

# Ai GROUP SUBMISSION

**Inquiry into the trade system and the digital economy**

OCTOBER 2017

The logo for Ai GROUP, featuring the letters 'Ai' in a stylized, bold font above the word 'GROUP' in a smaller, sans-serif font, all in white.

**Ai**  
GROUP

## **Inquiry into the trade system and the digital economy**

### **About Australian Industry Group**

The Australian Industry Group (Ai Group) is a peak industry association in Australia which along with its affiliates represents the interests of more than 60,000 businesses in an expanding range of sectors including: manufacturing; engineering; construction; automotive; food; transport; information technology; telecommunications; call centres; labour hire; printing; defence; mining equipment and supplies; airlines; and other industries. The businesses which we represent employ more than one million people. Ai Group members operate small, medium and large businesses across a range of industries. Ai Group is closely affiliated with more than 50 other employer groups in Australia alone and directly manages a number of those organisations.

### **Australian Industry Group contact for this submission**

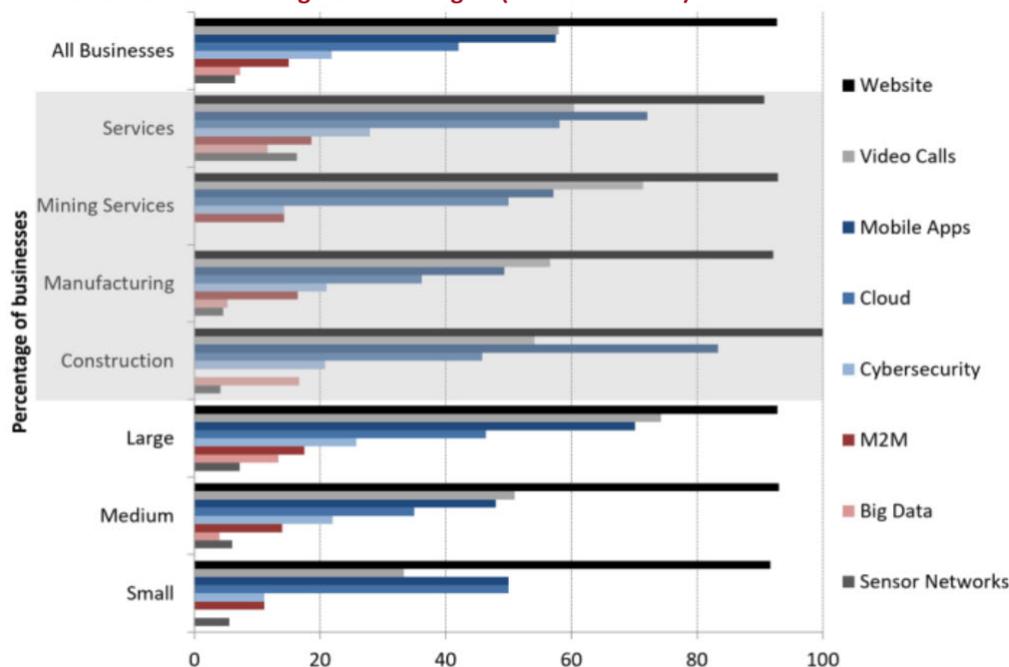
Louise McGrath – National Manager Business and International Advisory Services

**Inquiry into the trade system and the digital economy**

# 1. Summary

Digital technology has revolutionized modern trade and the products and services that we are able to sell to the world. Block chain Technology, Industrial Internet of Things (IOT) and electronic communication are all essential elements of a globally competitive industry. A common characteristic of all successful businesses is their ability to harness the benefits of digital technology to support their strategic goals. The chart below shows the results of an Ai Group CEO survey that illustrates that the use of digital technologies is across all sectors and all sized companies.

**Australian business use of digital technologies (% of businesses)**



Source: Ai Group

The democratizing nature of the internet has reduced the barriers that previously excluded small to medium businesses to global markets, exposing them to greater opportunities and risks.

