DEAKIN BUSINESS SCHOOL

INSTITUTE OF PUBLIC ACCOUNTANTS®

AUSTRALIAN SMALL BUSINESS WHITE PAPER

OVERVIEW - 2018

About the Institute of Public Accountants

The IPA, formed in 1923, is one of Australia's three legally recognised professional accounting bodies with more than 36,000 members and students in over 80 countries. The IPA is a member of the International Federation of Accountants, the Accounting Professional and Ethical Standards Board and the Confederation of Asian and Pacific Accountants.

On 1 January 2015, the IPA acquired the Institute of Financial Accountants in the United Kingdom and in doing so formed the IPA Group which is now the largest small to medium enterprise focussed accounting organisation in the world. The IPA Group is an entity concept and refers to the shared infrastructure. The IPA Board is the governing body of the IPA Group.

The IPA-Deakin SME Research Centre

The IPA-Deakin SME Research Centre undertakes multidisciplinary research on small-and-medium-sized private businesses and not-for-profit enterprises.

Focusing on bringing together practitioner insights with world-class research, we provide informed comment for substantive policy development.

The evolution of the Centre began when the Institute of Public Accountants (IPA) and the former School of Accounting, Economics and Finance commenced the IPA-Deakin SME Research Partnership in June 2013, signing a highly-successful three-year research and consultancy agreement.

In 2016, the partnership expanded by bringing together researchers from the Deakin Business School and Deakin Law School to become the multidisciplinary IPA-Deakin SME Research Centre.

The Centre aims to build on its existing portfolio of research and consultancy for small-and-medium-sized private enterprises (SMEs) and not-for-profit enterprises (NFPs). It is also affiliated with leading international SME researchers and research centres, such as the Small Business Research Centre at Kingston University (United Kingdom).

The Centre's scope of activities includes providing submissions, reports, original research, thought leadership papers and its flagship *Small Business White Paper* in areas such as (but not limited to) taxation, retirement incomes policy, regulation, corporations law, financial services, competition policy, trade and investment policy, access to finance, access to justice, workplace relations, cyber security, sustainability and corporate governance.

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Foreword

Prof Andrew Conway FIPA FFA

In a crowded, saturated public arena, there has never been a more important time for thoughtful policy that builds on the best available academic research informed by practice. The methodology applied in this *Australian Small Business White Paper* combines a range of inputs to provide a voice to Australia's small business owners, advisers and researchers.

The publication of the second *Australian Small Business White Paper* represents a significant milestone for the IPA Deakin SME Research Centre and the policy dialogue for small business in Australia. The IPA prides itself on its long, strong association with small business – through more than 36,000 members and students we see and hear accounts of small business issues every day. We felt it was vital to bring these insights together with academic research to provide a series of policy options to policy makers, at all levels of government, to provide the framework for enhanced future prosperity which, unfortunately and alarmingly, is at significant risk.

This publication, which I have had the privilege of co-directing and editing, builds on the original *Small Business White Paper*, which was extremely well-received by policy makers around Australia and in markets like China and the United Kingdom. The first white paper was used by the Australian Government and many state governments to guide significant reforms. We anticipate that the recommendations in this second white paper will take the advocacy of small business to a new level.

Never before has there been such an assembly of informed academic research, together with practitioner insights. Perhaps today, more than ever, our economy needs to think bigger than ever before. Small business does not equate with small opportunity or narrow vision. Small businesses and our economy require policy solutions that promote small businesses with bold ideas. We therefore focus the recommendations on the theme of 'small business: big vision'.

This means we must encourage, at every junction, policy makers to have the courage to develop policies that deliver a seismic shift. There is one compelling reason for this: Australia's declining productivity.

We know, through our research, that Australia's multi-factor productivity (or our quality of life) is in decline. We face the disgraceful dilemma of potentially willing to future generations a quality of life that is worse than the one we currently enjoy. This would be the first time in our history that we are faced with such a prospect. The *Australian Small Business White Paper* seeks to jolt policy makers into action, to realise that unleashing the productive capacity of small business will boost our economy in ways we can only imagine. To do this requires policy makers to adopt the mindset of an entrepreneur – almost a 'nothing ventured, nothing gained' approach.

In other words, stop talking and start doing. Politics is the art of doing and we have an opportunity, informed by evidence and practice, to deliver real change. We recognise that small business will not be the panacea for the productivity crisis befalling Australia. However, it is a key part of the cure. We make recommendations in this paper for Australia to re-engage with the 'One Belt, One Road' initiative to ensure the maintenance of trade markets and ongoing competitiveness.

