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LAWYERS

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Committee Secretary
Senate Standing Committee on Rural and Regional Affairs and Transport

Via email: rrat@aph.gov.au

Export Market Development Grants Legislation Amendment Bill 2020

Thank you for the opportunity to submit my views on the Export Market Development Grants Legislation Amendment Bill 2020 (the Bill).

By way of background, I have worked with intellectual property exporters for more than 30 years, particularly in the entertainment industry. I have been a Board Member of the Export Council of Australia, Australian Services Roundtable and been a legal advisor to the Federal Government.

The overwhelming majority of my clients are "born globals". They market to the world from inception. They will all be negatively affected by the proposed changes to the Export Grant Scheme. Instead of their current entitlement to 8 export grants, they will now receive 3. The quantum of each grant will reduce from the $150,000 paid in 2019, to a maximum of $80,000.

This reduction in grant entitlement for high growth born globals, is in direct conflict with the recommendations of Innovation and Science Australia 2030 "Prosperity Though Innovation" Report. It recommended increased Export Grant support for high-growth born globals as an imperative.

There is no discussion of intellectual property exporters in the Review of Financial Assistance to SME Exporters (the Review). In fact page vi of the Report (attached) fails to acknowledge that these industries currently qualify. It should be noted that under the provisions of Section 94 of the current legislation, born global clients who have already received 3 grants, may have no further entitlement to claim an export grant rebate i.e. our best and brightest exporters will be removed from the scheme.

Executive Summary

The Minister for Trade has stated that "the Bill maintains an entitlement grants program that does not favour an industry or export market".

In respect to born globals whose principal export is intellectual property, this is incorrect for reasons set out below.

The proposed new scheme has three stages:

Stage 1 is for those new to export, who have an established business in Australia and who are deemed export ready. They will be entitled to $80,000 over two years

Stage 2 is for expanding exporters with grants of $240,000 over three years

Stage 3 is for exporters who wish to expand into new markets with grants of $450,000 over 3 years

This type of scheme may suit the "model" exporter set out on Page 55 of the Report, namely "Rebecca, an established Australian whisky company leader looking to transform to export quickly".

However, it will not suit:

- a bedroom start-up like Atlassian who achieved sales to 13 countries before a sale in Australia;
- a feature film like "Lion" whose foreign revenue was 96% of sales in Year 1;
- "Bluey" the award-winning animated series whose global sales dwarfed its Australian income within 12 months of release;
- a musical group such as Five Seconds of Summer who achieved a Number 1 internationally selling album contemporaneously with its Australian release;
- an outdoor arena show such as Nitro Circus who sold out arenas internationally before they toured Australia or;
- hit theatrical shows like Boy From Oz or Dirty Dancing, where the Australian creators receive royalties from sold out seasons in overseas market.

All of the above exporters used the Export Grant Scheme to accelerate their international success.

How will born globals fit within the new Export Grant Scheme?

As they all have export income from inception, born globals **will not qualify** under Stage 1.

They will qualify under Stage 2 for 3 grants of $80k.

They **will not qualify** under Stage 3 as being born global, they do not have "new markets". They market to the world from day 1.

New markets is a very old concept that does not apply to the online world. In fact, the administrative complexity of "new markets" provisions, lead to them to being removed from the Export Grant Scheme in 2004.

Born globals will go from potentially 8 grants of $150,000 to 3 grants of $80,000 (US $54k i.e. US$38k after tax). The quantum of the proposed grant (when converted into US dollars) is unlikely to influence behaviour, the principal reason given for the Scheme changes. An exporter will have to submit export plans to Austrade for approval and then seek approval to amend them as market conditions change or new opportunities arise. This will be an administrative nightmare for these dynamic companies and an impediment to their export success.

A second problem is that born globals finance themselves from export sales. As they achieve export sales, they reinvest in marketing. As sales increase, the level of marketing increases. The online world is not the "static" world of Rebecca the established whisky maker in the Review. You often cannot plan 3 months in advance, let alone the 3 years in advance, as the proposed Stage 2 funding requires.

Under the proposals, a born global will need to show the ability to fund their 50% share of the grant they are seeking from Austrade. This will often be impractical. The reviewer incorrectly states on Page 15 of the Review: "While there are SME's that are born global, these businesses often have significant management experience and funding from the start of their operation".

I attach a quote from the Atlassian story to show the inaccuracy of this statement:

2014 JJC Bradfield Lecture by Atlassian Co-CEO Scott Farquhar, "A Start-Up Nation"

We began operations – not in a garage but in our bedrooms – in 2002. It was a pretty classic start-up experience. We had no capital to start with; we 'bootstrapped' ourselves with a $10,000 credit card loan. From our suburban Sydney bedrooms, we were global from day one. Because that's the way the world works now.

