

New Zealand firms: reaching for the frontier

Submission Paper from The Icehouse

26 August 2020

Gavin Lennox

Group CEO, The Icehouse (g.lennox@theicehouse.co.nz)

David Irving

Chairman and Trustee, International Centre for Entrepreneurship (ICE) Foundation
(david@davidirving.nz)

In response to the request for feedback on the Productivity Commission's issue paper, April 2020, *New Zealand firms: reaching for the frontier*, The Icehouse provide the following feedback for your consideration.

Q1

How should the inquiry define frontier firms? What data are available to enable the study of frontier firms under your suggested definition?

- The definition of frontier firms as the in the top 10% of domestic or international competitors is reasonable for established firms.
- See ExportNZ Award finalists and recipients (www.exportnz.org.nz) to cross-reference with the other sources identified in the report.
- For start-up or early stage firms driving innovation and future job growth, I would look at a few other sources:
 - Hi-Tech Awards finalists and recipients (www.hitech.org.nz)
 - TechNZ members (www.technz.org.nz)
 - Portfolio companies of VCs (e.g. Icehouse Ventures' Demo Day and Showcase companies)

Q2

Do you think the OECD framework is useful to guide the Commission's thinking in this inquiry? Are there other frameworks the Commission should consider?

- The framework is simple and easy to understand.
- Comment: note that innovation does not only happen with frontier companies as indicated in the diagram.

Q3

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

- In the context of the framework, innovation is the most important driver for productivity
- I do not believe that R&D is the same as innovation nor is R&D the most important driver - innovation is. Innovation can be defined as 'a new method or product that becomes a new practice somewhere in the world' (see book: 'How Innovation Works' – Matt Ridley, 2020) – it is much more than the idea generation and early research into novel methods that are disconnected from the real world.
- Generally, there is insufficient support for business-focused innovation in NZ versus R&D. The commercialisation and global expansion of businesses, the iterative and collaborative improvements to basic research to make them marketable products.
- There is not universal understanding of what is meant by innovation? Clearly NZ firm owners and advisers need to be of one mind on that.

- There is a case for management capability together with organisation form and governance to be elevated from the classification of a driver to instead be regarded alongside innovation, diffusion and reallocation as a broad driver of aggregate productivity growth.

Q4

What makes frontier firms different? What do they do differently, or have that other firms don't?

- Export/international market focused
- Critical capacity of organisational and management ability to successfully grow the firm. Experienced management with ambition to grow
- Competition (largely seeing competitors globally, not just domestic)

Q5

Can the success of frontier firms be replicated? For example, how much of their success is down to highly motivated and talented individuals, good timing, or even just good luck?

- It can be grown, but requires clusters of like-minded leaders in an ecosystem.
- See Germany's mittelstand for a well-recognised example.

Q6

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

- Frontier firms tend to suck up talent in the market. With that talent come the ideas and business practices that move the dial.
- Outstanding learning opportunities for leaders of businesses to listen and exchange ideas.

Q7

How easily do resources flow from lower to higher productivity firms and vice versa? What are the most important drivers of the reallocation of labour, capital and other resources between firms in New Zealand?

- Open and less-restrictive labour laws
- Encouraging talent from off-shore relocating to New Zealand
- High success clusters e.g. wine industry where there are multiple connection opportunities for employees between firms.

Q8

In your view, what are the key ingredients that would lead to a successful New Zealand economy, and what would success look like?

- Identify internationally competitive clusters e.g. primary sector and weightless economy (Frontier Firms by David Skilling)
- Select out the Frontier Firms from these two clusters

- Provide concentrated support to these firms including access to Crown capital (for international expansion), flexible governance (to enable best use of directors with relevant high management experience), partnered leadership (opportunity for owner managers to retain a highly capable manager to lead the firm through high risk phases of change- this appointment has the possibility of becoming permanent) and learning.
- Use the example of these frontier firm's success to transfer the learning throughout the remainder of the clusters and onwards through the remainder of NZ firms.

Q9

Does the Commission's description of New Zealand's frontier firms and the performance of frontier and non-frontier firms seem accurate?

- There are few if any truly global frontier firms based in New Zealand. So yes, our relative weakness in this area is fair.

Q10

To what extent do you agree with the Commission's tentative picture of why New Zealand's frontier and non-frontier firms are underperforming?

- I agree with the high level categories of weaknesses (weak international connections, lack of competition (particularly domestically), small markets (domestic), lack of managerial experience, relatively low investment in innovation, limited capital markets (though improving), governance)
- The Icehouse Owner-Manager Programme (<https://www.theicehouse.co.nz/programme/owner-manager-programme>) experience highlights low levels of strategy setting and management capability as the most prevalent hindrances to the latent underperformance of NZ SME's.

Q11

In your view, why does it appear that the productivity of frontier firms in New Zealand has not grown faster than non-frontier firms, unlike the situation globally?

- This seems counter-intuitive. It may be that to compete globally you need to invest significantly which requires more capital and relatively expensive experienced labour. This would depress profits in the short term, but should allow longer term expansion assuming the firms can compete.
- There is something unclear about the impact the Australian market has on traditional NZ business opportunity. Its scale and familiarity should lead to greater productivity yet perhaps the NZ firm is not prepared for the size of the step or the relative toughness.