This document has been prepared with numerous inputs. I acknowledge the hundreds of small businesses who shared their insights at our consultation sessions which I was delighted to personally facilitate around Australia, from Darwin to Geelong. We gathered evidence from UK-based academics to inform the way we structured our recommendations. We also looked far afield to places like the OECD for insights.

The primary recommendation in this paper is a message to policy makers: think big, get out of the way of entrepreneurs, and watch small business truly drive productivity.

This *Australian Small Business White Paper* covers 12 topics which are, to an extent, interrelated:

- Productivity
- Regulation
- Taxation
- SME financial markets
- Workplace relations
- Job creation and job destruction
- Innovation
- Competition policy
- Family firms
- Internationalisation
- Mental health
- Digitisation and cybersecurity

The purpose of the document is, through the detailed findings, to make specific, targeted recommendations for policy reform here and now, while at the same time creating a platform for discussion on providing a clearer, bolder vision for the future of small business in this country.

We need to tell policy makers that it is acceptable to be bold in thinking and to generate a new wave of reform. We should begin with the 'big three' issues as key productivity enablers: tax, finance and competitiveness. The passage of the tax reforms in the United States on 22 December 2017 should give all stakeholders confidence that major reform is possible. What is required is mature, bi-partisan debate and a focus on productivity and boosting Australia's competitiveness.

In relation to tax, the three key recommendations are:

1. Broaden the base and lift the rate of GST (subject to appropriate equity measures)
2. Cut direct taxes
3. Undertake a zero-base design of a thoroughly modern taxation system.

We must, for the sake of Australia's competitiveness, initiate a conversation and deliver on the principles of a tax system that is simpler, fairer and more competitive.

What would it look like, for example, if Australia's GST rate rose to 15% and personal income taxes were slashed or removed for a new entrepreneur's first five years in business? What does a tax system look like that rewards rather than punishes people under the age of 50 for saving for their retirement? Why do we have excess contributions taxes for those wanting to remove the burden from the state in their retirement? What impact would a policy recommendation have that said: if you're on the minimum wage, you pay minimum tax? What about a tax rate that applied a tax-free threshold at $30,000 per annum and 15% for minimum wage earners? Or a tax system that rewarded entrepreneurialism, investment in health, education and supporting charities?

As a consequence of increasing the rate of GST, state and territory governments would have greater capacity to substantially reduce or eliminate key stamp duties and charges on transactions such as property transfers, vehicle registration and insurances.

Income	Tax rate
$0-$30,000	0%
$30,001 - $60,000	15%
$60,000 - $100,000	25%
$100,000+	35%

By increasing the disposable income of Australians on incomes under $100,000 per annum, the system could facilitate the removal (or substantial restructuring and simplification) of complex family tax benefits.

Deductions could be simplified to five broad categories: charitable, educational, entrepreneurial, health and investment.

For companies, the tax rate should be standardised to 25% across the board.

In such a streamlined regime, banks would be levied to fund an Australian growth fund to generate a pool of funds to initiate a surge in start-up businesses that may not ordinarily meet the requirements for traditional bank finance. This would complement a loan guarantee scheme that would support development in a particular industry or geographic location, to reduce reliance on already strained infrastructure.

Foreign investment in critical infrastructure may be matched by a dollar-for-dollar investment to reduce sovereign risk.

States and territories could be incentivised to reduce stamp duties, payroll tax and other charges that were committed to be reduced or abolished following the introduction of the GST, as documented in the Intergovernmental Agreement on Tax Reform.

Such charges and levies which serve to stifle entrepreneurship should be quarantined and directed to special state and territory infrastructure funds to grow regions and the capacity of the economy. If you like, they could form localised 'future funds', with a critical focus on growing the size of the segmented economies within the Commonwealth.

These are all topics for consideration – suggestions for deliberate measures to put on the table for discussion. They will no doubt attract widespread views. However, without a clear, bold direction for tax in Australia, we risk simply missing an opportunity to secure future sustainability due to the fiscal pressure applied by, among other things, our significantly aging population. Australia's tax mix is simply unsustainable and we hope, through this white paper, to put real concepts forward that provide quick wins and maintain our focus on the future.

