Why are big businesses looking to start-ups for innovation?

Seven start-up practices your business can learn to become more innovative

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Summary

Innovation is no longer a buzzword. More than ever, it is a critical element in fuelling business growth and maintaining market share.
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Businesses today face a market of constant instability and disruption due to significant changes in customer behaviour, technology, regulation and demographics. This demands an innovative response from business otherwise they risk losing revenue and market share to more forward thinking, innovative and agile competitors. The question is no longer, why should your business innovate, but rather, in what ways are you innovating and how fast?

Successful innovation lies not simply in generating ideas, but in understanding the disruptions of today and tomorrow, in building an innovative culture and, most importantly, in efficient and effective implementation. This, in turn, needs to be supported by a well-designed process to ensure the right ideas are uncovered and successfully brought to market.

For many organisations, innovation is difficult to understand and execute. There remains a clear discrepancy between how big business and start-ups approach it. As a result, big business is looking to start-ups and entrepreneurs to identify disruptive ideas and opportunities for their business, and to unlock innovation through the spirit, blood, sweat and tears of entrepreneurship. It is no longer about David versus Goliath; it is David and Goliath.

Discussion points

In this paper we will:

1. explain the differences between how big businesses and start-ups innovate,
2. explore the business trends of working with start-ups, and
3. provide seven practical tips to help your business innovate.
The need to innovate

The commercial benefits of innovation are well known. Today, however, there is an added urgency in businesses’ efforts to devise and execute on new ideas. Increasingly, they are faced with the risk of disruption from many known and unknown sources. How businesses respond is critical to their continued success and ultimately, their existence.
The need to innovate

The decline of Kodak is a salient example. Once a global powerhouse of technology and innovation, and the original developer of the digital camera, Kodak is the often cited example of how a business can fail to effectively innovate and respond to disruptive technology.

Innovation is a core strategic goal for chief executives of small, medium and large companies in Australia and globally. In a 2013 global innovation survey, 91 percent of senior leaders said that innovation was a strategic priority and would be the biggest contributor of revenue growth over the coming years.

Yet big business often struggle to innovate. Many are not adept at turning ideas into valuable business propositions, particularly those that are disruptive and ‘game-changing’. As a result, many are looking to learn from start-ups – often through strategic partnerships – with some notable success.

The changing nature of innovation

Innovation can be defined as something new, improved or introduced that creates value. It can be summarised into two key elements:

2. GE 2013 Global Innovation Barometer.
The need to innovate

Innovation is not new to the world of business. Long before it became a buzzword, businesses were innovating. Thomas Edison and Henry Ford, amongst many others, are regularly referred to as pioneers of innovation in modern business. Experimentation, core research and development (R&D), innovation in process and breakthrough technology were the key drivers of taking new ideas to market.

Nevertheless, businesses’ approach to innovation has changed considerably over the years. The key difference today is the speed to market, largely due to the emergence of a deeply interconnected global economy and the hyper-connectivity of businesses and people enabled by the internet.¹

These trends, among many others, have empowered talented individuals (or entrepreneurs) and created conditions for the rapid growth of disruptive business models such as Uber, Salesforce and Netflix.² Many organisations have now shifted their focus from direct investment in core research and development, to investment in multiple sources of innovation, focussing in particular on the role of the customer, digital technology and start-ups and entrepreneurs.

Global trends driving changes in innovation include (but not limited to):

- **Mobile devices**
  
  anytime, anywhere

  Mobile devices mean individuals are connected and contactable anytime, anywhere and have the ability to perform all types of tasks on the run. This provides businesses the opportunity to reach more customers, through more channels.

- **Big data and cloud computing**
  
  more data than ever before

  The emergence of big data has allowed businesses to gain better insights and deliver better customer solutions. Big data is driving new business models and operational improvements and has helped business better understand customer behaviour. Cloud computing has enabled businesses to keep up with technological demands by allowing access to more processing power than before with minimal investment in infrastructure.

