



# Industry Action Plan

**NSW Professional Services**

**Industry Action Plan**

**Issues Paper**

# Professional Services Industry Action Plan Issues Paper

## Introduction

This paper is the first step of an ongoing dialogue with stakeholders to identify opportunities and challenges to local industry competitiveness and innovative capacity. Specifically this will inform the development of a 10-year Industry Action Plan (IAP) to support both the growth of the industry as well as its broader contribution to the overall competitiveness of the NSW economy.

This IAP, while supporting the overall competitiveness of the sector, will have a particular focus on: finance and insurance; legal and regulatory services; and engineering and associated services.

The Taskforce is seeking industry and expert input to help it deliver on its Terms of Reference.

## ***Terms of Reference***

At the end of one year (unless otherwise agreed), the Industry Taskforce will submit to the Deputy Premier for their industry, an Industry Action Plan that:

1. Outlines a vision and 10 year development strategy for the industry, including 2 year and 5 year goals.
2. Articulates a way forward to achieve the vision, including priority issues to be addressed (including, but not limited to, skills, regulations and regulatory barriers, innovation and productivity, R&D, infrastructure and policy reform).
3. Proposes ways to build stakeholder engagement and commitment in delivering long-term industry development needs.
4. Identifies drivers for and barriers to growth and innovation in the industry (including those caused by Government practices, as well as identifying specific issues facing regional businesses and SMEs).
5. Identifies and validates the key domestic, Asia-Pacific and global trends, opportunities and challenges for the industry's development (including for regional NSW and small business development).
6. Develops detailed recommendations and rationale of the strategies and actions proposed to be undertaken by industry, industry associations, educational and research institutions, and Government to encourage sector growth, enhance productivity and innovation, improve export performance and, where required, facilitate structural adjustment.
7. Identifies key performance indicators, progress and outcome metrics, clear benchmarks and timeframes for major initiatives to be included in the Industry Action Plan.
8. Clearly identifies roles and responsibilities for the delivery of the Industry Action Plan's recommendations, and oversee and report on the progress of its implementation.

# Professional Services Industry Action Plan Issues Paper

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# Professional Services Industry Action Plan Issues Paper

## 1 Executive Summary

The Professional Services (including finance) Industry has been identified as a key driver of growth, exports, and productivity and innovation for the NSW economy over the next decade.

### **Key Growth Drivers**

Access Economics' *The NSW economy in 2020: a foresighting study* identifies four megatrends that will influence the growth rate of our sector over the next ten years, namely: demand and competition from emerging economies, particularly in Asia, widespread adoption of ICT, Australia's growing and ageing population; and national and global policy actions to address climate change. Their modelling forecasts that the sector has the potential to develop into one of the most important exporters for Australia over the coming decade.

### **Opportunities**

Sydney's position as Australia's leading financial and professional services centre can be capitalised to strengthen its position as a centre of excellence in the Asia Pacific Region. However competition from within the region and domestically is strong. Sydney also has the opportunity to position itself as a regional centre for niche financial services, such as wealth management and project finance.

Our trade in financial and insurance services are low by international standards and there is considerable scope for further development. There is also scope to increase legal services exports considerably as developing countries grow and address climate change, resource and financial regulatory issues. Opportunities exist to build on our competitive advantage and reputation in regulatory services by providing developing countries with regulatory tools such as energy rating, trading and licensing schemes, know how and training to strengthen their own regulatory framework, particularly in areas of finance, and environmental management.

Our engineering and related services are developing rapidly in parallel with the resources boom. Specialist skills exist in water treatment, wastewater management, waste management and mine rehabilitation services. NSW also has strong capabilities in infrastructure and sustainable buildings. There are opportunities to not only grow the domestic market for these services, but to export these to the world.

International financial and professional services firms are entering the Australian market to tap into work arising from the energy and resources boom and cross-border work with a strongly growing Asia. Many of our leading firms have successful overseas operations.

### **Key Issues**

A number of common challenges and barriers exist across these subsectors, primarily relating to the regulatory environment, innovation and productivity performance, workforce and skills, export growth and investment. Developing

solution to many of these will span the responsibility of industry, industry associations, education and research organisations as well as Government (both NSW and Commonwealth)

Issues around the regulatory environment that affect the efficiency, competitiveness and overseas market access of NSW firms can include:

- Differences, duplication, and inconsistencies in regulatory requirements across states, countries and professions;
- Uncertainties relating to the regulatory and tax systems;
- Regulatory consultation processes, compliance, review and updating of regulation;
- Government procurement practices; and
- Increasing environmental regulation or “green tape”.

The Professional Services sector delivers high skill/high value output, and relies on investments in innovation increasing labour productivity and profitability. However innovation in the sector and how it lifts productivity is not well understood, particularly as the boundaries between high tech goods and services converge. The digital economy and response to climate change are key drivers of innovation in the sector. These drivers are facilitating information flows over large distances cheaply; reshaping business models; directing investment choices; delivering environmental solutions; and changing customer interactions. The sector is also capable of contributing significant innovation across other sectors of the economy. Key challenges for the sector are e-security, piracy, and protection of intellectual property.

