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PERSPECTIVES

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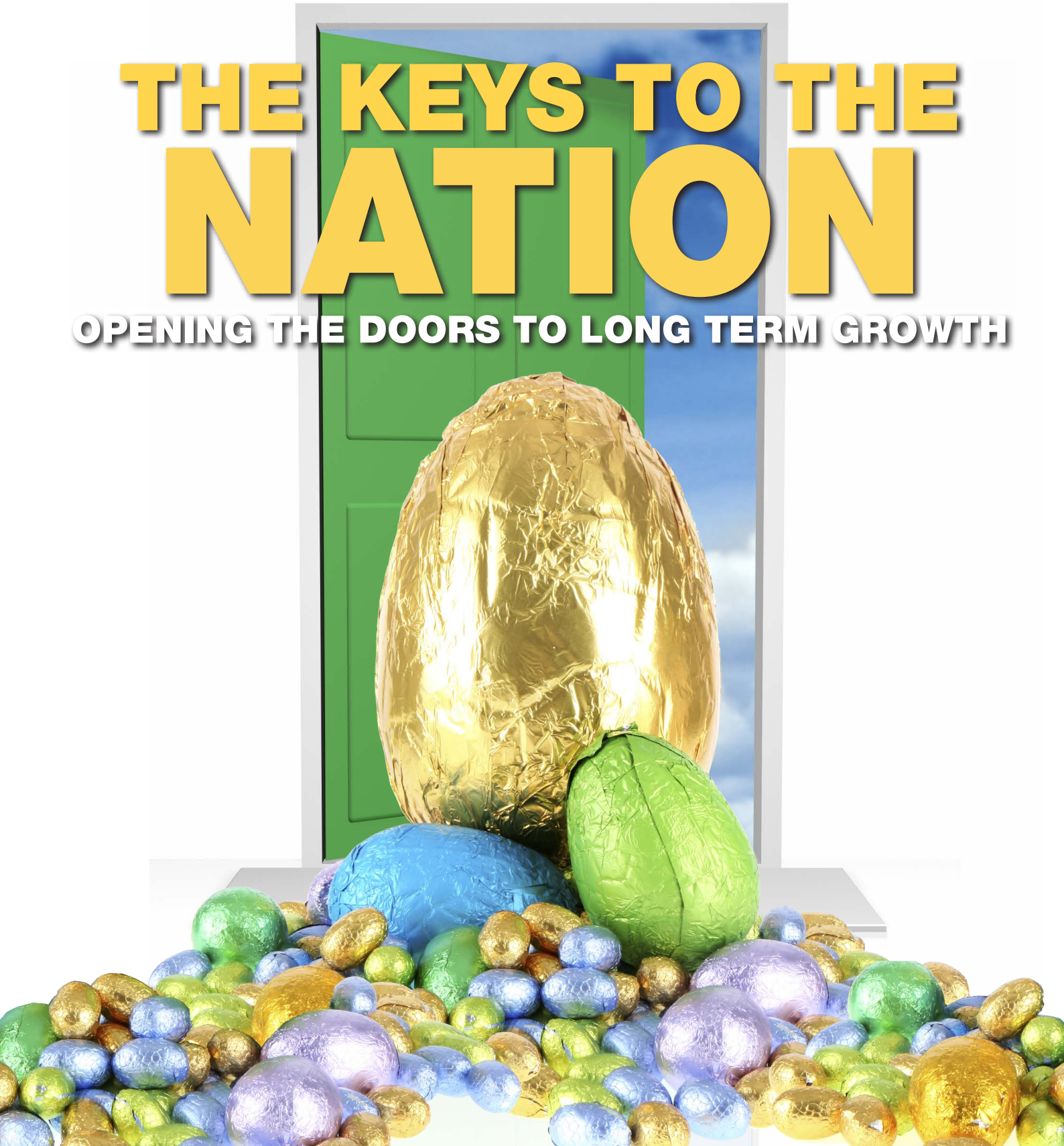
THE KEYS TO THE NATION

OPENING THE DOORS TO LONG TERM GROWTH



Australia is the only major developed nation globally to have increased its world ranking in terms of overall GDP since 2000. Over the last twelve months, the country reached an all time high of twelfth, having overtaken Spain, Mexico and Korea in the last couple of years. By market value, NSW alone is home to two of the world's top 20 banks, two of the top ten general insurers, one of the top five retailers and one of the top five stock exchanges. Meanwhile, Sydney is home to the world's most patented innovator (responsible for over 10,000 patents), and Australia is responsible for amazing innovation in technology (contributing to the development of wifi), one of the world's most successful business to business internet companies (Atlassian), revolutions in health care (the cure for the stomach ulcer and the cervical cancer vaccine), smash hit smart phone apps (Flight Control), and world-leading advances in agri-science in areas such as crop productivity and resilience.