¹ Joined up Innovation, Microsoft, at https://enterprise.blob.core.windows.net/whitepapers/MSFT_Joined-Up_Innovation_Paper.pdf
² https://hbr.org/2014/06/whats-holding-uber-back/
Technology driving business growth

Technology driven companies have seen exponential growth in the past 10 years and they are here to stay. This is demonstrated by many high profile, billion dollar initial public offerings (IPOs) including Facebook, LinkedIn and Alibaba. In a recent global innovation survey, it was found that at least 50 percent of the top 20 most innovative companies were technology based companies, including Google, Dropbox, Netflix, AirBnB, Twitter, Apple and Amazon.6

Start-ups and entrepreneurs the time is ripe

It has never been easier to establish a start-up and launch a disruptive product or services into the market. Conditions are favourable for start-ups worldwide, with disruptive technologies and global megatrends driving innovation and opportunities for entrepreneurs. Established companies are also spurring the popularity of start-ups as they look beyond their organisations for innovative ideas.

The internet of everything smart and connected devices

The internet of everything, where everything is connected (people to people, people to devices and, most recently, devices to devices) was estimated to be a US$3.8 trillion industry in 2014.7 The latest technological devices, such as sensors, smart phones and Near Field Communication (NFC), are transforming the way we live, work, play and connect with each other and the world. Already these devices have resulted in a wide range of smart and connected devices such as wearables, home security, medical devices, thermostats and even jet engines. Apple’s recently announced Apple Watch is a great example of the improved connectedness and interactivity of a device with the world around us.

The customer power to the people

The customer has become the centre of products and services. The customer demands personalisation through convenience and customisation while also expecting to be able to interact with a company 24/7. In turn, businesses are gaining valuable insights into their customers based on an infinite array of data, allowing them to meet customers’ every perceived need.

The large scale usage of social media platforms such as Facebook, YouTube, Snapchat, Twitter and Instagram are also putting the power in customers’ hands by providing them with a platform to share opinions and interact anywhere, anytime, shifting the marketing paradigm along the way.

The company, Netflix, is an example of how disruptive technology can be successfully used to meet – or even exceed – customer expectations. Netflix has the customer demand, customisation and data at the heart of its business model, allowing it to improve the customer experience considerably. Its streaming movie service, together with other competitive products in the market such as iTunes, has uprooted the video chain Blockbuster, globally.8

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6 http:\/\/www.fastcompany.com\/section\/most-innovative-companies-2014
7 ‘Gartner says it’s the beginning of a new era: the digital industrial economy’, 7 October 2014, Gartner, at https:\/\/www.gartner.com\/newsroom\/id\/2602817
8 https:\/\/hbr.org\/2013\/11\/blockbuster-becomes-a-casualty-of-big-bang-disruption
Big business — open for innovation

Big business has been considerably challenged by the changing nature of innovation. To overcome this, many are establishing corporate innovation groups and are looking for new ways to innovate – internally and in the market. More businesses are looking to start-ups and entrepreneurs for ideas and solutions, to bring new thinking into their organisations and to challenge the status quo.
Innovation, by its very nature, is risky and involves failure. This does not sit comfortably with the approach of many big businesses. As businesses get bigger, their ability to innovate is often limited by their size and the processes and procedures developed to help them achieve their objectives and, importantly, to mitigate risks.

So how do established businesses step outside their traditional processes and procedures to foster innovation? One trend has been to set up internal corporate innovation teams. These are small and nimble and often look to draw on sources external to the organisation for the purposes of innovation.

However, internal corporate innovation can still be hindered by issues inherent in an organisation: the perceived risks associated with promoting new ideas, attachment to the status quo, and a lack of access to capable people with the time to build new ideas into workable products. Furthermore, given big business’ aversion to risk, many will wait until markets are developed before investing limited resources. This approach can however limit an organisation’s ability to develop disruptive innovation internally.

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9 A New Model for Innovation in Big Companies, at http://blogs.hbr.org/2013/11/a-new-model-for-innovation-in-big-companies/
Many corporate innovation programs have turned to start-ups and entrepreneurs for help in overcoming these challenges. Australian companies are among those organisations that have successfully used start-ups and their methods to improve their levels of innovation. A concept known as ‘open innovation’. They do this through a number of means, including some of the following.

