

Submission by



to the

**New Zealand Productivity Commission**

on the

**New Zealand firms: reaching for the frontier issues paper.**

**August 2020**

## **SUBMISSION**

ExportNZ is pleased that the New Zealand Productivity Commission (NZPC) is investigating New Zealand's most productive firms and how their economic performance can be maximized, and spillover effects can benefit other New Zealand firms. This is particularly relevant now as New Zealand faces an economic shock from COVID-19.

## **GENERAL DISCUSSION**

Economic research concludes that New Zealand has an enduring problem with low productivity. Productivity levels are much lower than the average of high-income OECD economies, and despite many efforts by Government to lift productivity through various policy settings New Zealand's productivity has continued to fall behind. The result is that New Zealanders work, on average, about 10% more hours than the OECD average to produce about 20% less<sup>1</sup>

New Zealand has a unique economy that faces distinctive challenges. The distance from major markets and our absence of scaled-up companies create a huge challenge as we seek to make our mark on the global marketplace.

## **COMMENTS ON THE CONSULTATION DOCUMENT PROPOSAL**

### **1. What do you think are the most important drivers of the productivity of New Zealand's frontier firms?**

#### **1.1 International connections**

Global connectivity is an important driver of the productivity of New Zealand's frontier firms. New Zealand's internationally connected firms and international facing sectors have relatively high productivity levels and are particularly important drivers of productivity in a small, advanced economy like in New Zealand. Foreign Direct

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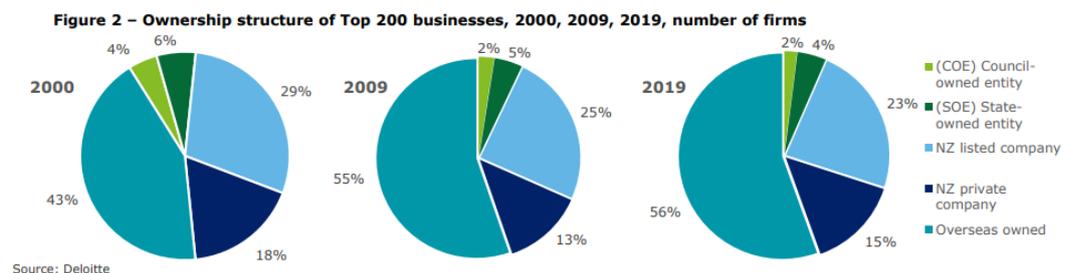
<sup>1</sup> Moving on from New Zealand's Productivity Paradox; Nolan, P., Fraser, H., & Conway, P. 2018.

Investment (FDI) and international connections play a critical role in the growth of exports. Access to parent company knowledge and resources, technology, and international networks has facilitated the growth of more productive firms. New Zealand’s COVID-free status may also make the country more attractive to overseas investment. New Zealand should be supporting the opportunity for more FDI, which may also help to improve New Zealand’s productivity by deepening the availability of capital, as well as diffusion of knowledge and skills. Figure 1 below taken from the 2019 analysis of the Deloitte top 200 companies shows that overseas-owned firms outperform both NZ owned, NZX listed, state-owned entities, and council-owned entities by a significant margin.

**Figure 1.**

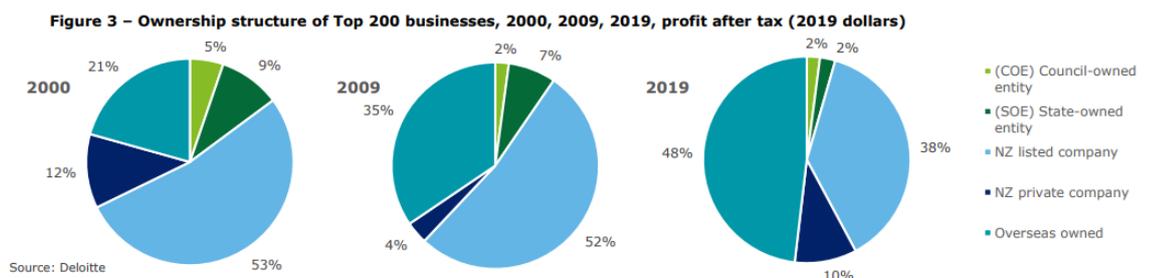
What is the ownership of Top 200 companies?