Skills shortages and upskilling have also been identified as major issues that need to be addressed to support emerging opportunities and rapid sector growth over the next decade. With increasing specialisation, changing business models and upskilling related to the low carbon economy, greater coordination is required between industry and government on strategies to address current and future skill shortages. Our highly skilled workforce is one of our competitive advantages however emerging economies are developing their own capacity to move up the skill value chain.

Financial and professional services are predominately domestically focused, but have the potential to be one of our most important export sectors if the sector can increase its international orientation. However a number of challenges will need to be addressed such as behind the border non-tariff barriers to services trade, and access to finance for export.

This issues paper is the first step in the process of developing the Professional Services Industry Action Plan. The information presented here is intended to stimulate thinking on what industry and government could jointly achieve over the next ten years, the opportunities that would need to be taken, and the challenges that would need to be overcome to achieve an agreed vision for the sector.

## 2 Industry Vision and Growth and Development Targets

### Draft Vision:

Sydney is one of the top three leading financial and professional services centres in the Asia-Pacific, by being recognised as:

- The primary centre for international clients to access: project finance, project design and management, and project operations capabilities; and
- A leading global centre for wealth and retirement income management.

### 2 year Goal:

### 5 year Goal:

The Professional Services Industry Action Plan will outline a vision and short and medium term goals that industry and Government will aim for. The Vision and goals will require industry to build on its strengths including Australia's global reputation as a well regulated centre for services excellence.

To achieve the industry's Vision, Sydney and NSW will need to:

1. Further cultivate a **business and regulatory environment** that will encourage a vibrant and competitive industry, servicing Australia's sophisticated clients and industry needs.
2. Provide a business climate and institutional framework strongly supportive of **innovation and productivity** enhancing activities, and their adoption.
3. Ensure it is home to one of Asia-Pacific's most **highly capable and skilled workforces** by building on its strengths and through a leading role in the region's industry education, research, regulation and standard setting.
4. Achieve an increasingly globally and regionally connected and engaged industry supporting mutually-beneficial regional growth, measured by:
  - a. Maintaining/growing our percentage share of Australian industry **exports**.
  - b. Attracting increasing levels of globally and nationally mobile direct **investment**

1. What is your Vision for the Sector?
2. What achievements could be completed within two years and five years that would indicate we are on track to create this Vision?
3. In what specific service area could Sydney become an international hub / develop 'unique' strengths and capabilities?

### 3 Industry Action Plan Scope

The scope for the Professional Services Industry Action Plan is what is broadly defined as the Finance, Insurance, Professional and Technical Services industries<sup>1</sup>. The key sub-sectors proposed to be prioritised as part of this Industry Action Plan that make up the “sector” in this paper are:

- Finance and insurance;
- Legal and regulatory services; and
- Engineering and associated services

The Plan’s focus will build on Sydney’s standing as a globally recognised centre for finance and professional services and to improve local industry competitiveness and innovative capability and build on that platform to meet the increasing need for more sophisticated services domestically, within our region and globally.

The NSW 2021 State Plan identifies a number of targets and priority actions for this sector including targets and actions to:

- Grow critical industries such as professional services (finance, professional and legal) through the development of Industry Action Plans by June 2012;
- Increase business innovation by supporting high performing businesses to innovate to further enhance productivity through Industry Action Plans which will identify innovation drivers and barriers; and
- Position Sydney as a global financial capital and regional centre for international development finance.

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<sup>1</sup> Reference in this document to Finance and Professional Services is taken to mean the industries broadly covered by the ABS ANZSIC classification of Finance and Insurance and Professional, Scientific, and Technical Services. With respect to Professional, Scientific, and Technical Services, however, the scope of this Industry Action Plan will exclude certain professional and technical industry sub-sectors that will be considered as part of the Digital Economy Industry Action Plan. Specifically these are: advertising, computer engineering, and professional photography. In addition, Scientific Research Services will be covered by the International Education and Research IAP. This categorisation, however, is not to restrict the Taskforce in its ability to consider actions or issues in other industries where this is critical to the growth and competitiveness of the Professional Services Industry.

## 4 Industry Profile

Financial, Insurance, Professional and Technical Services within the scope of this Industry Action Plan collectively represent around 18 percent of the NSW economy in 2009 -10 and approximately 10 percent of total NSW employment. NSW employment growth for these industries has averaged 1.8 percent per annum over the last ten years to 2009–10.

Key sub-sectors of this industry in particular generate high value jobs, higher levels of profits and resulting taxation revenues. Average wages in the finance industry, for example, are 40 percent higher than that of Australian average earnings. While it represents 7.3 percent of Australia's GDP, the industry contributes approximately 13 percent of Australia's total taxation revenue.

Exports of these services have been rising with strong average growth of 4.2 percent per annum over the last 10 years. These services now account for 6.9 percent of total NSW exports in 2009-10. Key exports include:

- Legal, Accounting and Management Consulting Services. These account for 3.8 percent of total NSW exports in 2009-10 and have grown at an average annual rate of 7.8 percent over the last 10 years.
- Architectural, Engineering and Technical Services. These account for 1.0 percent of total NSW exports and have grown at an average annual rate of 8.1 percent over the last decade.
- Finance. This accounts for 1.9 percent of total NSW exports. Over the last 10 years this has grown at an average annual rate of 5.8 percent.