1. **Accelerators and incubator programs**

These typically run for up to 6 months and provide mentoring, business coaching, and a co-working space to start-ups who have been selected to participate. Seed funding in the vicinity of AUS$20,000 to AUS$50,000 may be provided to the start-up in exchange for an equity stake of around 6 to 30 percent. This provides the business direct access to the start-up ecosystem, at the same time supporting the start-ups who may potentially become customers, suppliers or an acquisition.

A number of large Australian corporates have set up their own accelerator/incubator programs including:

- **Telstra** – Muru-D
- **ANZ Bank** – ANZ InnovyzSTART (now closed)
- **Optus** – Innov8 Seed.

There is also a growing trend for non-corporate backed Australian incubators shifting their focus from working directly with entrepreneurs to assisting Australian companies with their corporate innovation programs and helping them to work effectively with entrepreneurs and start-ups.

2. **Corporate venture capital**

Armed with big balance sheets and a need to stay ahead of emerging technology trends, large companies are increasingly diving into corporate venture capital for both strategic gain and financial returns. While historically big business tends to invest only for financial return, today the trend is to invest strategically in start-ups whose goals align with a business’ objectives. The intention is to acquire talent and innovative products and services at a lower cost than through research and development.

A number of large Australian corporates have set up their own venture capital funds to invest in start-ups including:

- **Westpac** – invested AUS$50 million in a venture capital fund called Reinventure with the goal to invest in adjacencies to Westpac and financial services in general to create strategic diversification. The fund’s founders have invested alongside Westpac. It has invested in Zetaris Corporation, in which Westpac took an equity stake investing AUS$1 million in seed capital into a big data analytics company. The deal highlights how the convergence of unstructured and enterprise data is becoming a digital battleground in the banking sector.

3. **Start-up acquisitions and alliances**

Big business finds it difficult to create disruptive innovation from within. Therefore, many are looking to acquire start-ups for their intellectual property, the product or service, the team, or the entire business. This allows the business to build innovation capability quickly while allowing the business to focus on its core competencies without disrupting the existing business model.

A number of Australian and global companies have adopted this approach, including:

- **MYOB** – recently acquired two start-ups complementing their current products, Banklink and Dovetail, an innovative start-up that provides online document collaboration solutions for accountants. The acquisitions are key to strengthening MYOB’s connected accounting vision by making cloud accounting easier for accountants and their clients.

- **iSelect** – acquired the infochoice, BidMyLoan and OnceLife businesses, all part of an Australian comparison-website market. The acquisitions are significant for the industry as it brings together two market leaders in online comparison, creating a one-stop shop for Australians looking for household and financial products and services.

- **Facebook** – acquired Instagram, fuelled by the desire to maintain relevance among the younger customer segment which was becoming increasingly disengaged.
Start-ups — disruptive by default

Start-ups are at the fore-front of innovation. They disrupt the market and represent everything big business isn’t. Start-ups embrace failure as they take on risks as a matter of course. How can your business replicate their success?
Start-ups — disruptive by default

According to research by the Harvard Business School, at least 75 percent of all start-ups fail. Yet failure is integral to the success of those that survive. By accepting the risk of failure, start-ups are truly free to innovate. The question is, what insights, if any, can start-ups offer big business, which avoid the very notion of risk?

A start-up is defined as a temporary organisation designed to search for a repeatable and scalable business model. In comparison, a business is a permanent organisation designed to execute a repeatable and scalable business model. This is why innovation within an established business is much harder than it is in a start-up.

Importantly, a start-up is not a smaller version of a big business. Start-ups, and entrepreneurs more broadly, embody the core principles of innovation to drive real commercial outcomes. Start-ups embrace failure and risk taking, a core requirement for successful innovation.

Start-ups regularly ‘pivot’ business offerings to best meet market demand. They can respond to challenges and opportunities with ease because of their agility. Start-ups, risk taking and failure, is now perceived as ‘cool’.

Never has it been easier for an entrepreneur to dream an idea, form a team, develop a disruptive product or service and sell it for US$1 billion (the simple story of Instagram). According to the recent StartupAus Crossroads report and the Economist, the start-up sector worldwide is exploding. Lower costs and accessibility to the building blocks for technology start-ups to launch is leading to more entrepreneurs tackling billion dollar markets than at any time in history.