Five new pillars of strength

In this article, we consider where to from here. How can Australia build new pillars of strength alongside resources to underpin the country's long-term development as the resources construction boom subsides? This is an easy question to ask, but the answers are much more challenging to imagine. To find them, we need to reflect objectively on Australia's true natural advantages when judged from a global and long term perspective. There are a number of significant areas of opportunity for Australia and we believe that policies to unlock these are key. In particular, we see significant potential for Australia to establish a leadership position globally in industries that will be critical to the longterm sustainable growth of our region for many decades to come. We consider the following:

• **Asia's organic grocer:** Australia has a unique opportunity to be the high-end, organic grocery store for Asia. Consider this: the same everyday milk that you purchase for a dollar a litre in the supermarket retails for many times that price in Beijing, as there it is perceived as a high quality product, produced in a safe and clean environment within a reliable and tightly regulated food chain. So what Australians see domestically as a low cost commodity product is a premium purchase in offshore markets. This applies in many categories of primary production, highlighting the opportunity to capture a substantial export price premium ourselves. More broadly, Australia produces food for some 60 million people, and has potential capacity to increase this by 40 million to feed some 100 million people.

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With Asia's population set to grow by one billion over the next thirty to forty years, however, the real opportunity for the country is to crystallise the inherent value of this production in the eyes of the top 5% of customers, not just meet 5% of the basic needs of a billion mass market customers. To achieve this, more than anything else Australia needs a strong national brand for its domestic agricultural production, which recognises the high quality and environmentally secure manner in which that food is grown and processed.

• **The NASDAQ of the Asia-Pacific:** Judged from New York or London, Australia is an attractive destination for a global financial hub. In particular, it is likely that three major stock exchange groups will emerge globally, driven by regulatory constraints in both North America and Europe. As a result, these three exchanges will each seek their own foot in the Asian time zone, to allow customers to trade seamlessly 24 hours a day. With Chinese stock exchanges unlikely to be available for purchase, this leaves three exchanges to be chosen from amongst Tokyo, the ASX, Hong Kong and Singapore. As we explored in *AFR Boss*, Sydney is particularly appealing as a global financial centre when you consider that Australia is home to the fourth largest pool of managed funds in the world, with strong net investment flows driven by the country's compulsory superannuation scheme. Moreover, no exchange in the region has yet truly claimed the title as "best Asian exchange for cross-border listings", despite significant effort by Singapore to build its offering in this regard.

• **InnovAsian Nation and Silicon Harbour:** Technology and innovation is already one of Australia's natural strengths – Asia does not (yet) have its equivalent of Silicon Valley, so Australia has every opportunity to be Asia's Silicon Harbour.

Australia has six of the top 100 universities in the world (according to the latest *Times* ranking), substantially more than any other country in the Asia-Pacific region

The country has seen amazing innovation within its universities and through other government and privately-sponsored programmes, but in nearly all cases the multi-billion dollar commercialisation profits have been earned offshore by overseas investors. If Australia's large capital pool and strong track record of investing in discovery-based projects such as resources could be re-tuned to focus on the analogous opportunities in technology and innovation, a globally significantly innovation cluster can be retained in Australia. As we explored in *Australia – The Asian Home of Innovation*, with the right investment framework, others from around the region would naturally gravitate to Australia, securing the country's position as the InnovAsian Nation.

• **Asia's university:** Australia's education exports are now greater than exports of almost any natural resource, and a committee chaired by NAB Chair Michael Chaney found that Australia's education exports could grow to $19 billion by 2020. International students already make up 20% of Australian university enrolments compared to 3.5% in the US, and the growth of a massive Asian middle class (projected to be over three billion by 2030) will create unprecedented demand for tertiary and VET courses. Australia has six of the top 100 universities in the world (according to the latest *Times* ranking), substantially more than any other country in the Asia-Pacific region. Just as we should focus on our premium agricultural offering – we should be looking to take advantage of our premium education offering – and build hospitality and tourism industries on the back of this growth opportunity.

• **The energy revolution:** Although Australia remains significantly dependent on coal-fired power, there is an opportunity for the country to follow China in harnessing renewable energy technologies to drive down energy costs over the long term. China embarked on this path years ago, and has already shifted 20% of its domestic energy production to renewable sources – eight years ahead of Australia's own 20:20 renewable energy target. Indeed in February, the China Energy Council reported that 96% of the net increase in generation capacity added in 2012 was renewable. Whilst in China's case, much of this capacity was hydro-electric, recent analysis by a *Bloomberg New Energy Finance* report in February 2013 suggests that the construction costs of new power stations may already be lower for solar and wind power than for new coal-fired power stations, even without a price on carbon. Moreover, Australia has significant natural reserves of the element thorium, which is at the heart of the much cleaner and safer thorium nuclear power cycle, currently under commercialisation in both China and the United States. Meanwhile, other proven technologies, including plasma fusion of waste (see *Free energy!*) offer alternative sources of energy that are substantially cheaper than legacy coal fired power. These developments highlight the potential economic and environmental benefits for both Australian consumers and industries of repositioning our energy supply chain.