Sydney is the head office of many of Australia's key regulatory bodies, such as the Reserve Bank of Australia (RBA), Australian Prudential Regulatory Authority (APRA), Australian Securities Exchange, and Australian Securities and Investment Commission (ASIC). It is home to a number of important national institutions such as the St James Ethics Centre, Australian International Disputes Centre, the Centre for International Finance and Regulation, and the National Occupational Licensing Authority. It is also the head office location of many of Australia's leading industry associations, and headquarters to most of Australia's main financial institutions and insurers.

### Finance and Insurance

Finance and insurance is the largest industry in NSW, contributing \$58 billion to the State's economy in 2009 -10. NSW makes up 46 percent of the national finance and insurance industry and the NSW finance and insurance industry accounts for almost five per cent of Australia's GDP.<sup>2</sup>

Sydney is home to major financial institutions including the Commonwealth Bank of Australia, Westpac Banking Corporation, Macquarie Group Limited, QBE Insurance Group and Insurance Australia Group (IAG). New businesses continue to locate in Sydney, with the recent establishment of several offshore banks including China Construction Bank, Bank of Communications, Bank of Baroda, and Australia's first foreign central bank, The People's Bank of China.

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<sup>2</sup> State Accounts, 2009-10 (current prices)



## **Legal and Regulatory Services**

The six major law firms are expected to account for almost 13 percent of industry revenue in Australia.<sup>3</sup> The top areas of work done by Australian legal and related service providers were corporate law, banking / financial services, and dispute resolution. NSW accounts for 41.7 percent of legal services in Australia<sup>3</sup>.

Australian legal firms have a growing presence in key overseas markets, especially in the Asia-Pacific region. Furthermore, there has been a strong recent trend of global business legal firms establishing in Australia, and Sydney in particular. The latter has been driven by an increasing focus by European and North American legal firms to use Australia as a base for their engagement with the rapidly growing Asian markets.

There has been a growing interest in regulatory training and capability, with activities and institutions in Sydney including the Centre for International Finance and Regulation, ASIC Summer School, Macquarie University's Master of Banking and Finance Regulation, and the UTS Centre for Corporate Governance.

## **Engineering and Associated Services**

Engineering consultancy services have averaged revenue growth of 6.5 percent per annum over the five years through 2010-11, exceeding the pace of Australia's GDP growth (2.9 percent per annum).

NSW accounts for about a third of all engineering consulting firms in Australia with five major players holding 15.5 percent of the market share. The major locally owned firms generate a substantial share of revenue offshore and maintain a presence in the Asia-Pacific market. However foreign owned firms generate about a quarter of the industry's revenue.<sup>4</sup>

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<sup>3</sup> Legal Services in Australia – IBISWORLD L7841

<sup>4</sup> IBISWorld Industry Report L7823. Engineering Consultancy Services in Australia. June 2011.

## 5 Key trends and industry outlook

This section outlines broad industry trends, outlook, opportunities, and challenges expected to impact on the sector over the next decade and beyond, then examines each subsector in more detail.

Four key mega-trends were analysed in the Access Economics' *The NSW economy in 2020: a foresighting study*<sup>5</sup>. These were: demand and competition from emerging economies, particularly in Asia; Australia's growing and ageing population; widespread adoption of ICT, and national and global policy actions to address climate change.

### **Demand and competition from emerging economies**

Access forecasts that the demand from Asia for professional, scientific and technical services will increase leveraging off Australia's reputation as a stable country from which to conduct business in the region and Sydney's position as a global city. There are real growth opportunities in providing high levels of skills to support businesses in the Asia Pacific Region.

Access Economics' 2020 foresighting study identified the potential for expanded business service exports to Asia potentially through new markets and opportunities from Islamic finance, global middle-office operations, management consulting, and carbon accounting and compliance. Over the next decade, the development of emerging economies is expected to drive:

- Demand for infrastructure and construction activity, and its resulting increase in demand for resources;
- An increasing middle class, with resultant demand for more sophisticated goods and services;
- Improvements in education levels and training capabilities, resulting in improvements in skill levels within these economies. This will increase competition for NSW businesses in the production and supply of progressively higher value goods and services. Australia's competitiveness in exporting services into Asia has been based on a substantial advantage in skill and capability. Over the next decade, this advantage will fade, and advantages in specific capabilities will become of greater importance.<sup>6</sup>
- Greater foreign investment in Australia, either through mergers, acquisitions or greenfield projects generating demand for financial and professional services.

### **Australia's growing and ageing population**

An ageing population will create opportunities and challenges:

- There are likely to be future growth opportunities in Australia's funds management due to superannuation implications of an ageing population. Recently announced changes to the superannuation guarantee are projected to add approximately A\$500 billion to Australia's pool of superannuation savings.
- Opportunities will also increase across the region as wealth increases.

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<sup>5</sup> [http://www.business.nsw.gov.au/\\_data/assets/pdf\\_file/0006/5379/NSWEconomyin2020\\_Final\\_100917.pdf](http://www.business.nsw.gov.au/_data/assets/pdf_file/0006/5379/NSWEconomyin2020_Final_100917.pdf)

<sup>6</sup> Australian Services Roundtable 2010. *The New Economic Challenge: Responding to the Rise of Services in the Australian Economy*. A joint report by ACIL Tasman and the Australian Services Roundtable.