13 © 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.
In Australia, there are many reasons for the growth in start-ups including (but not limited to):

1. **The prevalence of start-up programs - incubators and accelerators.**
   - There are now many independent and corporate backed accelerators and incubators in Australia. They are largely concentrated in Sydney and Melbourne, both comprising an increasingly dynamic start-up scene.

2. **Established start-up communities which offer learning and support**
   - Start-ups have formed communities where regular meet ups, co-working spaces and mentoring programs are offered, as are classes in programming, coding and design. Many of these communities can be found on social meet-up websites.

3. **Easier access to funding, including venture capital and crowd funding**
   - More dedicated Australian venture capital funds have emerged, which invest in new and emerging companies, products, services and technology. In late 2014 KPMG Australia and Artesian Venture Partners joined together to provide up to 1,000 Australian high growth start-ups with a new structure of support and capital, to expedite their business’ success.¹⁸
   - Other alternative sources of capital include Venture Crowd, an Australian-based crowd funding platform that was recently launched and allows individuals to make equity investments in start-ups.¹⁹

4. **Demand from big business and consumers for innovation**
   - The demand for new and innovative products by customers from traditional businesses is driving more partnerships with, and acquisitions of start-ups.
   - A common exit strategy for start-ups is a trade sale to a large organisation looking to innovate.

5. **Internet and mobile technology is enabling start-ups to rapidly innovate and disrupt**
   - The internet and proliferation of mobile computing devices has made it easier to establish a start-up and gain traction, providing start-ups with the ability to reach the 2.4 billion consumers connected to the internet.²⁰
   - Despite the threat posed by start-ups and nimble entrepreneurs to established organisations, there is a growing opportunity for big business to develop mutually beneficial partnerships with start-ups to drive innovation from within.
Seven practical start-up tips you can learn to become more innovative.

We have identified seven start-up innovation practices and outlined a number of practical tips you can adopt in your business to help improve innovation practices.
Seven practical start-up tips you can learn to become more innovative

1. Think big and follow your vision

What do start-ups do?
Start-ups are visionaries who passionately believe in their product or service and have a plan to scale up fast and grow to achieve the vision. They are constantly on the lookout for opportunities in the market.

What can you do?
Is your business vision and strategy big and bold? To challenge your current vision, try asking yourself and your team the following questions:

1. What is your reason for being in business?
2. When was the last time you updated your vision?
3. Do you communicate your vision with your customers and team regularly?
4. Does your team know and believe in the vision?

According to Peter Drucker, a statement should be: “...short and sharply focused. It should fit on a T-shirt... [and] says why you do what you do, not the means by which you do it.”

What do start-ups do?

Start-ups work directly with customers along each step of the journey, testing and validating key assumptions that underpin their ideas about the product and its market. Start-ups will ‘pivot’ the product or service based on their customer’s experience to ensure the product responds to their problems effectively and adds value.

What can you do?

For some time, business has had a habit of developing a concept, undertaking research and development, building a business case, and building a product or service for a market. The common problem is, not as many customers might want the product as you initially thought.

To help put the customer at the centre of your products and services, try:

- **Getting out of the building**—go out and talk to your customers by undertaking surveys, interviews, group focus sessions and reach out to your customers for insights on your social media or crowd sourcing platforms. Build the product around the customer and try to understand how your product or service will change their life.22

- **Walking in your customer’s shoes**—try to understand the customer’s experience as they interact with your products and services. A simple way to try this is to let your staff experience being a customer. For example, Airbnb ensures new hires appreciate what it is like to be the customer by sending them on a trip to a listed accommodation to document answers to structured questions. They then share this with the entire organisation.23

What do start-ups do?

Start-ups embrace failure, promote it and are responsive to change. They see failure as a learning experience to improve their product and/or business. Start-ups constantly tweak, pivot and iterate their business model, design, product or service to fit their market and create customer value.

What can you do?

