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Executive Search & Board Advisory

## WHAT INVESTMENT IN INNOVATION – ARE WE FOOLING OURSELVES?

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Innovation is the implementation of a new or significantly improved product (good or service), process, new marketing method or a new organisational method in business practices, workplace organisation or external relations.

### **Is Australia investing enough in innovation or are we fooling ourselves?**

According to the latest Organisation for Economic Co-operation and Development (OECD) figures, Australia does not fare well compared with other OECD countries. Australia earns only a relatively modest proportion of its total income from the sale of innovative goods and services compared to other OECD countries. In 2014–15, income from new or significantly improved goods and services was around 7.2% of total sales. With this estimate, Australia ranks 20<sup>th</sup> out of the 23 countries in the OECD. The average of the top five OECD countries is 19.1%.

### **Reasons for Australia's lack of innovation**

The discrepancy between Australia's poor performance compared to its OECD peers, may be explained by factors such as:

## 1. Lack of access to additional funds

Lack of access to additional funds is the most commonly reported barrier to the development or introduction of new or significantly improved goods, services, processes or methods.

## 2. The size of the business innovating

The proportion of large Australian businesses that are innovation-active (undertook any innovative activity irrespective of whether the innovation was introduced, still in development or abandoned) is relatively small. This means that it is less likely that their sales will result from innovative goods or services.

## 3. The type of innovations being undertaken

Many Australian businesses are process innovators. This means that their innovations may reduce their operating costs or improve efficiency instead of producing a new product for market.

## 4. The proportion of earnings retained in the business for reinvestment

Dividends paid by Australian listed companies have grown substantially since the global financial crisis (GFC), most notably among large resources companies and the banks.

According to the Reserve Bank of Australia, in 2015, Australian-domiciled listed companies paid \$78bn in dividends. These payments represented 81% of these companies' underlying earnings for the same period (the 'payout ratio'). In comparison to global peers, United States had a payout ratio of 48%, Europe had a payout ratio of 55% and the United Kingdom had a payout ratio of 61%.

The increase in dividends over recent years could reflect an increase in shareholder preferences to receive income payments amid lower yields on traditional cash-paying bond-like investments or a perception among company managers that there are fewer viable investment opportunities.

## Why is innovation important?

Innovation is a key driver of business competitiveness, economic growth, and improved living standards. The OECD estimates that as much as 50% of long-term economic growth in its member countries can be attributed to innovation, and this contribution is expected to grow. On average, every \$1 invested in innovation returns \$2 in sales.

Data from the Business Characteristics Survey (BCS) reveals that innovation-active businesses outperform non-innovation-active businesses on a range of measures. Innovation-active businesses in Australia makeup 45% of all employing businesses but contribute to over 60% of sales and employment. Compared to non-innovation-active businesses they are 40% more likely to increase income and profitability, twice as likely to export, and two-to-three times more likely to report increased productivity, employment

and training.

The positive impacts of innovation on performance become stronger the more regularly businesses innovate. High-growth businesses drive the majority of employment, sales, exports and economic growth in Australia. In particular, start-up businesses that are less than three years old make a disproportionate contribution to growth on every indicator examined.

In December 2015, Australian Prime Minister, Malcolm Turnbull launched a four year, \$1.bn, “ideas boom” initiative to promote business-based research, development and innovation. His plan was focused around strengthening ties between the business community, Universities and scientific institutions. His innovation agenda recognised that Australia was not investing enough in innovation and that the changes would help Australia transition “away from the mining boom” to a modern, dynamic 21st-century economy. He stated that “we have to be prepared to do things differently tomorrow than yesterday because the pace of change and the world in which we live is unprecedentedly fast”.

Although, Australia’s economic performance to date has proven to be remarkably resilient, particularly when global economic recovery in the wake of the global financial crisis remains fragile. Australia’s future output and employment performance will be determined by our ability to find new sources of growth. Without another resources boom, growth is likely to rely on greater use of knowledge, innovation and entrepreneurship. To facilitate this process, businesses should also lower the payout ratio in line with international peers and reinvest a higher proportion of its profits into growing the business with the goal of generating more earnings in the longer term. The most successful corporate innovation strategies to date are the ones that predominantly focus on people and human capital issues.

### Types of innovation

Innovation investment can include external expenditures on ‘tangible’ items such as new equipment, machinery or technology; or purchases of ‘intangible’ items such research, consulting or design services, technology licences or patents. Alternatively, internal innovation investments include expenses on development activities within the business, such as for staff training or in-house software development.

#### 1. Product innovation

Product innovation is the introduction of a good or service that is new or significantly improved with respect to its characteristics or intended uses. This includes significant improvements in technical specifications, components and materials, incorporated software, user-friendliness, or other functional characteristics.