Q12

What explains the research finding of a weak connection between innovation and productivity growth among New Zealand firms?

- I don't think we invest in innovation, and specifically commercialisation, sufficiently, therefore you will not see the productivity growth.

- Low level management cohesiveness, e.g. not recognising the difference between the important and unimportant.

Q13

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

- Role models / heroes to aspire to
- Physical isolation from large markets (lack of immediate competitive impact)
- NZ ownership capacity runs out leaving the Kiwi exposed to international players with different agenda's (which are not known at the time)
- Commitment to the business before everything else.
- International cultures

Q14

Are New Zealand firms ambitious about growing and scaling up? If not, why not? If they are, what's getting in their way?

- There is no doubt that being an island at the bottom of the world removed from markets is a hindrance. Imagine how much worse that would be without Australia.
- The current shift to a more nationalist world together with COVID 19 conveys an even less likelihood of NZ firms connecting to the world.
- Perhaps an earlier point made of de-risking through support from Crown equity until growth risk mitigated.

Q15

How do New Zealand's frontier firms learn about, adapt and adopt cutting edge technologies and practices?

- From each other and the ecosystem (though could be stronger)
- From competitors

Q16

What types of international connections make the biggest difference for diffusion from the global to the domestic frontier? What could be done to improve these kinds of connections?

- Talent – where to find real experienced talent that can be trusted to work effectively with a remote, New Zealand-based leadership team
- Customer or potential partner connections – helping to build out a distribution channel or get cornerstone customers in key markets
- International technology rights (patents, trademarks, know how) expose the NZ firm to global use.
- Smart money – with relevant and powerful product/validation network connections.

Q17

Do frontier firms have a problem sustaining their performance? What is needed to maintain high productivity over the long-term?

- Long term view and shareholder support – going international often takes patience and a long term view, access to patient capital to show returns. E.g. Mainfreight
- Continuous innovation, renewal, strategic leadership, inter-generational succession, alignment, highly fulfilling purpose for all.
- Typically the controlling shareholders want to sell (at a certain scale) rather than grow.

Q18

Why don't other firms follow the example of frontier firms? What's holding them back?

- Too content with just being 'world famous in NZ'?
- For most the desk in their office in Papakura seems a very long way from a very big office in Shanghai
- Perceived risk and the lack of support (or tolerance of failure).

Q19

How could the lessons from New Zealand's frontier firms be better shared?

- MORGO (annual entrepreneur conference www.morgo.co.nz)
- World-class New Zealander Awards
- KEA (Kiwi Expat Association)
- Icehouse Conference (annual event run by The Icehouse)

Q20

How do different types of corporate form and ownership structure affect firms' incentives to innovate, grow and internationalise?

- In response to earlier questions I have proffered the idea of Crown ownership partnering with a NZ owner for such time as the frontier firm has well established itself internationally. Too often we see the fledging NZ frontier firm bought by an international firm early in its entry into international markets. Crown ownership would protect the NZ firm until it has established itself internationally.

Q21

What are the pros and cons of the standard corporate governance model for stimulating business growth, innovation and productivity?

- Earlier I introduced the term flexible governance. Under this regime the roles of directors and managers have greater freedom to contribute to each other's domain. In particular it provides the opportunity for directors, who are themselves very experienced managers, to assist management where they can e.g. chair a senior leadership team, write the personal description for a HR manager.

Q22

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

- Find some very good example frontier firms that would be very willing to test the Commissions ideas, implement the low hanging fruit as they say and spread (diffuse) from there.

Q23

How should this inquiry think about and define a Māori frontier firm?

Q24

What resources/opportunities and constraints/barriers are unique or greater for Māori frontier firms, compared to non-Māori firms?

- How do these opportunities and constraints vary by the organisational form of the Māori entity?
- How do Māori firms maximise opportunities within these constraints?

What would help mitigate barriers or enable Māori firms to better maximise their potential?

Q25

How are knowledge, technology and practices diffused from Māori frontier firms to other Māori and/or non-Māori firms? In what ways does this differ from diffusion from non-Māori firms? How can these diffusion mechanisms be strengthened?

Q26

Which policy levers matter the most and would have the largest potential impact in:

- helping New Zealand frontier firms get closer to the global frontier?
- helping diffusion from New Zealand frontier firms to other New Zealand firms?
- supporting resource reallocation from lower to higher productivity firms within New Zealand?

Q27

What measures could the business sector take to help New Zealand frontier firms get closer to the global frontier, improve diffusion from frontier firms, or support resource reallocation from lower to higher productivity firms?

Q28

Do you agree with the Commission's proposed approach to the inquiry? Where would you like to see the Commission put the most emphasis? Are there modifications to the proposed approach that would better fulfil the inquiry's Terms of Reference in your view?

Q29

Is there any other research underway of relevance to this inquiry that the Commission should be aware of? How could the Commission best engage with this work?

- Annual global competitiveness Index by World Economic Forum
http://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf
- IMD 2020 World Competitive Ranking – worth reviewing for the criteria used to rank countries, both in terms of government policies and private sector companies.

Q30

What are the top three things you would like to see come out of this inquiry?

- Influencing government to take innovation (rather than R&D) seriously through a more balanced investment strategy.
- Elevating management capability and organisation form and governance alongside innovation, diffusion and reallocation as broad drivers of productivity growth.