The presence of overseas owned firms has increased between 2000 and 2019, while the number of NZX listed businesses remained below 30%



What is the ownership of Top 200 companies?

NZX listed firms previously made up the bulk of profit, but were overtaken by overseas owned firms in 2019



New Zealand’s economy relies on overseas capital for infrastructure, skills, technology, and financing to compete in a globalised world. While foreign ownership has increased

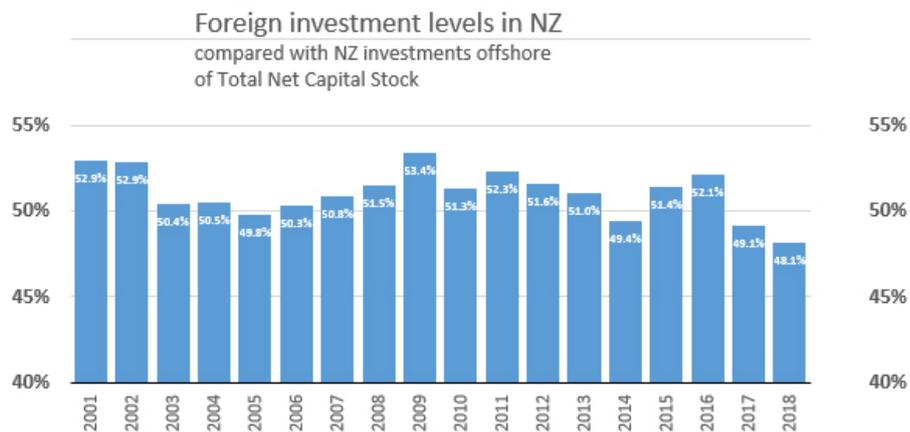
in the top 200 companies, foreign investment levels in New Zealand have decreased overall. As shown in Figures 2 and 3 below, foreign investment is now at its lowest proportion since 2001.

**Figure 2.**

	Foreign ownership	Foreign share	Total NZ capital stock
	<i>\$ bln</i>	%	<i>\$ bln</i>
2001	172,479	52.9	326,011
2006	232,004	50.3	465,229
2011	301,228	52.3	576,039
2016	386,138	52.1	740,997
2018	398,870	<b>48.1</b>	828,801

This data is drawn from Statistics NZ National Accounts series. See SNE055AA.

**Figure 3.**



This data is drawn from Statistics NZ National Accounts series. See IIP085AA.

Globally connected firms that have access to deep capital markets, parent company knowledge and resources, technology, and international networks facilitate the growth of businesses and boosts productivity. However, New Zealand currently has the lowest proportion of foreign investment since modern records began.

## **What are the most important drivers of the diffusion of technology, ideas, and business practices from frontier firms to other firms in New Zealand?**

### **1.2 Geographic clusters**

New Zealand's frontier firms are distributed across the country but are clustered around major cities, including Auckland, Hamilton, Wellington, and Christchurch. People with higher skill levels, tend to gravitate towards cities.

Clusters have a positive impact on regional and industry performance, although there are few economically significant manufacturing clusters in New Zealand. Industry clusters create an environment where firms can share specialised services, save on logistics costs, and run a leaner and more efficient operation. Industrial clusters draw in industry-specific specialised workers, who acquire cluster-specific skills. Furthermore, clusters can have a positive impact on the functioning of a labour market through better matching between employers and employees. Industry clusters facilitate the exchange of information and knowledge.

The size of New Zealand's economy, coupled with our large geographic area makes it difficult to develop industry clusters. Promisingly, New Zealand has increased our ranking for cluster development in the Global Competitiveness Report from 64<sup>th</sup> in 2012/2013 to 44<sup>th</sup> in 2017/2018. Food and beverage manufacturing in Auckland is New Zealand's largest naturally occurring cluster. There should be an emphasis on fostering more New Zealand clusters and promoting them both domestically and internationally. Small advanced economies that do clusters well include the Nordic countries, and lessons can be learned from them. They tend to have a deliberate economic policy of facilitating cluster development and putting resources behind them. The European Union has established the European cluster policy forum, which is a platform that enables a discussion on how to improve the design and implementation of cluster initiatives.