Creating a ‘safe to fail’ environment in a business is not simple. Care should be taken to ensure it does not disrupt your existing business model. To help your organisation to embrace failure, not over invest, and create a ‘safe to fail environment’ consider:

- **Encouraging experimentation and innovation** by including specific experimentation and innovation Key Performance Indicators (KPIs) in your performance and rewards framework. Consider rewarding and measuring learning, not just results. What is not measured is not achieved.24

- **Adopting Lean Start-up principles** of ‘build, measure, learn’ which require short product development cycles, fast prototyping, early market testing to gain customer feedback, and using market data to iterate in the next build phase. Start by undertaking this on a specific project and measure the results against your existing product development process.25

According to Steve Blank “What matters is having forward momentum and a tight fact-based feedback loop to help you quickly recognise and reverse any incorrect decisions.”26

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24 https://hbr.org/2013/07/how-to-innovate-faster
25 http://theleanstartup.com/principles
26 http://steveblank.com/2009/04/10/good-enough-decision-making/

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What do start-ups do?

Start-ups collaborate by working in teams, sharing experiences and resources with other start-ups at co-working spaces. They also work closely with customers, suppliers, universities, and even competitors to form ideas and test and develop solutions that create value.

What can you do?

To open up your business to collaboration, new ideas and approaches internally and externally, try:

- **Crowdsourcing**—Obtain ideas, products, services and funding from a large number of people by publishing a business problem on your website, social media or purpose-built platform. Alternatively, approach parties for direct submissions.
- **Hackathons**—Run short and intense competitions where computer programmers form small, collaborative groups and are given confidential access to your data and the freedom to build any solution that leverages group creativity and problem solving.
- **Co-creation and partnering**—Collaborate with customers, suppliers, universities, private research institutions and the government for the purposes of research and development, design, development or marketing of products or services. This can even include accessing government grants and incentives for funding.

What do start-ups do?

Start-ups have smaller teams, which bring the right skills and allow agile decision making to increase the speed of the innovation process.

What can you do?

To help increase the speed of your innovation process, try:

- **Forming small, focussed project teams that can move fast (no more than four).** Generally in business, the bigger the issue, the larger the team we assign to it to solve or manage the problem. This can be restrictive and slow down the innovation process.

  A good example of the use of smaller teams is at Spotify, a music streaming service, where it divides its business into small clusters, called ‘squads’, and runs each like a start-up in its own right. Each focusses on a specific function and iterates to form a minimum viable product, a version of the new product which allows the team to collect the maximum amount of validated learning about customers with the least effort to release updates early and often.27

- **Creating a flat project team structure.** Provide the team autonomy to make certain decisions without needing to seek prior approval. Agree up front on the rules of engagement so the team understands the ‘safe to fail’ boundaries.

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What do start-ups do?
Start-ups get things done with limited resources by financing their venture through ‘bootstrapping’. They are motivated by the need to survive, often making just enough money to cover basic living costs.

What can you do?
To help improve the way you fund innovation in your business, try:

- **Setting up an experimental project that is run independently from the normal course of business.** Give the project a tight budget, a limited set of resources and an audacious goal. Set a team up, see how it tackles the challenge and what evolves as a result. GE did this with its FastWorks program. A newly formed team was required to create a functioning product in just three months that would become a fully developed product in 12 months. The team was small and had limited resources and funding.

- **Funding innovation projects based on results, not the calendar year.** Not every project or idea is going to turn into a successful project. It is therefore important to manage the resources you have and, if necessary, to discontinue the project early on to avoid wasting time and resources. Limit the amount of capital you provide to projects based on the outcomes they produce rather than a set budget for the calendar year. If the project is successful in achieving set results, the project can be further funded.

What do start-ups do?
Many successful start-ups embrace technology to compete in today’s digital economy. Technology enables them to reach global markets and customers rapidly while allowing for greater scale and the reduction of costs.

What can you do?
Your business can embrace technological change to lower costs, improve employee productivity, increase customer engagement and improve the customer experience.

Partner with or invest in those in the know such as software providers or technology start-ups for R&D or commercialisation where your business does not have the technological capability or existing technology solutions exist. This allows you to grow and learn faster than developing in-house technology internally from scratch.

Consider the adoption of new technologies in your business including (but not limited to):

- **Cloud** – Adopt cloud solutions for Information Technology (IT) resources such as applications, infrastructure and platforms through the internet. The cloud minimises capital outlay and is flexible as it allows you to add or remove IT services based on demand, reducing the need for local processing power and storage capacity.