- Younger generations will also consume more financial services as there is a greater awareness of the need to build retirement savings without relying solely on the government.
- There will be increased demand for those that assist in the management of retirement incomes.

### **Widespread adoption of ICT**

The expansion of ICT is expected to have a significant effect on the industry. Increased off-shoring of back office functions can be expected as both a cost-cutting measure as well as in response to the increased international purchasing power of the Australian dollar. However it also provides a range of opportunities, including the potential to access new markets.

- While certain back and middle office functions may be offshored, NSW has competitive strengths in certain other high-value middle office activities, which in turn may be onshored from more expensive locations to NSW. This will also provide further opportunities for regional NSW to host advanced shared services centres.
- The adoption and widespread availability of high speed broadband can have a fundamental impact on the way businesses operate and provide services to customers. High speed and capacity broadband has facilitated the globalisation of a number of industries and increasing remote delivery of certain services.
- High penetration and use of mobile communications systems has helped to boost productivity and expand markets as well as introduced new business models and processes.

### **Actions to address climate change**

Community, political and commercial interest and actions to improve sustainability and energy efficiency are expected to continue. Early mover advantages and an ability to leverage locally gained experience will develop future competitive advantage and provide export opportunities. The establishment of a price for carbon and other measures will support new activities in the finance industry as well as in design, assessment, monitoring, and compliance.

For example, the proposed introduction of a carbon price and transition to permit trading will generate new opportunities. Ernst & Young<sup>7</sup> found that the introduction of a Carbon Emissions Trading Scheme would potentially bring an additional \$200 million in revenue to the NSW economy with an expected 610 increase in full time employment by 2020, including:

- 100 new jobs in banking and finance;
- 220 new jobs in business services industry; and
- 250 jobs in emissions trading industry.

## **5.1 Finance and Insurance Services**

Finance and insurance services are forecast by Access Economics to grow by 2.8 percent annually over the coming decade. Financial services represent approximately 71 percent of this subsector and look to represent a similar

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<sup>7</sup> Ernst & Young 2010. *Business Opportunities in a low carbon economy*. Final Report Industry and Investment NSW. 17 September 2010.

proportion to 2020. They contribute 11.5 percent of value added to the NSW economy, which is expected to grow slightly to 11.6 percent to 2020. On the other hand, insurance services make up 4.6 percent of value added, expected to represent a similar proportion or decline marginally over the next decade.

Back office functions such as call centres and help desks are continuing to locate in regional NSW. Centres based in the Hunter, Central Coast, Riverina and Illawarra are taking advantage of competitive business costs and stable skilled workforce.

Banking accounts for 59 percent of total financial institution assets<sup>8</sup> and continues to grow, with the recent establishment of several international banks in Sydney.

Australia's A\$1.7 trillion investment management industry is the largest in the region however the volume of funds under management that is sourced offshore is very low. There is considerable scope for development, particularly via export markets and entry or expansion of international market participants.<sup>9</sup>

Australia's exports of financial services relative to its size are low by international standards.<sup>10</sup> Finance and insurance services have the potential to develop into one of the most important exporters for Australia over the coming decade, given the prospective growth in emerging Asia.

Services firms are increasingly establishing foreign affiliates to deliver services to the world. The trend is particularly strong in finance and insurance, where Australian firms have invested \$71.1 billion to operate overseas affiliates.<sup>11</sup>

## 5.2 Legal and Regulatory Services

International firms are continuing to enter the market driven by a desire to tap into work arising from the energy and resources boom and cross-border opportunities within a strongly growing Asia.

Environmental and climate change law, and energy and resources, along with financial regulation in the wake of the GFC represent the growth areas over the next five years. Companies will increasingly require the services of regulatory specialists as they prepare for the introduction of any carbon emissions regulation. Demand for legal services for resource purchasing and research and development will increase given the rate of export of minerals, oil, coal, iron ore, gas and uranium.<sup>12</sup>

Business activities in areas such as corporate restructuring, cross-border mergers and acquisitions, intellectual property rights, new financial instruments and competition law are expanding. There is also increasing use of dispute resolution services.<sup>13</sup>

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<sup>8</sup> Reserve Bank of Australia, Assets and Liabilities of Financial Institutions and Non-Financial Sectors, Table B1 – Assets of Financial Institutions. Reserve Bank assets included as total financial assets.

<sup>9</sup> Australian Trade Commission. Investment Management Industry in Australia. Australian Government 2010.

<sup>10</sup> Australian Government 2008. Winning in World Markets: meeting the competitive challenge of the new global economy. Review of export policies and programs. September 2008.

<sup>11</sup> ABS 2011. Australian Outward Finance and Insurance Foreign Affiliate Trade, 2009-10.

<sup>12</sup> IBISWorld L7841 Legal Services in Australia

<sup>13</sup> World Trade Organisation. Legal Services Background Note by the Secretariat June 2010.

NSW continues to benefit from the capabilities and reputation of the NSW Supreme Court and the NSW registry of the Federal Court. NSW is also establishing a lead position in international and national arbitration and other dispute resolution. It is home to key institutions including the Australian International Disputes Centre and the Australian Centre for International Commercial Arbitration. The use of Sydney as a centre for arbitration and dispute resolution to resolve disputes in the region (and which do not necessarily have a NSW nexus) will be a key indicator of the strength and attractiveness of the local market.

