiatives. Lessons can be gleaned from the approach of New Zealand Trade and Enterprise (NZTE) that encourages and supports businesses with export potential and ambition with tailored services and links them to capability development services available from a wide range of providers.⁴

2.4. Innovation

Innovation can be distinguished from business or organisational improvement in general by the greater novelty of changes and the greater likelihood that they extend the frontiers of efficiency and economic activity rather than move organisations towards existing frontiers.

Whether or not innovation involves the introduction of wholly novel changes to business models, processes, products, services or distribution, it inevitably builds on and extends existing practice and is most likely to be generated by new or established innovation-ready organisations and entrepreneurs with a keen awareness of leading practice.

³ See https://www.inslm.gov.au/sites/default/files/2020-07/INSLM_Review_TOLA_related_matters.pdf.

⁴ See <https://www.nzte.govt.nz/>.

2.4.1. Centres of Excellence and Industry Networks

Organisations and networks that keep abreast of leading business practices, technologies and other developments in relevant fields can play central roles in improving innovation readiness and lifting awareness of new opportunities for Australian businesses. Critically, they can help keep stock of existing domestic capabilities and gaps in those capabilities and would assist in developing strategies to build resilience and preparedness to address disruptions like those highlighted during the early months of the COVID-19 crisis.

The Growth Centres, various CRCs, Centres of Excellence, some specialist industry associations and research organisations such as CSIRO already perform these roles to different degrees. Greater focus on opening, extending and linking existing networks would disperse benefits more broadly with commensurate improvements in economy-wide payoffs. Current coverage is far from exhaustive and there are strong opportunities to create new networks and Centres of Excellence.

Gains from these initiatives can be extended if their successes are celebrated and publicised. More extensive use of accessible case study material has the potential to lift awareness of specific opportunities. More generally, they can promote interest in collaborative approaches to innovation and help break down the cultural and information barriers to greater business-research collaboration.

There is scope also to build the capabilities of Centres of Excellence and their associated networks by ongoing critical examination and dissemination of leading practices, successes and failures.

2.4.2. Business / Research Collaboration

Lifting the frequency and quality of collaborative innovation between Australian businesses and our substantial capabilities in scientific research is essential to improve competitiveness and open new commercial opportunities. To build on recent progress a number of steps could be taken.

- Continue and expand the Innovation Connections element of the Entrepreneurs' Programme;
- Consider wider access beyond the Entrepreneurs' Programme to incentives for employment of recent STEM graduates in innovation roles;
- Promote case studies and best practices for collaboration to both business and researchers, including the benefits of cross-organisational teams and deeper 'stage zero' collaboration that starts from joint problem analysis rather than contracting out solution delivery;
- Assess the success of recent efforts to link public sector research funding to industry collaboration and real-world impact and refine the formulae and metrics if warranted in consultation with industry and the research community.

2.4.3. Supporting Business Research and Development

While recognising it as but one element of innovation, Ai Group is a strong supporter of business research and development activity as a key driver of improvements in productivity and, through that, of higher incomes and commensurate benefits across the broader community.

We also recognise the external benefits that can flow from business R&D by its contribution to knowledge that can be used by others without payment. These "positive externalities" or "spillovers" are benefits that accrue to others and are not captured by the individual business undertaking the R&D. Because of this, an individual business left to its own devices would finance less R&D than is socially optimal because it does not get rewarded for the full benefits flowing from the R&D activity.

Accordingly, Ai Group supports public backing for business research and development activity as a means of lifting the total amount of business R&D to more closely approximate its optimum level.

For several decades the central policy instrument supporting business R&D in Australia has been the Research and Development Tax Incentive (R&DTI). Over much of this period business expenditure on R&D (BERD) increased markedly. In

1981-82 BERD was recorded at 0.24% of GDP. With the support of the R&DTI, BERD measured as a proportion of GDP rose, albeit in fits and starts, peaking at 1.38% of GDP in 2008-09.

“Since 2008 the uncertainty surrounding the R&DTI and the various measures to pare back its cost have seen business R&D fall back towards levels last seen in the 20th century”

From 1981 to 2008 Australia’s Gross Domestic Expenditure on R&D rose (GDERD) from less than half the weighted average of OECD countries (49%) to just about on par with the OECD average (99%) - see Figure 1. As shown in Table 1 below, the vast majority (81.9%) of this catch-up was due to the increase in Australian BERD over the same period.