## **2. What are the main challenges for New Zealand firms that aspire to reach the performance of the best firms globally?**

### **2.1 Strict FDI regulations**

New Zealand's small population size can make it difficult for businesses to scale. Market size can be increased across international markets – through trade, investment, people, and the flow of ideas. While New Zealand is reasonably open to trade on paper, the New Zealand economy is not well connected internationally. The weakness of firms' connections into global value chains and the flow of foreign direct investment is important. Foreign-owned and globally connected firms operating in New Zealand outperform domestic firms on almost all measures of performance, with higher capital intensity, higher average wages, and higher labour productivity<sup>2</sup>. New Zealand's innovation could benefit largely from the critical contributions of new technologies, practices, and ideas brought by foreign companies, as well as the advantages of additional global connectivity.

Aspects of the current foreign ownership regime work relatively well. However, concerns still exist within the current regime. These include, but are not limited to; the length of time and expense involved in applying for OIO consent, the inclusion of investments that are not likely to be high risk that without significant ownership value to New Zealanders and most concerning, the National interest test, which creates uncertainty for potential overseas investors. ExportNZ believes that removing barriers to Foreign Direct Investment (FDI) is necessary to facilitate the growth of New Zealand businesses and increase productivity. Overseas investment plays a vital role in transforming New Zealand businesses into firms that reach the global frontier. This is not reflected in New Zealand's poorly targeted foreign investment screening process that creates delays, significant compliance costs, and uncertainty for investors. New Zealand is currently ranked last (34/34) in the OECD Product Market Regulation Indicators for Regulation of FDI.

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<sup>2</sup> Maré, David C. and Sanderson, Lynda and Fabling, Richard, Earnings and Employment in Foreign-Owned Firms. IZA Discussion Paper No. 8541.

There are several examples where foreign investors in New Zealand have brought currently underperforming New Zealand domestic assets<sup>34</sup> and then have used their expertise and capital to increase productivity and reap some of the gains. The OECD has found that FDI stocks in New Zealand are relatively low for a small, open economy.

New Zealand is a nation of small to medium-sized businesses (SMEs), and the relative lack of large local firms and multinationals limits our best people the opportunity to develop the kind of business skills that would allow greater diffusion amongst firms. Middle managers in multi-nationals are typically the skilled people that go on to run startups or take a mid-sized company to the next level. We have very few multinationals in New Zealand compared to other small, advanced economies.

## **2.2 Lack of competition**

The barriers to competition from international firms include New Zealand's distance from major markets, which isolates domestic firms somewhat from international competition. International firms seeking to expand to new markets may find the potential returns in New Zealand low when compared to the costs of entry, due to its small market size. This disincentivises the entry of new competitors. This is problematic not only because of the loss of competition, but because international connections facilitate technology diffusion into domestic firms, which raises productivity.

Many countries have programmes specifically aimed at attracting the investment of large multinationals into their economy, particularly if those companies intend to embark on R&D investments.

New Zealand would need to be careful and strategic when thinking about such policies, given we do not have a location close to big markets (e.g. Singapore, Ireland, and

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<sup>3</sup> Foreign Direct Investment in New Zealand A brief review of the pros and cons (pp. 1-10, Rep.). Wellington, New Zealand: NZIER, 2016.

<sup>4</sup> Understanding Chinese Investment In New Zealand (pp. 6-35, Rep.). New Zealand China Council, 2019.

Dubai) and we are unlikely to be winners in a race to dangle economic incentives in front of multinationals that would then be a long way from their customers. Given those constraints, any efforts to attract more investment would be best focussed on either areas of natural competitive advantage, such as the 'future of food' or for endeavours that produce a weightless export, such as R&D and IP creation. Sir Paul Callaghan expressed views that New Zealand should be a place where "talent wants to live" and given the current state of the world, we have plenty of interest from overseas-based talent and investors. This opportunity should not be squandered and New Zealand should have a policy on talent and investment attraction and retention. What are the barriers, and what could the incentives be? It may not need to be tax breaks etc, but it could be a welcoming regulatory regime, e.g. Rocket Lab and Wisk–autonomous aircraft, autonomous vehicles.