Access to capital can also be a limiting factor for the global growth of NSW (and Australian) based law firms.

### **5.3 Engineering and Associated Services**

In Australia overall engineering consulting services are growing in response to the surge in infrastructure construction (particularly mining, energy and road and bridge construction), resources and environmental markets. Unfortunately however, with the exception of coal export expansion, this is not the case in New South Wales. As a result there has been a reduction in the engineering services capability in Sydney contrasting with strong growth in Perth and Brisbane. This expansion has seen a trend towards amalgamations and strategic alliances between leading consultancy firms. A number of these have significant global operations headquartered in Australia. The market also comprises many small to medium firms, contesting narrow geographic or specialist services markets. Outsourcing of engineering services has been a growing trend amongst large private and public sector corporations for efficiency gains.

IBISWorld expects engineering consultancy services revenue to grow an average 2 percent per annum to 2015-16, lagging behind general economic growth, reflecting a weaker demand from the non-building infrastructure markets, notably mining developments. Demand conditions are predicted to gradually decline from 2014-15, in line with the winding back of investment in start-up mining projects and downward trends in other key infrastructure markets.<sup>14</sup>

However a recent report for ANZ Bank by Port Jackson Partners<sup>15</sup> outlines the case that a global transformation is underway as economic growth shifts from the developed to the developing world. The report outlines the hidden opportunity in domestic and export support services on the back of commodity industry growth. Specialist service providers and suppliers covering most aspects of the commodity value chain could have domestic sales grow to around \$200 billion by 2030 with export orientated service providers positioned to extend reach beyond Australia's natural resources endowment.

A significant focus on energy efficiency across all sectors of the economy is needed to achieve the NSW 2021 State Plan targets to contain electricity costs through efficient energy use<sup>16</sup> and will require the expertise of a range of leading clean energy and environmental services firms, many of which are located in NSW.

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<sup>14</sup> IBISWorld 2011. IBISWorld Industry Report L7823 Engineering Consultancy Services in Australia June 2011.

<sup>15</sup> ANZ 2011. ANZ Insight Earth, Fire, Wind and Water: Economic Opportunities and the Australian Commodities Cycle.

<sup>16</sup> Relevant NSW 2021 State Plan targets are:

The sustainable building sector has the capability to reduce electricity demand and greenhouse gas emissions and drive significant economic development opportunities. Australia's proximity to neighbouring countries in the Asia Pacific Region provides opportunities for NSW's competitive strengths in environmental management services. The market for such services, which are often a non-core offering of large engineering firms, is rapidly growing due to the urban development of countries such as China. For example, half of the world's construction activity until 2020 is expected to occur in China. Buildings account for approximately 30-40 percent of China's total energy use and construction causes about 40 percent of air pollution, presenting significant opportunities for environmental management firms.<sup>17</sup>

NSW is home to approximately 80 defence sites and many defence platforms and assets whether they be ships, vehicles or aircraft, which require extensive through-life support to ensure they remain operational. Opportunities for engineering and other professional service companies are often found in the supply chains of defence prime contractors. The Defence Material Organisation's Support Services (DMOSS) Panel also provides companies with a standard arrangement to deliver a range of project management, engineering, logistics and procurement services to Defence.

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- Assisting business and households to realise annual energy savings of 16,000 GWh by 2020 compared to 'business as usual' trends; and
  - Support 220,000 low income households to reduce energy use by up to 20% by June 2014.

<sup>17</sup> Austrade powerpoint 'globally Green 3' from Green Cities Conference'

## 6 Industry Issues

There are challenges and barriers affecting the competitiveness, productivity and innovative capacity of the sector. There are also opportunities for future growth. Some of these issues are identified below, but will be further scoped during industry consultation.

### 6.1 Business and regulatory environment

Encouraging a vibrant, responsive and competitive finance and professional services industry will enable productivity gains, access to markets, and will also contribute significant value add to many other sectors of the economy.

#### Regulatory issues

Reducing the regulatory burden imposed by the various levels of government on financial and professional service businesses is important for productivity growth.

The Australian Services Roundtable's submission<sup>18</sup> to the Productivity Commission's review of regulatory reform noted that there were substantial unrealised opportunities to re-engineer regulation so as to enhance the role of the business sector, markets and international engagement across the full range of services sectors. Some issues raised by the Roundtable and the Productivity Commission's Annual Review of Regulatory Burdens on Business<sup>19</sup> include:

- Overlap and inconsistencies in regulation of businesses or occupations across jurisdictions;
- Differences in regulation across jurisdictions leading to excessive compliance costs for businesses that operate in more than one jurisdiction and impose unnecessary barriers to the movement of labour;
- Inadequacy of existing consultation processes including lack of transparency and participation, continuity, evidence of stated benefits and costs, and short timeframes;
- Greater reliance on international standards over domestically developed standards;
- Robust and auditable compliance regimes that are cost effective; and
- Regulatory uncertainty as a potential barrier to establishing markets.