Our first two sales were to the UK. Our next three were to Sweden the USA and Germany. We sold to in 13 other countries including Puerto Rico and Slovenia before we sold to anyone in Australia. It is the ability for us to sell globally, and to sell online that has allowed us to grow without outside capital from $18,000 in sales in our first year to over $200 million last year. Only 6% of our revenue comes from Australia today.

It should be noted that there are many such start-ups who have chosen to locate in regional areas. The increase in internet speeds and Covid 19 has accelerated this trend. These exporters should receive increased Government support, not the reductions proposed under this legislation.

Take as an example our client (let's call them Photon) an app developer located in regional NSW. Photon has achieved sales of $500,000 in their first year of operation (2019/20). Their export sales were $432,623 i.e. 93% of revenue. They received an export grant rebate of $68,381. They have reinvested the profits into additional promotion with a view to a substantially increased rebate in 2020/21. Under the proposed changes, they (and all others like them) will be capped at 3 grants only i.e. just when they are hitting their straps export grant support will be pulled out from under them.

Additional Effect of the Changes on Intellectual Property Licensing

A common method of financing in either film, music or theatre is for the Australian licensor of intellectual property to borrow against its future royalty flows to co-finance international marketing. The Australian licensor's share is then deducted from their royalties via an offset. This allows the level of export promotion to be increased, which leads to an increased royalty flow back to the Australian licensor.

Under the proposed changes to the scheme, such deductions will no longer qualify as an eligible expense. Hence most of the entertainment industry will be negatively affected by the proposed changes to the Export Grant Scheme.

An intellectual property exporter may also incur substantial costs on international trademarks and /or patents. This cost is not reflected in the spending caps the new scheme imposes.

How Relevant Is the Report to Current Export Activity

Serious questions must be raised as to relevance of the Report to current export conditions. The writing of the Report was principally concluded prior to the global pandemic. On Page 9 the Reviewer notes "at the time of writing this report (early 2020)". Alarmingly it uses statistical analysis from the 2017-18 grant year to arrive at what support is needed going forward.

On Page 48 the Review notes " travel overseas and travel to attend trade shows are clearly the activities for which exporters prefer to receive financial support". This information was derived from an online survey completed by less than 3% of applicants. For most of my clients, the survey was irrelevant. They were not given the opportunity to lodge their own submissions, which outlined their particular circumstances.

The way exporters go about their business has changed for the foreseeable future. Using as a benchmark what happened in 2019, is not an accurate way to assess the needs of SME exporters today. The use of overseas representatives may increase, as will online marketing and virtual trade shows. Due to exchange rate variations, an overseas representative will cost significantly more, than the applicant undertaking marketing through travel and attending trade shows. For this dramatic change in circumstances not to be considered in the Review, is a major oversight.

Why Focus On Born Globals?

The principal reason the Export Grant Scheme exists is not to increase exports, rather it is to increase productivity through SME internationalisation. As the Report notes on Page 63;

"As exporters benefit from "learning by doing" their knowledge and access to technology "spills-over" to the rest of the economy. This can lift the competitive performance of all businesses and improve the efficiency of the Australian micro-economy. McKinsey Australia Research shows that businesses with international exposure have more than double the rate of productivity growth, and those businesses are more innovative".

The Reserve Bank has noted a collapse in productivity has led to a wages slowdown, saved only by a surge in prices for key commodities. It has urged investment in areas that would boost the economy and offset ongoing weak productivity growth.

For this reason the Innovation and Science Australia 2030 Report "Prosperity Though Innovation" had as an imperative increased Export Grant support for high-growth born globals. It found an increase in SME productivity through internationalisation, which directly led to innovation. Chairmen Bill Ferris said "export was proxy for innovation". He publicly called for the Export Grant Scheme's budget to be doubled.

The 2015 Lee Report into the Export Grant Scheme accepted KPMG Research which showed an economic benefit of $7.03 for each dollar in EMDG assistance. Notably 6 out of every 7 dollars, came from productivity gains. KPMG found the EMDG Scheme lead to increased tax receipts that almost offset the budgetary cost of the scheme. The economic gains through productivity growth under EMDG was higher than any other form of government assistance, including the Research and Development Tax Incentive. The Lee report strongly argued for a separate Export Grant Scheme for high growth companies that was better funded and would provide greater certainty of rebate.