### **2.3. Limited firm innovation**

New Zealand's expenditure on Research and Development (R&D) is well below the OECD average. However, in 2019 Business R&D expenditure reached \$2.4 billion, twice that spent in 2012, and the number of businesses performing R&D increased by 17 percent from 2012. This is promising for increasing innovation in New Zealand. Almost three-quarters of the funding for business R&D came from within the business itself. ExportNZ advocates that more support from Government to incentivise R&D investment would ensure that high-value jobs are created.

In addition, the Government should be looking at the whole Research, Science and Innovation (RSI) system to ensure it is focussed on the right outcomes for New Zealand and dealing with barriers and having the correct incentives in place. As an example, the feedback we got from the large companies that invest a lot in R&D is that the ecosystem, made up of CRI's and universities, are not that easy to work with. For example, the funding model for Universities incentivises research and publication in academic journals. Academics are rewarded for publishing. Publishing can be at odds with the protection of intellectual property – which needs to be kept secret until properly protected. Furthermore, businesses can find working with academics difficult because their primary motivations are teaching and publishing, so working with

industry cannot always be done promptly. Academics are not incentivised or rewarded for working with businesses and it is not easy for them to move jobs between academia and industry very easily.

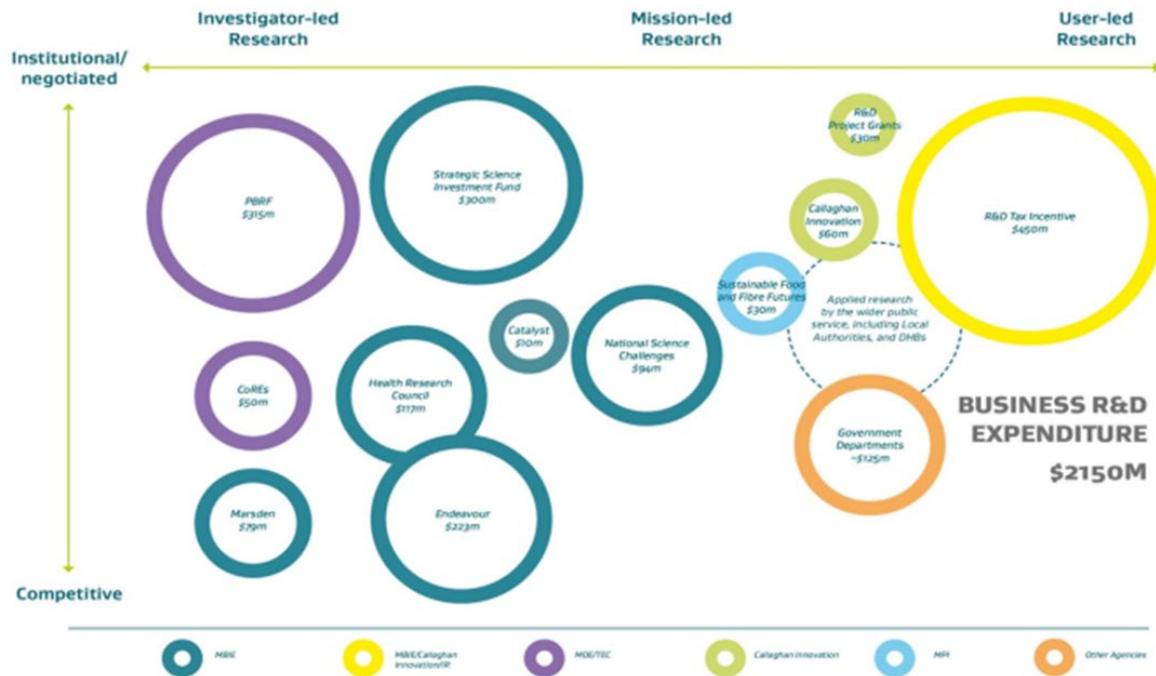
Other feedback is that Universities and CRI's and Commercialisation Offices want too much for their IP. Large companies that invest a lot in R&D tell us that if the value of the IP is \$1.00, the cost to commercialise it is \$100. The failure to recognise this means a lot of IP probably gets left on a shelf. There needs to be a more realistic approach to the value of the IP coming out of our RSI institutions and it needs to be in closer collaboration with industry, otherwise, rather than being market and customer-led, the research can be a solution looking for a problem to solve, so not commercially viable.