Specifically, there has been a dramatic increase in actions needed to meet various jurisdictional environmental standards and compliance requirements. The NSW Business Chamber, in its submission to the Prime Minister's Task Group on Energy Efficiency, submitted that an uncoordinated, ad hoc approach to environmental standards could diminish the goodwill of businesses wanting to improve energy processes and also result in Australia losing competitive advantage in key industries.<sup>20</sup> While affected businesses are increasingly

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<sup>18</sup> Australian Services Roundtable *Response to the Productivity Commission's Regulation Reform Issues Paper* 5 August 2011

<sup>19</sup> Australian Government, *Annual Review of Regulatory Burdens on Business: Business and Consumer Services*. Productivity Commission Research Report August 2010.

<sup>20</sup> NSW Business Chamber 2010. *Submission to the Prime Minister's Task Group on Energy Efficiency*.

burdened by these 'green tape' processes, professional services firms may benefit by meeting demand for sustainability and environmental services.

### **Government Procurement**

Public sector procurement is a significant component of the economy. According to the NSW Auditor-General's Report to Parliament, in 2009 whole-of-government expenditure was estimated to be \$12.9 billion<sup>21</sup>, with over \$100 billion spent by all levels of Australian Government each year.<sup>22</sup> Government Procurement accounts for approximately 10-15 percent of GDP within OECD countries. Furthermore as one of the largest purchasers, the public sector can shape markets through demand side 'pull' factors, including its attitude towards creativity and innovation.

The Australian Services Roundtable<sup>23</sup> has identified the importance of reforming government procurement practices. While not specifically identifying NSW Government practices, issues included:

- Support for Australian access to global government procurement markets; and
- Address inflexibility in procurement rules that stifle innovation, control intellectual property and attempt to shift risk in ways that are not value for money.

A number of industry associations have sought the NSW (and other) Governments to adopt common – preferably international – standards, where appropriate.

## **6.2 Innovation and productivity**

Innovation and productivity are important drivers of long-term growth.

The Productivity Commission notes that “productivity is determined by: the available technology or know-how for converting resources into outputs desired in an economy; and the way in which resources are organised in firms and industries to produce goods and services”.<sup>24</sup>

Innovation is considered to be the main driver of productivity. Innovation represents actions that seek to introduce new or significantly improved goods and services, management, production and organisational processes and marketing channels to produce improvements in economic or commercial outcomes. It can increase productivity by increasing the efficiency of use of inputs or increasing the value added embedded in the good or service.

Providing a business climate and institutional framework strongly supportive of innovation and productivity will result in productivity gains for the sector and the economy.

Key catalysts that encourage innovation include customer needs, innovations in ICT, competition in the market place, and government drivers such as investment

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<sup>21</sup> Auditor General's report to Parliament 2009 Volume six *Department of Commerce* p.45

<sup>22</sup> Australian Procurement and Construction Council *Australian and New Zealand Government Framework for Sustainable Procurement 2007* 'Introduction' p.4

<sup>23</sup> Australian Services Roundtable, Response to the Productivity Commission's Regulation Reform Issues Paper 5 August 2011

<sup>24</sup> Productivity Commission's *Productivity Primer: Sources of productivity growth*, accessible at: <http://www.pc.gov.au/research/productivity/primer/growth>



in infrastructure, education and training.<sup>25</sup> The skills of employees and inter-organisational collaborative skills are also critical.

### **Closer integration with the delivery of goods**

The sector is based on high skill/high value output with investments in new technology increasing labour productivity and profitability. The boundaries between high tech goods and services are blurring, with services bundled with goods at point of sale.

### **Role of ICT in transforming business operations**

The digital economy drives significant innovation that can lead to efficiency and productivity gains creating new opportunities for NSW businesses through:

- Facilitating information flows over large distances with low transactional costs, changing the ways the sector relates to customers and reshaping business operations and consumer expectations;
- Effective acquisition, analysis and use of information, which has become a key determinant of business services performance;
- Transforming business models, enabling, for example, co-creation techniques to develop new or improved services;
- Rapid technology changes in areas such as hand held devices, back office processing and cloud computing; and
- Improved planning and operations, such as through increasing adoption of tools and techniques such as Building Information Modelling.

While open markets create opportunities for NSW businesses, there are also reduced entry barriers for interstate and overseas businesses with advances in ICT. Increasing uptake of cloud computing and data centres, particularly those offshore, have security implications. Concerns over data protection, piracy and intellectual property also remain high.

### **New opportunities created by the transition to a lower carbon-intensive economy**

Sustainability and the response to climate change will be key drivers of innovation in markets over the next decade as:

- Significant amounts of investment (eg power and transport) will be required to transition to a low carbon economy;
- NSW is positioned to drive growth in related low carbon economy business services, given its dominance both delivering such services and the high demand in NSW as the largest emitter of greenhouse gas emissions in Australia;
- Climate change will impact on the long term investment by fund managers and insurance brokers; and
- Engineering services will increasingly be used as a mode of delivery for environmental technologies.

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<sup>25</sup> Australian Government 2009. Services Sector Overview of Structural Change Industry Brief 2007- 8. p 74

## **Industry's role in supporting NSW-wide innovation, productivity and competitiveness**

The Professional Services industries also have an important role in enabling innovation and productivity – and through that the overall competitiveness of the NSW economy. The sector is recognised as contributing to innovation across the economy through:

- Supporting businesses adjusting to structural and cyclical changes. For example, this can include financing and advising on the introduction of new business models to enable businesses to access new markets by using technology to directly engage with new clients or remote delivery of services;
- Providing businesses with access to world class management, research and technology, and the capacity to tailor these to local needs; and
- Supporting the development and implementation of new tools, technologies and solutions for businesses to reduce costs and improve productivity.