The Australian Government has trade experts who are highly skilled in 19th and 20th century trade issues such as anti-dumping, quotas and tariffs. To protect Australia’s future economic interests, greater effort should be made to both recruit expertise in digital trade issues and develop internal talent within our Trade Negotiating teams. We are signing Free Trade Agreements today that are setting trade rules for technology that hasn’t been invented yet.

Australia also needs to be a strong advocate for the development of a structure and nomenclature within WTO and other multilateral bodies to address digital trade barriers. The multilateral infrastructure that supports global trade rules was created in an age when most trade was between two businesses, shipping a box of items between two countries using a global payment system that was first used on the Silk Route. Digital technologies have created a new world where businesses can sell direct to consumers using a trading platform developed in one country and housed on a server in a third country.

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# 2. Protecting our Digital Future

IOT refers to a digital ecosystem where everything connects and communicates, including inanimate objects like everyday devices and industrial equipment, and living organisms such as people and animals. With all these types of things connecting, they can form an entire network of things, resulting in a smart home, factory or business – or an entire smart city or global community. A UK Government study estimates there were about 14 billion devices connected in 2013, and predicts that there will be between 20 and 100 billion connected devices by 2020 across the globe.

The manufacturing sector is one of the top users of IoT, with 25 per cent of global manufacturers estimated to currently use IoT technologies. This is estimated to grow to over 80 per cent by 2025 and according to Deloitte's recent Tech Trends report, ambient computing (where real business value is extracted from the use of IoT) is one of the "exponential" technologies whose performance (relative to cost and size) will experience rapid growth, and create new competition and opportunities. In a recent World Economic Forum survey, 72 per cent of businesses believed that the development of IoT will be disruptive to their businesses and industries – and 79 per cent of businesses think those disruptions will occur within the next five years.

Unfortunately, our multilateral rules bodies have not kept up with the changes to the digital landscape, particularly when faced with protectionist barriers.

Recent action taken by China to pass Cyber Security Laws is a good example of the way governments around the world are introducing restrictions to trade and the free flow of data. While the stated motivation might be security, these new laws are a significant protectionist measure that inhibits innovation and disadvantages small to medium sized businesses. Businesses most at risk will be those with special hardware and systems for network management.

The rules state that companies operating in China must provide the government with their anti-hacking proprietary security hardware and software, which could then be passed on to relevant Chinese firms. And having access to the hardware and software means firms would have access to the data as well. The law also requires business information and data on Chinese citizens gathered within the country to be kept on domestic servers and not be transferred abroad without

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*Australis Engineering is a family owned materials handling equipment manufacturer established in Sydney in 1983. Recently they embraced the potential of IoT and now supply network enabled machines around the world. Providing an IoT enabled machine gives them a competitive advantage over 'dumb' machines as manufactures are demanding equipment that can interact with other components on an assembly line or can provide real time performance data. A significant part of their post sales service is monitoring the performance of those machines by accessing the data online and repairing machines located anywhere in the world. Should they export their machines to China once these new laws are enacted they would be forced to either ignore their competitive advantage and sell a 'dumb' machine or build and own servers in China, and share their intellectual property with a Government keen to support a local high tech industry.*

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permission. This means that Australian businesses who sell networked enabled machines to China will need to share their intellectual property and establish their own servers in China. In fact, all Australian companies with a physical presence in China will be impacted by these laws, particularly if they want to send intra-company communications back to the Australian head office. Members large and small with an operation in China have complained that they struggle to get clarity on China's domestic data security regulations and would appreciate advice and support from fellow Australian companies or Austrade.

Digital technology also has the power to improve the efficiency of international transactions, reducing costs and paperwork for all international traders. In 2016 the Commonwealth Bank of Australia was involved in an international transaction that used Blockchain, Internet of Things, GPS, smart contracts and a secure electronic distribution system to support the first completely paperless international shipment and financial transaction. Any changes or discrepancies were communicated to all parties in real time and the movement of goods and money were completely traceable. Traditional trade finance and international shipping is paper and labour intensive, contributing to a process where errors and delays are rampant.