To round out our calls for greater leadership at all levels of government, we believe the Commonwealth should play a key facilitation role. It is vital that we re-think our approach to small business policy with a view to the following:

1. An incoming government should commit to holding a small business summit within the first six months of assuming office. It is vital that we curate the brightest minds in research,

innovation, regulation, practice and policy to turn Australia into the world's best place to start and run a small business.

2. The Prime Minister should form and chair a small business advisory council that would provide direct policy options to government to inform the COAG agenda, with productivity at its core. This critical platform should follow the model set by many other jurisdictions in our region, with an eye towards the regulatory burden.

3. The Small Business Minister should remain in Cabinet, within the Treasury portfolio. This is critical to ensure the principal economic driver of the economy is central to the administration of government within a 'whole of government' agency.

4. An incoming government should conduct a zero-base design of Australia's tax system. From our understanding, such an activity has never been undertaken. This should be in partnership with the profession and researchers to develop an applied model for tax reform.

Finally, and perhaps most importantly, we seek to generate a new-level dialogue in relation to the importance of mental health and the wellbeing of small business owners and their advisers. We spend a great deal of time educating accountants and other advisers about the technical elements of small business ownership – however, we have not prepared advisers to look for the signs of mental ill-health or to promote a greater sense of personal wellbeing. One of the most staggering changes in the dialogue we have had with small businesses across Australia, compared to 2015, was how frequently we heard the issue of mental health raised. The prevalence of mental ill-health among small business owners and operators, particularly in regional areas, has prompted an urgent review of the body of evidence in this space. We have commissioned a separate, dedicated research focus on these issues, with a view to developing a suite of resources for accountants who, so often, are seen by small business owners as their first, most trusted advisers.

I would like to thank the co-contributors and authors of this white paper; namely the IPA's Ms Vicki Stylianou and Mr Tony Greco, Professors Nick Mroczkowski (Deakin University), George Tanewski (Deakin University), Peter Carey (Deakin University), Robert Blackburn (Kingston University UK) and Marc Cowling (Brighton Business School UK), Ms Rachel Burgess (Deakin University), Mr Arthur Athanasiou (Thomson Geer), Mr Wayne Debernardi (IPA Media and Communications team), Dr Vince Giuca (Partners-In-Business Institute), Professor Matthew Warren (Deakin University), Professor Andrew Noblett (Deakin University), Dr Geoff Speight (Deakin University), Dr Tunyar Kiaterittinun (Deakin University) and the many hundreds of small businesses and advisers who came to our consultation sessions across Australia and the UK.

In addition, I would like to thank and commend the IPA Deakin SME Research Centre Advisory Board – comprising The Hon Bruce Billson (Chair), Dr Michael Schaper, Ms Su McCluskey, Mr Arthur Anastasiou, Prof Nick Mroczkowski, Prof George Tanewski, Prof Barry Cooper and Ms Vicki Stylianou – for the Research Centre's guidance and leadership

We welcome feedback and discussion, and encourage you to engage with us as we release the second edition of the *Australian Small Business White Paper – Small Business: Big Vision*.

Small Business:
Big Vision recommendations

1. Broaden the base and lift the rate of GST (subject to the appropriate equity measures).

2. Cut direct taxes.

3. Undertake a zero-base design of a thoroughly modern taxation system.

4. Reform and simplify the personal income tax scale.

5. Standardise a company tax rate at 25%.

6. States and territories should be held accountable to the Intergovernmental Agreement on Tax Reform to eliminate payroll tax and stamp duties. These revenues should be channeled into a state infrastructure fund to grow the economies.

7. Commit an incoming federal government to hold a small business summit within the first six months of assuming office.

8. The Prime Minister should form and chair a small business advisory council to provide direct policy input and options to the government to inform the COAG agenda with a core focus on productivity.

9. The federal Small Business Minister should remain a permanent position in Cabinet, preferably with its own department.

10. The federal government should facilitate small businesses joining global value chains to remain competitive and access global markets.

Prof Andrew Conway FIPA FFA
Group CEO, Institute of Public Accountants
Adjunct Professor, Deakin University
Professor of Accounting (honoris causa), SUFE

Executive summary

Peter-John Lewis: Communications Specialist, Momentum Connect*

The focus of this second *Australian Small Business White Paper* – researched, written and published by the IPA-Deakin SME Research Centre – is on Australia's small business sector and how it can contribute to lifting our national productivity.