However the role of innovation and R&D in lifting productivity in the services sector is less understood than in the goods sector.<sup>26</sup> This ambiguity may have an adverse affect on industry development and public policy responses to market failures in this area.

### **6.3 Workforce and skills**

The sector's workforce skills are high and are one of the principal reasons offshore companies base their regional operations here. A highly skilled workforce is essential to capture emerging opportunities, particularly relating to climate change, and support rapid growth into global markets over the next decade. Ensuring NSW is home to one of Asia-Pacific's most highly capable and skilled workforces will be critical. By building on our strengths and playing a leading role in the region's industry education, research, regulation and standard setting activities will provide further growth and development opportunities for the industry.

There are opportunities to build on NSW strengths in education and training of professional services employees, and to play a lead role delivering education and training programs within the Asia Pacific region utilising our major education and research institutions such as the Centre for International Finance and Regulation, Capital Markets CRC, and Macquarie University's Applied Finance School.

However there is a range of issues facing workforce and skill development that need to be addressed including:

- Skills shortages are likely to become more acute due to increasing demand for services, poor growth in new graduates, combined with an ageing working population nearing retirement – engineering skills development in particular requires strategic intervention to meet future needs;
- An increasingly mobile and specialised workforce impacted by overseas brain drain and internationally sourced skilled labour;
- Greater coordination needed between industry and government on strategies to deal with identified skills shortages;

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<sup>26</sup> Australian Government 2007. Servicing our future – Inquiry into the current and future directions of Australia's services exports sector. House of Representatives Standing Committee on Economics, Finance and Public Administration

- Forward planning essential to optimise workforce participation training for rapidly evolving business needs;
- Increasing demand on education and training providers to up-skill both current and future professionals; and
- Ambition of emerging economies to develop the capacity to move up the skill value chain.

## 6.4 Exports

The needs of emerging economies provide opportunities for NSW's Professional Services industries and which will help strengthen these economies' future prosperity. However, a number of challenges will need to be overcome to allow the industry to fully take advantage of these opportunities.

### **Barriers to translating strong domestic capabilities into export growth**

The ACCI reports on a number of suggested reasons why strong domestic capabilities have not been translated into growth in exports, including: "Australia's geographical distance from major markets, the lack of inclusion in a formal regulatory regime with trading partners such as in the European Union, and possibly a lack of commitment to trade by our services industries themselves".<sup>27</sup>

However, the ACCI and other industry associations have argued that the greatest factor is the range of trade services barriers that exist both within Australia and overseas. These non-tariff barriers are less obvious and can be imposed by either governments or professional bodies. However, the Australian Services Roundtable states that the economic significance of barriers to services trade, such as nationality requirements and restrictions on investing, generally exceed those for goods.<sup>6</sup>

### **Need for better industry data**

Measurement of service export is problematic and is still relatively rarely researched and relatively poorly understood.<sup>28</sup> A substantial proportion (estimated up to 65 percent of services exports in Australia) is not measured in ABS export figures. These are the services that are delivered through Australian owned affiliates offshore otherwise termed commercial presence exports (see *Appendix A: Estimates of Services Exports - Mode 3* for further information).

### **Growth in outward direct investment**

The Mortimer Report<sup>29</sup> noted that there has been a significant increase in Australia's outward direct investment in recent years, mostly in banking and insurance, concentrated in the US and UK and New Zealand. This has mainly been driven by the expansion of Australian businesses into other markets. A little under half of outward investment is in service-related industries. The review believes that reducing barriers to investment and services in markets in the Asia-Pacific region will generate significant benefits.

<sup>27</sup> ACCI (2011), *ACCI Services Industries Blueprint – Services: The New Economic Paradigm*, Page 80.

<sup>28</sup> Australian Services Roundtable 2008. *Securing Australia's Place in the Global Services Economy*. Submission to the Mortimer Review Export Policies and Programs July 2008.

<sup>29</sup> Australian Government 2008. *Winning in World Markets: meeting the competitive challenge of the new global economy*. Review of export policies and programs. September 2008.

## **Opportunities in International Development Finance**

With current Australian aid spending at \$4.3 billion, with a commitment to double this to \$8 billion by 2015 - and the potential to attract a larger share of the international development finance to NSW - there is an opportunity to work with the Federal Government and AusAID to develop Sydney as a leading international development finance centre. In addition, international aid and development agencies continue to invest in the region to strengthen internal governance arrangements and institutions and deliver economic and social infrastructure. Supporting these activities will provide mutually-beneficial results by facilitating the development of regional economies and institutions and providing export opportunities for NSW businesses.

## **6.5 Investment**

Attracting increasing levels of globally and nationally mobile direct investment can improve local industry competition and competitiveness. Globalisation of the sector will see greater services market integration with Asia and greater openness to foreign competition in Australia. Foreign competition is often an effective catalyst for driving growth in innovation and productivity, and can help to unblock persistent domestic impediments in local business's capacity to make productivity gains. For example allowing foreign banks to operate fully in Australia resulted in a flurry of investment by domestic banks in ATMs, computerisation and EFTPOS that massively increased their productivity and that of other sectors such as retail.<sup>6</sup>

The local establishment of foreign institutions and corporations can also be an important conduit for new business activity for local businesses servicing the needs of these new customers. It provides an opportunity for local businesses to be involved in these organisation's global supply chains. Recently several offshore banks have established in Sydney including China Construction Bank, Bank of Communications, Bank of Baroda, and Australia's first foreign central bank, The People's Bank of China.