### **3. Are there particular barriers to innovation, diffusion, and reallocation that the Commission should focus on?**

Indicative evidence suggests that New Zealand firms have been slow to invest in knowledge-based assets, which are becoming increasingly important in driving productivity improvements.

As mentioned above, the feedback we get from the larger firms on the RSI ecosystem is that there is too much emphasis on research and not enough on development. The New Zealand taxpayer invests a lot in the R&D system, but much of it is at the blue-sky end of the investment spectrum, as shown below.

**Figure 4**

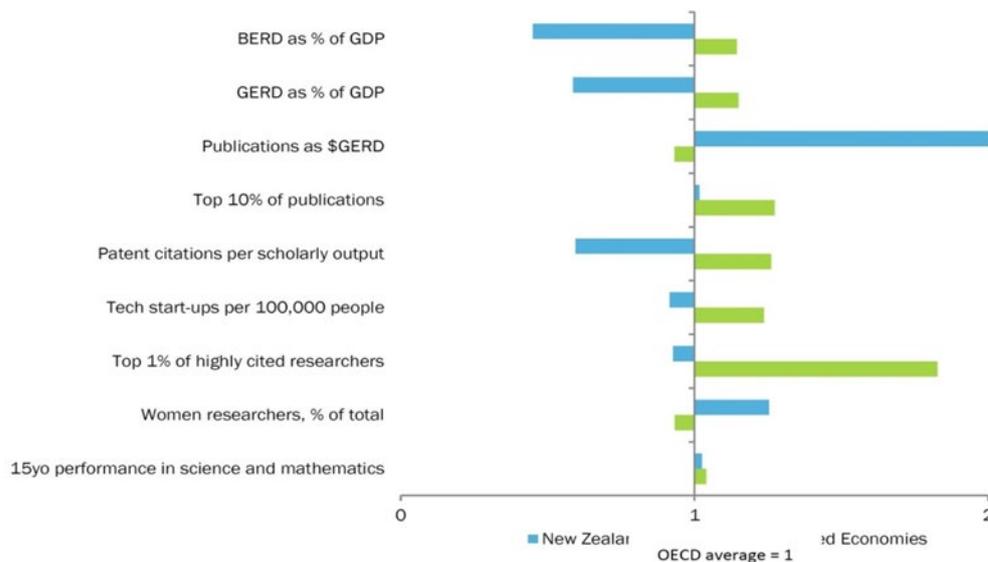


Link to clearer version of graph: [https://www.exportnz.org.nz/\\_data/assets/image/0013/200254/R-and-D.PNG](https://www.exportnz.org.nz/_data/assets/image/0013/200254/R-and-D.PNG)

From that investigator and mission-led research we get a lot of publications in international journals, but not a lot of Patents being filed, see below.

**Figure 5.**

**Figure 2: Summary statistics on our research, science, and innovation activity**



The unique challenge New Zealand faces in our view is a combination of distance from markets and a small domestic market, making it hard to grow large export capable firms that have deep enough pockets to execute well in overseas markets. So the question in our view is how do you grow bigger and better internationally connected companies?

There are shorter-term solutions in our view and longer-term solutions.

1. In the **short term**, use every avenue to encourage collaboration and innovation diffusion. This could be more deliberate and “World’s Best Practice” cluster support – and there is plenty of international literature and policy available on this. Currently, the only naturally occurring cluster of international significance in New Zealand is food and beverage manufacturing in Auckland.

2. New Zealand should embark on a talent and capital attraction policy. The time to do this is right now and this could make all the difference to our economic recovery post Covid19 and through those investors connect us to the markets they came from. New Zealand could be an R&D testbed for all sorts of new technologies. We have entrepreneurs such as Mohammed Hikmet from HMI Technologies here now that are having to take autonomous vehicles overseas for testing.

3. Get the incentives right for the RSI system to work more closely with industry. Make it easy for academics to work between academia and industry interchangeably. Once they leave academia for industry it can be hard for them to go back the other way without losing their place on the academic ladder. Incentives to publish work in journals is not resulting in creating new IP and it is not necessarily customer focussed either.