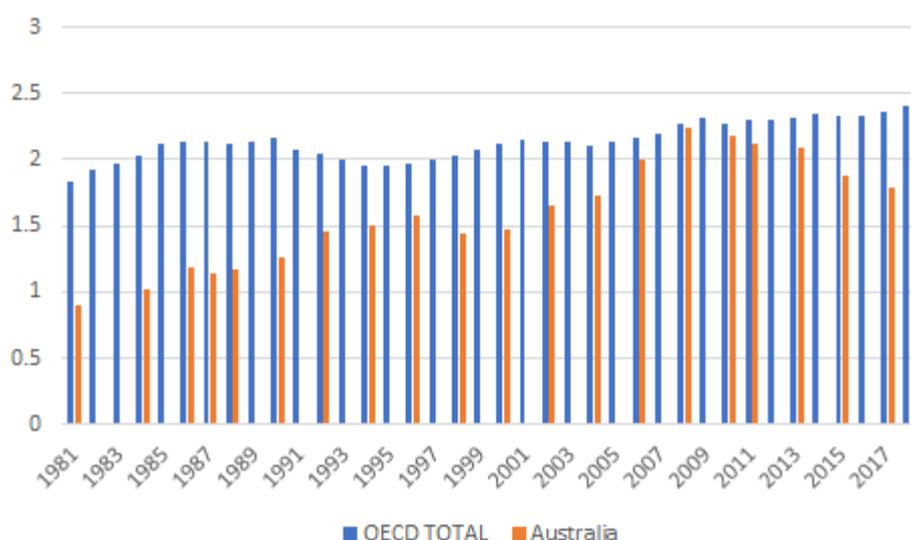


Figure 1 - Gross Domestic Expenditure on Research and Development 1981-2018 (% of GDP)⁵

That is the positive story. Since 2008 however, under governments of various persuasions, concerns with the cost of the R&DTI have seen numerous inquiries, proposals and modifications to the R&DTI. Over this period of instability, the uncertainty surrounding the R&DTI and the various measures to pare back its cost have seen business R&D fall back towards levels last seen in the 20th century. The R&DTI has been chipped away; the incentive it provides has been eroded and muffled; and investment has suffered as a consequence.

From 2008 and coinciding with the instability of the R&DTI, Australia’s level of GDERD measured as a share of GDP fell. By 2017 (the latest year for which the data is available) it had slipped to 75.6% of the OECD level. As shown in Table 1, the fall in BERD over this period accounted for more than all this fall (i.e. it was fractionally offset by a rise in other elements of GDERD).

⁵ See OECD data at <https://data.oecd.org/rd/gross-domestic-spending-on-r-d.htm>

	GDERD	BERD	BERD share of change in GDERD
Percentage point change 1981-2008	1.34	1.10	
Per cent			81.9%
Percentage point change 2008-2017	-0.46	-0.48	
Per cent			105.2%

Table 1 - Australian share of change in GDERD due to change in BERD⁶

While Ai Group would be open to a serious consideration of a partial replacement of the R&DTI with business research grants as has been canvassed in a variety of reviews, the success of the alternative approach would depend critically on the development of strong public sector capabilities so that grants were directed to where they would have best effect. A strength of the R&DTI is that it is demand driven and reflects business decisions about the best direction of their R&D efforts. Replicating the benefits of expenditure decisions informed by coal-face experience of individual businesses would be a major challenge in the design and implementation of a widespread system of grants.

In the meantime, Ai Group recommends that the Government’s currently proposed reconfiguration the R&DTI based on research intensity and an arbitrary cap on supportable R&D should not be pursued. This proposal would amount to a substantial across-the-board reduction in support for innovation, would not provide meaningful incentives and would give rise to well-documented anomalies.

Instead Australia should commit to much-needed stability for the R&DTI as part of a strong overall backing of business innovation.

2.5. Industry Transformation

Industry development has been characterised as a process of creative destruction. As new opportunities are developed, existing areas of activity are frequently disrupted by direct competition and the diversion of resources to the more prospective opportunities.

“There is strong scope to reduce the social and economic costs associated with the dislocation of employees, the concentrated impacts on particular regions and the social and political risks of people’s sense of being excluded from benefits.”

The faster pace of industry development advocated here will add somewhat to the already-considerable waves of change arising from technological developments, the continuing emergence of new centres of global economic activity and the imperative to decarbonise economic activity. While Australia should embrace these changes and seek to capitalise on the opportunities they present, we also need to recognise the disruption to traditional ways of doing things and the costs of creative destruction.

Recent decades have seen technological changes and competition from emerging economies expose significant segments of developed countries’ workforces to the social and economic costs of unemployment and relatively slow income growth. Since the GFC, these developments have been associated with the rise of populism and populist leaders reacting and appealing to dissatisfaction with the erosion of traditional areas of opportunity and a lack of confidence in access to the benefits flowing from new areas of opportunity.

There are clear advantages in taking action to ameliorate the costs of disruption that is part and parcel of the process of industry development. There is strong scope to reduce the social and economic costs associated with the dislocation of

⁶ See OCED at <https://data.oecd.org/rd/gross-domestic-spending-on-r-d.htm>; and ABS, cat 8104.0, *Research and Experimental Development*, various years

employees, the concentrated impacts on particular regions and the social and political risks of people's sense of being excluded from benefits.

Policy measures can be proactive and reactive. Proactive measures include equipping the existing and future workforce with strong foundations and transferable skills and improving the business capabilities that improve agility and resilience. Measures outlined above and in the other policy papers in this series lie at the heart of improving readiness for and the ability to cope with disruption.

There is also a role for reactive policies as disruption hits or carries the threat of hitting businesses directly, their supply chains and employees. Targeted measures, often with a regional or sectoral focus, can be put in place to assist transitions for employees and businesses where there is a risk of concentrated impacts and limited immediate scope to participate in new opportunities.

A further layer of protection is afforded by Australia's broader social safety net which cushions the impacts of unemployment and loss of income. Undoubtedly there is scope to improve the coverage of the social safety net and to ensure that it has a focus that avoids welfare dependency by assisting people to equip themselves and find alternative employment.