### **Asia Pacific Financial and Professional Services Hub**

A significant opportunity exists to develop Sydney and strengthen its position as a centre of excellence in the Asia-Pacific region. Sydney has sought to position itself:

- as an ideal entry point for international companies looking to invest or expand in Asia Pacific;
- to capture greater share of increasing cross-border activity and emergence of new growth opportunities; and
- attract business partners to establish a foothold in NSW by investing in cutting edge research collaborations that will lead to commercialisation opportunities.

However there is strong competition from within the region and domestically to capture these opportunities.

## **Currency**

While beyond the ability of the NSW Government to influence, an important consideration is the strength of the Australian dollar. The appreciation vis-à-vis other global currencies (eg US dollar and UK Sterling), in which many international companies price their global operations, makes Australia less competitive when seeking to attract the global operations of international businesses to NSW.

The liberalisation of China's Renminbi (RMB) currency continues to gain momentum. The Chinese Government has sought to increase the use of RMB for international trade settlements and has established Hong Kong as an 'offshore RMB' market. However there is limited awareness of the business opportunities and wide range of products and services in this new market.<sup>30</sup>

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<sup>30</sup> Asia Society 2011. Trading with China: the rise of offshore Renminbi business. Asia Society AustralAsia Centre, Hong Kong Centre and ANZ March 2011.

## Appendix A: Estimates of Services Exports - Mode 3

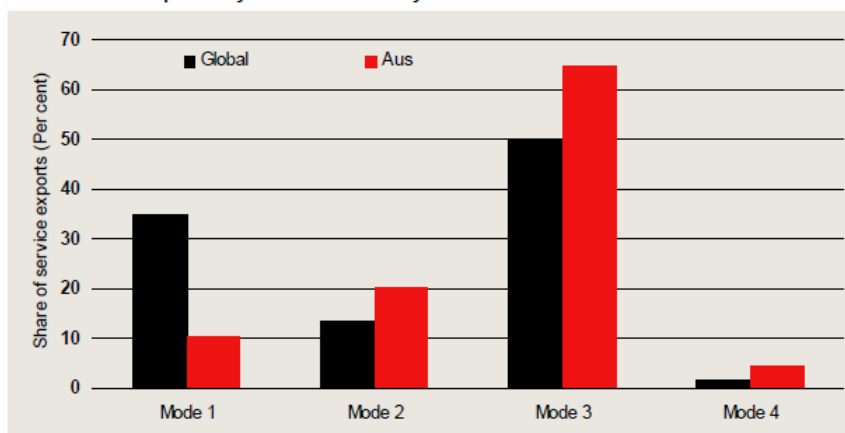
A substantial portion of services exports from NSW may not be documented nor identified in the above analysis. Services exports that are provided by Australian companies operating and/or registered overseas will not be identified as an export (in ABS 5368.0). This is called Mode 3 or Commercial presence exports (see table 1). According to WTO, around 50% of global services exports may have this character. For Australia, it is estimated that up to 65% of services exports may have this character.

Commercial presence means Australian companies operating overseas, remitting their profits to Australia. These companies may also be registered as businesses overseas or be involved in joint ventures. The closest available timely estimate of this export category performance is through FDI stock/flows. This indicates that FDI stock values result in export levels of around 35-39% of FDI. (See CIE, Quantifying the benefits of services trade liberalisation, page 9; see also ABS 5495.0, a 2003 estimate of Mode 3 totals)

Barriers to FDI are the main inhibitor of expansion in Mode 3 services exports. For the purpose of monitoring NSW service export performance, the mode 3 services export category is problematic for the following reasons:

- Inadequate centralised formal reporting, such as annual ABS statistics on export values.
- Australian companies providing services overseas are not necessarily NSW based. They have Australia wide and overseas shareholders. Only head office may be in NSW. Foreign earnings not clearly identified.
- Role of encouraging mode 3 services exports defers mainly to Commonwealth level trade negotiations.

### 1.2 Service exports by mode of delivery



Data sources: WTO; DFAT (2009), *Trade in Services 2008*, Market Information and Research Section Department of Foreign Affairs and Trade (July 2009); and CIE calculations.

Modes	Contribution (WTO estimate of global)
1. Cross-border trade: This most closely resembles trade in goods as it is conducted across national borders. Examples are international freight and insurance services on merchandise.	35%
2. Consumption abroad: Typically this involves the consumer of the service having to cross a national border to enjoy it. The most prominent examples are International tourists and international students.	10-15%
3. Commercial presence: This involves a supplier establishing an entity in another country to supply services to residents of the host country. Examples include international branch offices or agencies to provide services in banking, insurance, the professions, transport and telecommunications.	50% (65% for Australia suggested)
4. Presence of natural persons: This involves an individual travelling abroad temporarily to provide the service, for example, a consultancy assignment.	1-2%

<http://www.dfat.gov.au/publications/trade/Services-International-Linkages.pdf>

Services exports by country, for Australia: 25