All five of these areas offer real potential to drive significant growth in the Australian economy over the near term. In most cases, relatively little direct investment is needed, as the opportunities will be unlocked more by leadership and entrepreneurship than by pure financial capital. Ongoing growth of Australia's economy does, however, depend on the renewal and extension of the nation's infrastructure as well as other initiatives to drive improved productivity.

Five opportunities to supercharge growth

We recognise that significant and interlocking challenges lie ahead if the benefits offered by the above initiatives are to be realised. This places a high burden on our political and corporate leaders, as both need to balance day to day voter and market demands against the more weighty need to invest wisely to ensure sustainable long term performance and growth. Of course the best starting point for short term survival is a long term plan, but adhering to this approach takes real courage as the near term pressures mount. We see five areas as especially important:

• **Building Australia:** There has been unprecedented investment over the last decade in private infrastructure to support Australia's mining boom. Substantial public sector investment is now needed in basic infrastructure to support longer term growth. In particular, most major Australian cities now require major investment in rail and road infrastructure to ensure that adequate transport networks are maintained, and significant extension and renewal of social infrastructure such as schools and hospitals is also essential. To deliver all of this infrastructure in a cost effective manner, both federal and state governments will need to work together to ensure a highly competitive market for the provision of infrastructure construction services, and invest to ensure the most effective structures are used to finance such developments.

• **The digital continent:** Although Australia's national broadband network has been the subject of much heated debate, there is no doubt that very high speed point to point data networks will be at the heart of any successful digital economy over the relatively near term. As a simple example, data transmission volumes have continued to increase exponentially at annual growth rates between 35% and 40%, as they have done for over 30 years. It remains highly likely that data requirements will exceed the capacity that can be delivered using copper networks, even if the latter are only used for the last mile connection from pit to home, within five to eight years. Leaving aside the technical reasons for choosing fibre, the most fundamental opportunity is that fibre connections allow two-way $100MBs^{-1}$ connections. This means that both uploads and downloads over very long distances can run at the same speed as a corporate LAN.

Thus services previously only accessible over local area networks (such as remotely hosted email, as most people have in their offices), can be delivered remotely. In short, we see real opportunity in turning Australia into the first digital continent - the practical challenge is how best to maximise the reach of a national fibre network whilst ensuring delivery of the network to the majority of the population within the shortest economic time frame.

• **Train versus plane:** From a national perspective, east coast transport networks require some $75bn of investment, whether in a new high speed rail network connecting Melbourne, Canberra, Sydney and Brisbane, or alternatively to finance the construction of three new airports. To date, much of the discussion and commentary has addressed the rail infrastructure and airport capacity debates separately. But with over half of all Sydney airport's plane and passenger movements driven by journeys that would be replaced by a high speed rail network, we think a holistic train versus plane discussion is critical, as is consideration of the potentially beneficial impact on heavy freight transport costs. For those that have used the London – Paris – Brussels Eurostar/ Thalys train system, it is interesting to note that the journey from Sydney to Melbourne or Brisbane is very similar in length, and has brought about both better connections between the cities as well as significant productivity improvements for regular travellers.

• **Financing growth:** As a high growth nation, Australia remains significantly dependent on foreign investment to support its long term growth. This is not due to low savings (Australia saves slightly more than the OECD average) but rather that Australia's very high level of investment requires capital inflows. This has been the case for most of Australia's history. This has a strong impact on Australia's banking system, which is dependent on foreign sourced wholesale funding for a material component of overall funding. Meanwhile, a substantial amount of equity and debt finance will also be needed to build the infrastructure Australia needs to support growth. To address these challenges, Australia needs to find new ways to match the substantial volume of consumer savings in the superannuation sector with the demand from infrastructure projects and mortgage lenders for investment capital.

• **Getting fit for growth:** Australia has undergone a dramatic change over the last decade, with payroll and other costs having increased dramatically over a relatively short period of time. Unsurprisingly, many employers have become increasingly concerned about the impacts of labour costs and other restrictions on day to day productivity and overall competitiveness compared to other countries in the region. Indeed, a number of Australian companies have begun to invest large amounts of capital in overseas markets – seeing it as a significantly more attractive environment for the deployment of their capital. Whilst these decisions are to be welcomed in a free market sense, they highlight the risks to Australia's economy over the medium to long term of falling productivity and unsustainable growth in real wages. The underlying challenge is thus how best to utilise the skills in our workforce, and to reposition our economy towards higher value added activities.