These examples demonstrate that data is both a product and an enabler to improve international trade transactions. In all examples, companies are relying on the free movement of data across international borders using interoperable systems.

### Recommendations

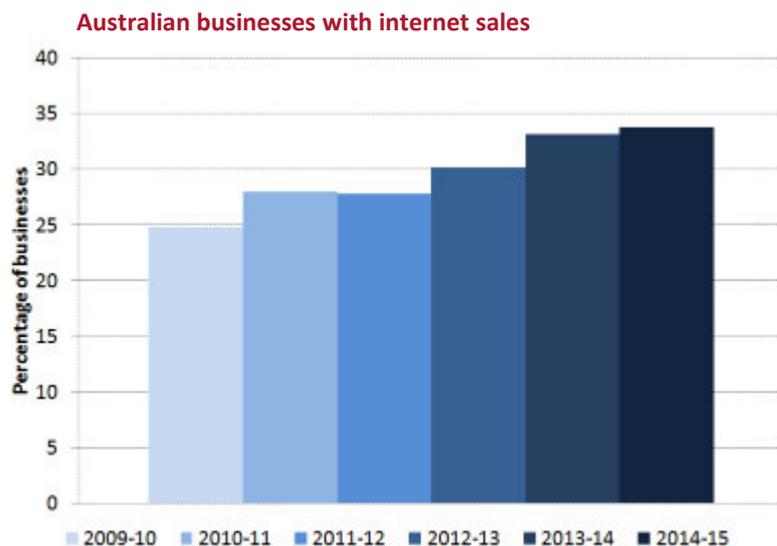
- **DFAT, Austrade and the Department of Industry should build internal capability to address emerging issues that may inhibit Australia's exports of digital technology and restrict digital communications for our global companies.**
- **Australia should be a global advocate for the creation of a multilateral framework for addressing restrictive digital trade barriers.**

## 3. Internet enabled exports

The Internet gives SMEs and firms enhanced scalability and better access to markets, financing, labor, skills, as well as new services and products, increasing their productivity and reach. However, the internet has not changed the fundamental rules of international trade nor removed the need to support SMES to develop sustainable business models.

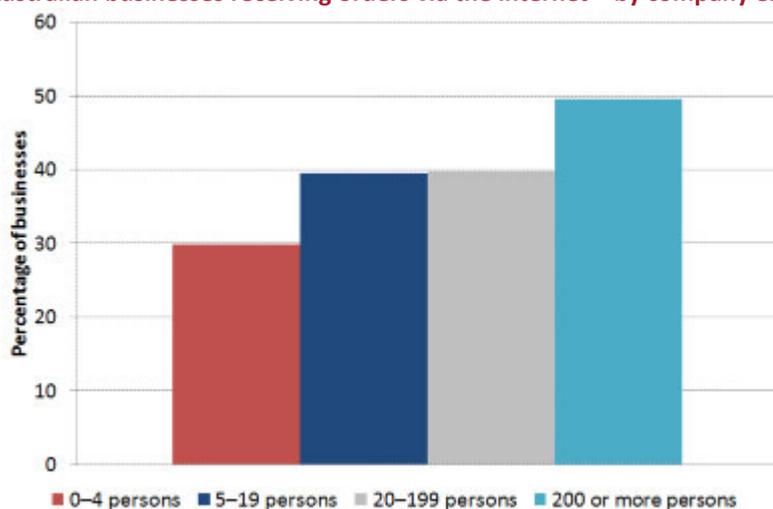
The growth of eCommerce activities has benefited from the increased availability of digital technologies. While there are many aspects to eCommerce, online sales are fundamental. In an Ai Group study into use of Digital Technologies, some 56% of respondent businesses said they had online sales, with the most activity reported by services (65%), and manufacturing businesses (57%).