"From Little Things Big Things Grow: Supporting Australian SME's Go Global", a detailed report in 2019 by the Joint Standing Committee on Foreign Affairs, Defence and Trade also recommended that the Government;

"assess the current funding arrangements for the Export Market Development Grant Scheme...including investigating strategies to better target the scheme towards high growth SME's".

One could question whether the principal Terms Of Reference of the Review namely "to provide assistance to SMEs that supports them to generate additional export sales" focused on the wrong reason for the Export Grant Scheme to exist.

Conclusion

To more than halve the export grant funding to high growth born global SME's as the Bill proposes, goes directly against the expert opinion of what is in the nations long term interests

A well-funded EMDG scheme for born globals based on existing but simplified guidelines, is the principal way we can correct (in the words of Industry Minister Karen Andrews) "years of missed opportunities of turning ideas into exports".

The Bill should be rejected with a request that any changes to the Export Grant Scheme do not adversely affect born globals.

Thank you for considering these matters. I would welcome the opportunity to appear before the Committee.

Yours sincerely

Warren Cross

SUMMARY AND RECOMMENDATIONS

BACKGROUND

The Export Market Development Grants (EMDG) scheme provides financial assistance to Australian small and medium enterprises (SMEs) with a turnover of less than $50 million. It aims to encourage them to create, develop and expand export markets for Australian goods, services, intellectual property and know-how.

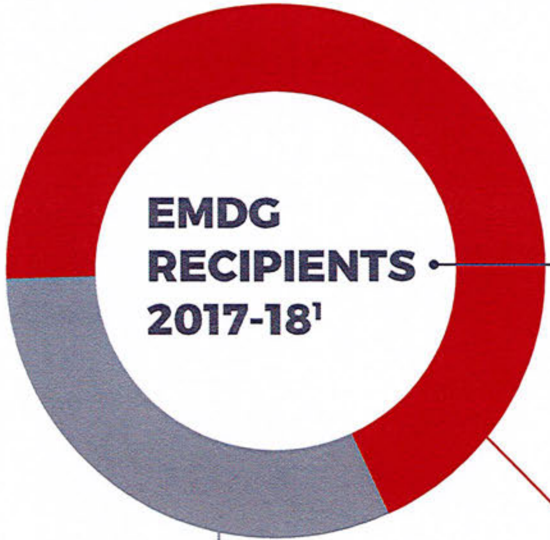
The scheme:

> reimburses up to 50% of eligible export promotion expenses above $5,000, provided the total expenses are at least $15,000

> allows for a maximum of eight grants of up to $150,000 (subject to available funds).

Industry associations and other groups can seek 'Approved Body status' to enable them to apply to be reimbursed for eligible export market development and promotion activities undertaken on behalf of their members.

More on the EMDG scheme can be found at **Appendix A**.



GENERATED **$3.8 BILLION** IN EXPORT EARNINGS

EMPLOYED **69,800** PEOPLE

WERE ACROSS **82** INDUSTRIES

EXPORTED TO **138** COUNTRIES

32% were **goods** exporters

Industries ranged from cereal, pasta and baking mixes, to iron and steel casting, and medical and surgical equipment

68% were **services** exporters

Industries were mainly education and training, tourism and related industries, and ICT services, while fewer services exporters were from forestry, aged care, architectural, financial and specialist medical services

NO REFERENCE TO INTELLECTUAL PROPERTY EXPORTERS

[1] Export Market Development Grants (EMDG) data for the 2017–18 Grant Year, where the grants were paid to recipients in the following financial year. Industry counts are based on ANZSIC subdivision level.

THE REVIEW

In October 2019, the Minister for Trade, Tourism and Investment, Senator the Hon Simon Birmingham called for a Review of the EMDG scheme, and of financial assistance to SME exporters under section 106A of the *Export Market Development Grants Act 1997*. The Terms of Reference for the Review is at **Appendix B**.

The following definitions are used in this report to describe the journey of an Australian exporter:

> *New to Export* – export-ready SME with an established business, doing business overseas for the first time

> *Expanding Exporter* – SME with established revenue from at least one export market, actively looking to grow their business (either within the current market or to new markets)

> *Established Exporter* – SMEs well-established in multiple markets, with plans to continue to grow export market activity.

EVIDENCE AND RESEARCH

Evidence for the Review was sought from exporters, individuals, industry associations, peak bodies and other interested parties in relation to the Terms of Reference. This included face-to-face sessions around Australia, workshops, online and written submissions. More information on the consultations is at **Appendix C**.