4. Research Institutions and Universities are unrealistic about the value of the IP they create. The cost to commercialise IP is not well understood by research institutions and therefore it can be left on the shelf. Institutional research can also be commercially irrelevant if not well informed by consumer needs.

5. Continue to increase the Government incentives for NZ firms to invest in R&D – both through increasing the R&D tax credit overtime and through growth grants from Callaghan Innovation. Stay the distance with these policies – they take time to show benefits and political flip flops on this type of support is not useful.

6. New Zealand’s location and small population are contributing factors as they constrain gains from specialisation and agglomeration. ExportNZ advocates for a population policy over the next 50 years. New Zealand would benefit from a larger population that would facilitate businesses to grow through a larger domestic market

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7. Government Procurement can also be a useful tool to help our businesses win more work, employ more people, and grow into bigger and more export capable firms. In a small economy lacking in multi-nationals, Both central and local governments invest in big projects. The following suggestions would enable more New Zealand businesses the opportunity to participate in Government Procurement:

- Structuring large contracts into smaller parts can be helpful for small New Zealand businesses that may not be able to compete for one large contract. For instance, instead of choosing one supplier who can deliver a national contract, split a contract by region and contract with multiple small, regional businesses.
- Structuring larger contracts into smaller parts also helps enable Māori businesses and Pasifika businesses to participate as they, like most New Zealand businesses, are often smaller and not able to compete for large contracts.
- If a large contract cannot be structured into smaller parts and only large businesses can tender for the contract, consider engaging with suppliers on how smaller New Zealand businesses can be included in the supply chain.

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<sup>5</sup> Lifting export performance Actions to drive growth in exports (pp. 7-24, Rep.). Wellington, New Zealand: NZIER.

8. We note that the literature cited in the NZPC report points to a problem in New Zealand whereby New Zealand firms are slow to invest in knowledge-based assets which are extremely important in driving productivity improvements. We hear a common refrain that industry in New Zealand is slow to invest in the latest plant and equipment and risks missing out on the “Industry 4.0” digital revolution. However – we would like to point out that industry statistics may be missing the point that many high tech New Zealand manufacturers are outsourcing their production to other countries – to the big state of the art manufacturers that have invested in Industry 4.0 technology. These New Zealand businesses are taking advantage of that technology without having to own it, or they are investing in factories themselves in places like China and doing the R&D and final assembly here in New Zealand. They import the components and technology to add to their bespoke products and re-export them. We think this phenomenon has been overlooked by academics, but it is increasingly common in high tech manufacturing.

## **9. Long term solutions**

New Zealand is not a small country – we are a big country with a small population. We should have a long-term strategic plan for what we want to be in the next 50 years. If we had 3 cities of 5 million people each in the next 30-50 years, then all the disadvantages of distance from markets would be somewhat compensated for by a bigger domestic market<sup>6</sup>. That in turn would allow companies to grow bigger domestically, be in a more competitive environment, be an incentive for larger multinationals to invest here, and improve the affordability of infrastructure and R&D investments. A bigger domestic market would also reduce our reliance on tourism and international education, which have come under severe strain in the current pandemic environment.

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<sup>6</sup> Lifting export performance Actions to drive growth in exports (pp. 7-24, Rep.).  
Wellington, New Zealand: NZIER

## **ABOUT EXPORTNZ**

ExportNZ is a national industry association representing a diverse range of exporters throughout New Zealand. ExportNZ is a division of BusinessNZ, New Zealand's peak business advocacy body.

We are a membership organisation and across our two brands have approximately 2,000 export members. We also have four regional partners: Employers Manufacturers Association (Upper North Island), Business Central (Lower North Island), Canterbury Employers Chamber of Commerce (Upper South Island) and Otago Southland Employers Association (Lower South Island) which between them represents the bulk of manufacturers in New Zealand.

Our value proposition for members is a mixture of policy and advocacy, education and training, networking, trade missions, and inspiration through awards events and conferences. Notably, we run a BusinessNZ Chief Technology Officers Group, incorporating the largest innovation-driven companies in New Zealand, many of which export.