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Source: ABS

### Australian businesses receiving orders via the internet – by company employee size



Source: ABS

By contrast, ABS data provides more conservative estimates, with 34% of businesses making internet sales for 2014-15 and only modest growth over recent years.

The differences may be attributable to the broader range of businesses surveyed by the ABS, including sole traders and non-employed businesses, which our survey did not intend to cover. There appears to be scope to considerably increase the proportion of businesses that generate revenue from online sales. For instance, although not explored in our survey, eCommerce activities such as social media marketing could also lead to increased online revenue. The ABS also estimates that around 34% of businesses now have a social media presence and there is clearly room to grow online sales activities through increased and improved use of social media.

SMEs require support from Trade facilitation services such as TradeStart to understand the mechanics of international markets and to harness the potential of online sales. Ai Group's TradeStart Advisers help exporters make informed decisions, gather and analyse information from

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a variety of sources to assist with market selection and liaise with Austrade's overseas staff and trade teams in Australia.

For Australian businesses that are ready to take on overseas markets, we provide the following trade services:

- Advice on doing business in international markets
- Help with international market selection
- Identification of relevant international contacts
- Assistance with market entry and expansion
- Identification and follow-up of specific international business opportunities
- Help with formulating an international pricing strategy.

E-commerce and the emergence of online platforms have made pricing strategies even more crucial as smaller exporters start to understand the value of cutting out middle men and selling direct to the consumer. A wine maker in Regional Victoria accessed Ai Group TradeStart advice when transitioning from using a consolidator into China, to going direct via an online platform such as Alibaba. Their revenue went from \$55 FOB Melbourne per case to \$186 FOB Melbourne per case, after taking out freight and commissions. The Chinese consumer was still paying a competitive price; however, the Australian company was able to capture a greater share of the value.

Online platforms, particularly those targeting the Chinese consumer, have also created a new business model, Daigou. Daigou are essentially a grey market of 40,000 to 60,000 “shoppers for hire”, buying to order on behalf of Chinese consumers. As informal as this salesforce might be, it still requires a strategy from exporters who need to protect their brand, market positioning and sales volume. This strategic development relies on advisors who possess current and innovative export expertise.

### **Recommendations**

- **Austrade has developed some amazing materials to assist companies to sell through China’s online sales platforms, however their general advice on their website appears to ignore the existence of digital technologies. They need to improve the capabilities of their internal and external advisor network and web based advice to include information on new forms of export, new risks and international digital compliance advice.**
- **The Digital Business Kit program, which ended in July 2017, could be extended and expanded to focus on providing digital business skills to existing and aspiring exporters.**

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# 4. Digital Skills

### Cyber security

Despite growing threats, use of and investment in cyber security technology is a relatively low priority for many businesses. This appears to be in stark contrast to trends overseas.

Cyber security threats are a growing risk management issue for many businesses. These threats are continually growing and evolving. If left unchecked, these threats may inhibit digital technology use and investment. Businesses that used cyber security technology had higher gross profit margins over the year (7% average increase for users versus a 1% decline for non-users; see Chart 2). That being said, responses to our survey suggest that cyber security technology is a relatively low business priority, both in terms of use and investment. This is concerning.

Our survey did not define “cyber security” and we can assume most businesses have access to basic cyber security protections such as off-the-shelf antivirus software or security features of standard operating systems. Noting this, only 22% of surveyed businesses reported using cyber security measures, with the highest users in services (28%), manufacturers (21%) and construction businesses (21%). Large businesses (26%) were more likely to implement cyber security measures, followed by medium sized businesses (22%), and a remarkably small proportion of small businesses (11%).

Surprisingly, few businesses (13%) nominated cyber security as an inhibiting factor for business investment in digital technologies. This may reflect a lack of consideration and awareness of cyber security threats and issues. This is in stark contrast to the trend overseas, particularly for manufacturers, where recent Boston Consulting Group (BCG) and McKinsey surveys show that cyber security is a major inhibiting factor for manufacturers investing in Industry 4.0.