Research to support the Review included an analysis of EMDG administrative program data (**Appendix F**) and an analysis of the impact that financial assistance can have on an exporter using the Business Longitudinal Analysis Data Environment (BLADE). This research was commissioned from Swinburne University of Technology (see **Appendix D** for the methodology), with the evaluation concluding that EMDG assistance had a strongly positive impact on the performance of participating businesses, compared to receiving Austrade general services only.

A scan of international export assistance programs was conducted and a summary of government export assistance for SMEs – discussed later in this report – was produced in collaboration with state and territory governments. This journey map details the experience of a *New to Export* SME.

UNDERSTANDING THE MOTIVATIONS AND CHALLENGES OF EXPORTERS

The Review explored the reasons why SMEs decide to export and the challenges they face. While there are many motivations for starting to export – which vary between businesses and industries – the dominant reasons were to grow their business and reduce dependence on the domestic market. However, some businesses make a strategic decision to export, while others enter export accidentally.

SMEs reported facing a number of challenges when exporting, including the costs of doing business overseas (for example, access to capital, market-based compliance and distribution costs), and with building their knowledge and developing relationships.

Exports are aligned with higher company performance, as global competition can drive businesses to be more innovative and use modern technology and management practices. Research undertaken by the Department of Industry, Innovation and Science found continuous or persistent exporters outperform non-exporters.

IMPERATIVE 2

Industry

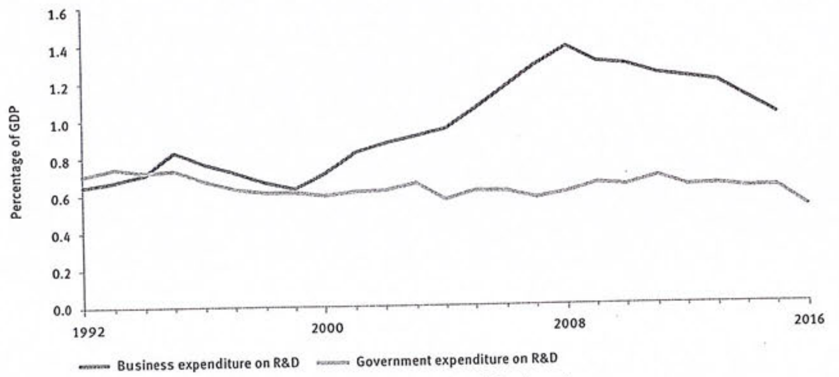
Ensure Australia's ongoing prosperity by stimulating high-growth firms and raising productivity

***ISA's vision** is that by 2030 Australia will accelerate growth and exports of Australian businesses by strengthening a competitive and productive business environment.*

Strategic Opportunities

- Business R&D investment can be increased by better targeting the Research and Development Tax Incentive (R&DTI) program, and increasing support for direct grant programs that target national priorities
- The growth of exporting firms, particularly young high-growth firms, can be encouraged by increasing Export Market Development Grants funding, and expanding and making better use of trade agreements
- The opportunities presented by the 'fourth wave' of the internet can be captured by strengthening Australia's digital economy including capability in Artificial Intelligence (AI) and machine learning
- Business productivity in all sectors can be facilitated by healthy levels of competition
- Australia's innovation investment and talent can be strengthened by improving access to global talent pools and fostering greater diversity

Figure: Australian business and government research and development expenditure, 1992–2016



BERD = business expenditure on research and development; R&D = research and development
Note: BERD has only been reported biannually since 2011. Data for missing years are an average of each adjacent year (e.g. BERD for 2012 is the average of 2011 and 2013).
Source: Australian Bureau of Statistics 2017, *Research and experimental development, businesses, Australia, 2015–16*, cat. no. 8104, ABS, Canberra, ‹http://www.abs.gov.au/ausstats/abs@.nsf/mf/8104.0›; Australian Government Department of Industry, Innovation and Science 2017, *Science, research and innovation budget tables*, DIIS, Canberra, ‹https://industry.gov.au/innovation/reportsandstudies/Pages/SRIBudget.aspx›.

One of the key challenges for this imperative is that innovation in Australia's firms, as measured by R&D expenditure by business, is lagging behind global peers, and has in fact been declining since 2008. ISA recommends that government should make it the top priority of innovation policy to reverse this decline.

Recommendations require the following actions:

6. Reverse the current decline in business expenditure on R&D by improved targeting of government support
7. Enhance efforts to help young firms access export markets
8. Prioritise investment in artificial intelligence and machine learning
9. Ensure healthy competition in knowledge intensive industry sectors
10. Strengthen efforts in talent attraction and skilled immigration