The Lucky Country once again

We hear often that the people of Australia are not foolish and that they know what is good for their future. As a colleague of mine, Cassandra Kelly, said in a speech recently regarding leadership:

"The people of Australia are looking for leadership, corporate and political. They want financial security, and will be prepared to tighten their belts a little further if they can be shown the opportunity, vision and hope for future generations. Quite simply, they want to wake up in the morning and be proud to be Australian... to be able to say in a steady, confident voice that Australia deserves to be called the Lucky Country once again."

Australia is a big country, with substantial natural and financial resources, as well as exceptional human talent. We have a strong national balance sheet, low corporate sector borrowings and our dollar is at record highs. We need to make the most of our current strength to lay the foundations for strong, multi-sector economic growth over the long term.

By Cassandra Kelly and Nigel Lake

About Pottinger

Our clients say that we offer a completely different proposition to traditional consulting and investment banking advisors, seamlessly integrating true strategic thinking, commercial insight, financial expertise and execution excellence. Our assignments typically relate to one or more of:

- Strategy and public policy
- Mergers and acquisitions
- Partnerships and joint ventures
- Restructuring and capital advice

Our approach to every assignment reflects a fundamental belief that strategy, business and execution perspectives must underpin any business initiative if it is to be commercially successful and stand the test of time.

Together our team has advised on over 200 M&A and financing transactions, as well as many significant strategic advisory assignments. Our first hand experience covers most of the world's larger economies, and we are accustomed to working on complex assignments across borders and cultures.

We are highly regarded for our investment in people, most recently being profiled by the Australian Workforce and Productivity Agency as a role model for effective skills development in financial services. In addition, Pottinger is the only organisation ever to have won the ABA's "Recommended Employer" award for six years in a row.

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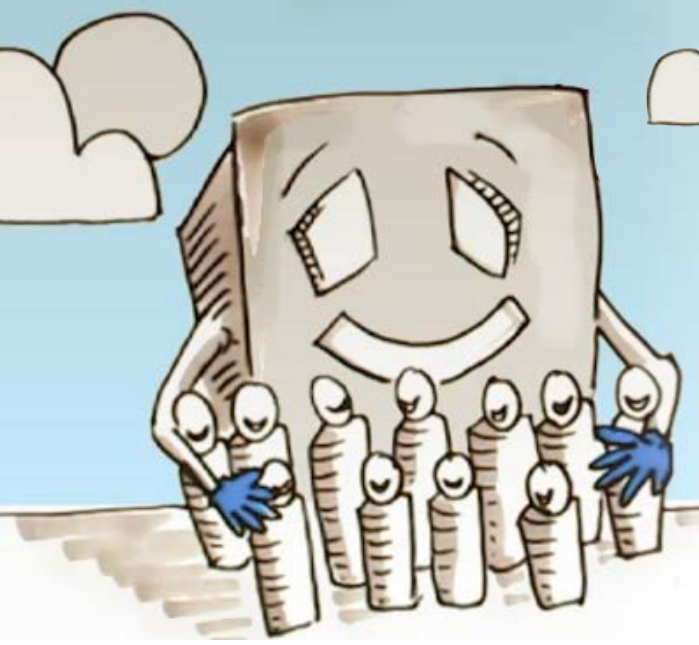

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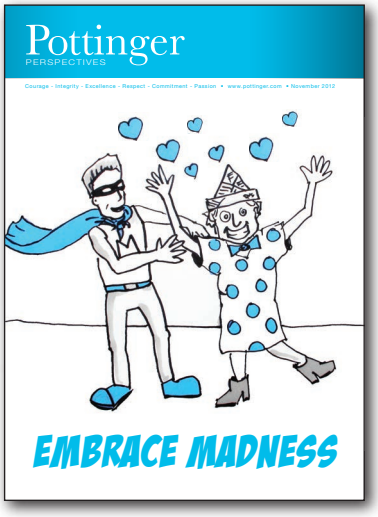

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Great companies stand out from the rest. They are leaders who drive the direction of entire industry sectors. They are more highly valued than their competitors. Their customers embrace them and loyally support them through thick and thin. And every management team wants their company to be seen as one of the greats.

But what does it really take to be a great company? The management books written on great companies refer to "competitive advantage", "sources of differentiation" and "customer centricity." The problem is that this jargon refers to ends, not means. Competitive advantage is not an ingredient of success, it is an outcome of the process of achieving market leadership. True leaders have several points of differentiation, but that description provides no insight into how a company goes about differentiating itself. Being "close to the customer" is a feature of great organisations, but what did they actually do to become customer centric?

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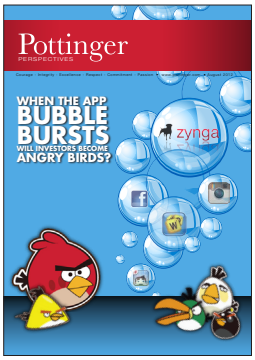

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