Innovate

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Short-term success not enough

Australia's rising productivity, its resurgent dollar and its strong growth in gross domestic product compared with other countries of the Organisation for Economic Co-operation and Development (OECD) suggest a sound economy. But dig deeper, and the data shows that Australia cannot afford to rest on its laurels. Viewed in longer-term perspective, Australia's recent performance masks prolonged economic decline. At the start of the 20th century, Australia had one of the highest standards of living in the world; in 2000, it ranked 27th in terms of per capita income. In the 11 years to the end of 2001, 15% of Australia's top companies in 1990, measured by market capitalisation, had been acquired by foreigners. And Australia has become a less important place to conduct business: in 1990, 113 of the world's biggest companies had offices in Australia; by 2000, that had declined to 92.

An Australian-born Harvard Business School professor, Jonathan West, provides a sobering analysis of Australian competitiveness. His article THE MYSTERY OF INNOVATION, published in August 2001 by the *Australian Journal of Management*, finds fundamental shortcomings in the Australian "innovation system", defined as the interactions, among national institutions, that determine the inventiveness of domestic business. Why assume that innovation is the key to competitiveness? West argues that innovation fosters economic growth, and the "me too" strategies of quick adopters of new techniques are not sustainable.

Governments once captured the value of innovation by promoting or insisting on local manufacture, and benefiting from the wages and taxes generated. As technology-based industries now represent a greater share of world output, this approach no longer works. West says: "In the knowledge-based industries … little value is captured as wages because, in several key technologies, replication of a product design — that is, manufacture and service delivery — is increasingly trivial and unskilled."

West emphasises that the vaunted United States productivity growth of the late 1990s came almost entirely from a very few sectors that were successful users of technology. Australia has made the risky assumption that it can prosper as a technology importer when growth increasingly is coming from innovation-based industries.

Another central element, well established in economic literature, is that the private sector, left to its own devices, will not spend what is best for the economy on research and development (R&D). A crucial role in sponsoring research is accordingly played by governments and non-profit bodies, and 85% of the drugs sold by US pharmaceutical companies are based on research funded by the National Institutes of Health. By any standard, Australia's commitment to public, non-profit research falls woefully short of other OECD nations. Australia may be the only developed country to have cut government spending on higher education and basic research in the past 10 years.

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West cites other weaknesses in the innovation system. Australia's chronically low savings rate raises the cost of capital for all enterprises and has a particularly chilling effect on new ventures with promise. Applying higher discount rates to their future pay-off makes them appear unattractive. Australia also lacks effective methods to diversify the risks of innovation: the public sector is unwilling to socialise risk, large corporate investment in R&D is lower than the OECD norm because payout is a higher priority, and venture capital firms are modestly funded and reluctant to bet on nascent technologies.

What is most surprising about West's article is not his assessments, but his pessimism. Despite finding fundamental and widespread flaws in Australia's innovation regime, his proposal to set up a scheme to provide public support for lending and certain types of venture funding to innovative businesses is modest, a partial solution at best. And he seems resigned to the continued inadequate funding of higher education and fundamental research, when these investments yield disproportionate rewards.

West is not wrong. It is striking to see lack of competitiveness openly acknowledged, and yet to see so little debate about it. Australia's isolation is too often accepted as a convenient excuse for managerial shortcomings. It almost seems expected, for example, that Australian companies will make a botch of overseas acquisitions. There also seems to be a tacit assumption that to compete effectively requires wholesale use of US business models and, with them, workaholism and winner-take-all reward systems, which are at odds with Australia's social values. But the success of Australia's health-care system shows it can devise approaches that steer between bare-knuckle capitalism (US-style) and quasi-socialism (European-style).

Countries have overcome fundamental disadvantages before. The size of the domestic economy usually determines military power, but Britain in the early modern era prevailed against much larger economies. Its superior tax-collection regime let it be a more reliable borrower, so advantaged access to capital compensated for a smaller economic base. Australian leaders need to give more thought to how Australia can compete more effectively. West points out that Australia has the resources — a wealthy economy, an educated workforce, an open and pro-business economic system — to enable it to succeed. What seems curiously lacking is the will to confront this challenge. ●

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