Example: Smartphones. Although smartphones are ubiquitous now, smartphones have become our digital hub, consolidating our communication, entertainment and utilitarian functions into a single device. Future generations may revise history into two areas – before smartphones and after smartphones. A key product introduced in 2007 was Apple’s iPhone. Its designers did not create a telephone with some extra features, but rather a full-fledged

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hand-held computer that could also make calls and browse the internet. It is arguably the most world-changing product of the last 30 years.

Examples of recent Australian product and service innovations include: DuluxGroup's Selleys STORM Sealant which delivers a waterproof seal on any surface, wet or dry. It's specially formulated to perform where conventional sealants fail, meaning it can be applied in the pouring rain and even underwater to stop active leaks instantly. In addition to this, Ikon Services Australia's Battery Operated High-Pressure Washing Unit is the world's first battery-powered commercial grade pressure washer unit. It plugs into an electric battery for recharging, consumes no fuel, has zero emissions and is comprehensively quieter with noise reduced by four times.

### 2. Process innovation

Process innovation is the implementation of a new or significantly improved production or delivery method. This includes significant changes in techniques, equipment and/or software.

Example: Automation. For years, companies have automated specific manual tasks, such as factory work or office functions. But today, they can automate whole processes. Uber manages more than one million drivers around the world with software that allocates work and provides feedback on how the work was performed. Cloud platforms such as Amazon Web Services have automated the provisioning of services, allowing end users to bypass company IT departments and sign up for software services with a credit card.

Examples of recent Australian businesses process innovations include: The Australian Government, MyServiceNSW digital platform which offers more control and autonomy for customers, to transact seamlessly with the NSW government through any device. It allows citizens to manage their own single, secure profile to find 900 transactions from 50 government agencies in three clicks or less. WorleyParsons, in partnership with a robotics company, has developed a robotic arm device to remove the need to manually unload catalyst. In the downstream oil industry, unloading catalyst is a necessary but dangerous and time-consuming task. It has historically been a manual task, exposing workers to toxic environments. The robotic device completely removes the need to expose workers to such environments.

### 3. Marketing innovation

Marketing innovation is the implementation of a new marketing method involving significant changes in product design or packaging, product placement, product promotion, or pricing.

Example: Volvo. Volvo crippled the competition with their "Interception" campaign during the 2015 Super Bowl. The Swedish automaker asked their followers to tweet using the hashtag #VolvoContest, whenever a competitor's commercial was aired during the game, about someone you thought deserves a new car. While the competitors were showing what matters to them, spending \$60m collectively, Volvo wanted to know who matters most to their customers. The best tweets got a response from Volvo, and five lucky winners were

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selected. The campaign drove significant impact and increased visibility for Volvo. They received over 50,000 tweets within 4 hours and increased sales by 70% for the Volvo XC60 the month following the game (the highest in its segment).

An example of a recent Australian businesses marketing innovation is media company, CHE Proximity developed a way for Cochlear to test people's hearing, without them knowing. 'Does Love Last Forever?' is a short film with two different endings, depending on the viewer's hearing ability. [Link](#)

### 4. Organisational innovation

Organisational innovation is the implementation of a new organisational method in the business' business practices, workplace organisation, or external relations.

Example: Toyota altered its organisation structure to further accelerate decision-making, strengthen management oversight, and boost its business innovation. To promote its goal of making ever-better cars by continuing the development of a talented workforce, Toyota made substantial changes to its structure in 2016 to create a company built around a product-based, rather than function-based, organisation. These changes were spurred by the vital realization that sustainable growth cannot be achieved without tackling two major challenges the company was facing as it continued to grow. The first was how to develop a sufficient number of people who can lead with quick judgment, quick decisions and quick action through genchi genbutsu (on-site learning and problem-solving) because the changes the company faced required a different way to think and act. The second was how to reduce the time and effort consumed by cross-functional coordination and establish work processes that allow the company to focus on making ever-better cars for its customers. Toyota is recognised as the leader in the global automobile industry.

An example of an Australian businesses' organisation innovation: E-commerce business, Kogan.com, founded by entrepreneur Ruslan Kogan in 2006, started a business by cutting out the middleman, got a private label that used the same or similar components to the big brands, and to sell it directly to the consumer, in a way that is more price efficient. He recently floated his business that started off in his parent's garage, on the ASX, with a market capitalisation of more than \$160m, with revenues projected to top \$240m in the 2017 financial year. Kogan largely accomplished this by building a company and culture around his original insight: that the connections and scaling power of the internet are incredibly valuable, especially if you can move quickly on the insights. "Every single person that we recruit, whether they are in the marketing team or IT team or the call centre, they need to sit a logical and analytical reasoning test. We've got analytics as part of our culture. We, as a business, act on stats," says Kogan.

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