- **Mobile** – Provide mobile devices and apps that allow your employees to be connected and perform sales or operational tasks anywhere, anytime and anyhow. Think beyond laptops, tablets and smartphones and investigate the realm of wearables.

- **Social** – Develop and maintain a presence on social media, create interest in your products and services, and engage your customers through Facebook, Twitter and LinkedIn. Monitor and analyse social media to understand customer sentiment and predict customer behaviour.

- **Data** – Make your organisation more data driven by investing in big data software that is used to mine for insights to help you make intelligent, fact-based business decisions. Make this data available in real time where appropriate and possible.

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29 https://hbr.org/2013/07/how-to-innovate-faster
Bluedot Innovation case study

“When we work with corporate partners and clients that understand the 'start-up' approach, there’s a unique opportunity to combine the agility and innovativeness of the start-up with the reach and resources of the established corporate. This is often a very potent combination.” Emil Davityan, Co-founder, Bluedot Innovation

Bluedot Innovation is an R&D and technology start-up co-founded by Filip Eldic and Emil Davityan in late 2012. Bluedot Innovation delivers a global location services platform called the Bluedot Point SDK. Bluedot technology powers applications for location-based commerce and social innovation.

Bluedot Innovation reflects the modern day relationship between the start-up community and big business. The company participated in the corporate accelerator program, ANZ InnovyzSTART. From this program, they received AU$20,000 in seed money, as well as networks and commercial and technical advice that placed them in a position to scale globally. Through this, Bluedot Innovation raised their first seed capital of AU$235,000 (at a AU$4.5 million post-money valuation) and used this to establish a development team, commence production of Bluedot Point and file further patents.

Following the initial product development phase of their enterprise product, Bluedot Innovation sought more funding from angel investors and were successful in receiving a Commercialisation Australia grant. In total, the company has raised over AU$3.5 million in funding and was most recently valued at AU$11.5 million.
According to Emil Davityan, co-founder of Bluedot Innovation, their success to date is due to the following five key principles:

1. **Global by design.** The product was available globally upon release and the company now has clients on every continent. Bluedot has ambitions to grow globally and the design of the technology can help the business achieve this goal.

2. **Everything is scalable.** Bluedot Innovation designs and builds globally scalable products from the start. They do not typically do custom work because it is difficult to replicate and is costly. By following this principle, Bluedot Innovation’s technology can already service 100 million mobile devices in a day with the current infrastructure capabilities.

3. **Embrace partnerships and collaboration.** Bluedot Innovation is not restricted to its team of eight. They look outside the business and ensure to build and maintain relationships with other businesses for custom solutions, payments, security, and privacy among others. Bluedot Innovation looks to work with businesses that share their vision.

4. **Embrace learning… quickly.** Bluedot Innovation looks to be both strategic in its approach and willing to test nearly every aspect of the business with external parties, including customers. Following the Lean Start-up model, Bluedot Innovation adopt a - build, test, fail, validate approach and constantly test the product with customers. They look to adjust rapidly and at the lowest possible cost. Bluedot Innovation’s founders are extremely careful about where they commit funding and run the company very lean but also identify the most critical areas to commit resources.

5. **Autonomous, smaller and flat teams.** Bluedot Innovation’s team combines smaller team size with creativity and execution by defining clear commercial objectives before the commencement of projects. Each team member is also empowered with a level of autonomy to decide how they approach their work which helps the team to deliver rapid results.
How we can help

KPMG Australia understands the drivers and forces that are requiring businesses to innovate. We work with our clients to grow and future proof their business and take advantage of the latest in innovative thinking and networks. We also work with our clients to develop and test innovation strategy and frameworks. Our own experience on the ‘innovation journey’ combined with our industry and academic partnerships, enables us to provide unique insights to organisations in both the public and private sector.

We assist our clients to innovate by:

- implementing or improving innovation practices, culture and processes,
- partnering with start-ups to develop new products or solutions,
- corporate venturing and investment in the entrepreneur sector,
- establishing and operate an open innovation platform, as well as
- searching for and acquiring new innovative or disruptive businesses.

Our deep industry experience and understanding of our clients, together with our investment we are making in innovation and the start-up sector, enables our clients to gain value from the start-up ecosystem.
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