While our survey did not explore the detail of corporate plans to manage cyber security (including training, education and governance), the low priority given by businesses suggests current cyber security systems across much of the Australian economy are potentially inadequate.

Consistent with the direction of our findings, a more indepth survey on cyber security governance by the Australian National University (ANU) found that there is considerable variation in governance and absence of cyber risk knowledge at the executive level.

For medium-sized businesses, ANU found insufficient executive knowledge of cyber risks, with just 58% of boards claiming sufficient knowledge and 46% rarely or never discussing it.

### Digital Transformation Agency

Ai Group supports the Federal Government’s previous Digital Transformation Office (DTO), which was aimed at improving the experience of Australian businesses and citizens dealing with the Government through more efficient and effective online government services. The digitisation of government agencies will create opportunities to streamline the way they collect and use data from businesses, and reduce compliance and regulatory costs for businesses and governments.

A challenge for the previous DTO was implementing projects in practice, since it was formed to demonstrate ICT solutions. The Digital Transformation Agency (DTA) should build on the work of the

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former DTO and improve engagement between more government agencies across the Commonwealth and States, as well as increase investment in ICT procurement. As the DTA builds its capability and strengthens whole-of-government digital strategy, the Government should be ready to increase and redirect investment accordingly.

### **Digital skills for business**

In an Ai Group analysis of business use of, investment in, and plans for digital technologies, we find that there are low levels of business use with respect to a number of digital technologies that are core to the fourth industrial revolution (or otherwise referred to as Industry 4.0 and more broadly the Internet of Things (IoT)); and that, while cyber security is a growing risk for many businesses, use of and investment in cyber security technology are considered a relatively low priority for many businesses.

Although digital technology investment is positive, there appears to be a disconnect between digital capabilities and businesses' strategies to drive growth. Related to strategy and investment, we also found that 17% of businesses plan to do nothing to improve technology skills.

Employee skills and perceived lack of relevance are among the major reasons that inhibit businesses from investing in digital technologies.

These findings suggest that businesses and the workforce would benefit from public support to help them realise the potential value of digital technologies, as well as in cyber security.

Those businesses not planning to improve digital skills may also benefit from support to understand the longer-term benefits of upskilling their staff.

### **Cyber Security Growth Centre**

Ai Group welcomes the Government's recent establishment of the Cyber Security Growth Centre (CSGC) and appointment of Craig Davies as its CEO, along with the government's allocation of \$31.9 million to fund the growth centre from 2016-17 to 2019-20.

The benefits of this initiative will be lost however, if the regulatory and policy framework does not strike the appropriate balance between risk and opportunity. The Federal Government's current cyber security processes need to deliver an outcome that is consistent with the objectives of the Government's revised National Cyber Security Strategy and NISA. Failure could mean that more companies move the investment and development of cyber security digital technology solutions offshore. Ai Group understands this was the experience in New Zealand, where more stringent legislative cyber security requirements led to some companies shifting their investment in research and development of innovative digital technologies offshore to Australia and the USA.

Along with the CSGC, we look forward to working with the Government on its various cyber security initiatives announced in the revised National Cyber Security Strategy.

- **Businesses need to maximise benefits from IoT and related digital technologies. Existing Government business capability initiatives may be helpful, including the Entrepreneurs'**

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**Programme and support for collaboration. However, there is still a gap in support for building workforce digital skills. A program similar to the recently closed Industry Skills Fund could offer a viable solution and should be reconsidered.**

- **Government agencies should be ready to increase and redirect investment in ICT procurement, once the Digital Transformation Agency (DTA) builds its capability and strengthens its whole-of-government digital strategy.**
- **Businesses could benefit from Government and industry support in increasing their cyber security skills and capabilities. Ai Group welcomes working with Government and industry to raise business awareness and facilitate business access to appropriate experts and existing initiatives for cyber security.**

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