Productivity matters because, simply put, productivity growth is the primary determinant of income growth. As long as productivity remains stagnant, Australia faces a significant challenge in maintaining the nation's living standards.

The small business sector (as a huge component of the economy) has the potential to positively influence productivity growth. However, Australian small businesses now operate in an increasingly complex global environment of increased interconnectedness, interdependence, uncertainty and change. For this reason, and others, the sector requires support to become more innovative and efficient, to employ more people and to export more.

At the IPA-Deakin SME Research Centre, we believe government has an important role to play in positively influencing productivity growth, especially through supporting the small business sector with measures such as:

- Enabling and promoting access to affordable finance to improve the longevity of small businesses
- Implementing the Harper competition reforms to enhance the competitiveness of small business
- Facilitating education and skills development for small business owner-managers
- Updating regulatory settings over time, so as not to impede private sector investment
- Resisting protectionism and facilitating increased access for small businesses to international markets
- Fine-tuning innovation policy to reward collaborative research, support innovation diffusion and expedite the commercialisation of innovative ideas, especially in the technology space
- Reforming the taxation system to increase incentives and decrease disincentives to the establishment and growth of innovative small businesses
- Undertaking workplace relations reform to ensure the framework delivers consistency and stability to small business owner-managers
- Supporting small businesses in developing effective cybersecurity processes and systems, with the aim of preventing or mitigating potential security exposures to their operations.

*Other Chapter Contributors, Consultants, Advisers, and Case Study Volunteers (See page 69)

Non-state actors (such as multinational companies, civil society groups, private interests and individuals) also have a role to play, as they are increasingly able to influence the agenda and outcomes, often through the expert use of social media.

This paper contains a number of key policy recommendations, focusing particularly on assisting the small business sector in the areas of productivity and efficiency; regulatory overload; taxation; access to finance; workplace relations; employment dynamics; innovation; competition policy; family firm financing; internationalisation; SME owners' mental health; and cybersecurity.

1. RECOMMENDATIONS RELATED TO PRODUCTIVITY AND EFFICIENCY

To support the small business sector's ability to contribute to Australia's national productivity growth, the federal government should:

- Introduce initiatives to improve managerial capabilities in SMEs
- Review capital market efficiency to address the problem of 'zombie companies' (those businesses that require bailouts to survive), where too much capital is currently held
- Review the regulatory framework to reduce insolvency resolution times
- Encourage business start-ups to stimulate efficient, dynamic resource reallocation
- Conduct a sector review of the mining industry
- Conduct a competition review of the 'mining', 'manufacturing' and 'electricity, gas, water, and waste' industries
- Introduce initiatives to enhance technological absorption rates in 'older' firms
- Speed up the roll-out and increase the coverage of high-speed broadband
- Introduce supply-chain efficiency initiatives
- Introduce initiatives to enhance firms' marketing capabilities
- Ensure the education system produces enough STEM (science, technology, engineering and maths) graduates, and that the business sector can absorb them at an efficient rate.

2. RECOMMENDATIONS RELATED TO REGULATORY OVERLOAD

With an increasing number of small businesses concerned about the impact of laws and regulations on their ability to operate and innovate, we recommend that the federal government should:

- Continue emphasising the need for 'risk-based' regulation, so entities at a 'low risk' of non-compliance are not subjected to inappropriate, unnecessary regulatory scrutiny
- Continue contributing to the work of the OECD in enhancing global awareness of good regulatory practice
- Continue periodic reviews of regulatory agencies/bodies and statutory boards to ensure the public interest is well served
- Continue using the Office of Best Practice Regulation (OBPR) to ensure laws and regulations take account of small business needs
- Strengthen the use of small business regulation impact statements
- Ensure company extracts and financial statements lodged with the regulator are made freely available
- Facilitate the application of technology ('regtech') solutions, especially by small business, as a means of easing the regulatory burden
- Consolidate corporate and other registers, so small business owners can deal with one portal for all their compliance needs
- Pursue necessary measures to implement one regime for registration and regulation of charities and not-for-profits.

We recommend that the Australian Accounting Standards Board (AASB) should continue reviewing existing accounting frameworks to ensure they reflect community needs and maintain the integrity of the measurement and recognition requirements in international financial reporting standards.

We also recommend that preparers of special purpose financial statements should review the format of such statements (following changes made by international accounting standard setters to the conceptual framework).

3. RECOMMENDATIONS RELATED TO TAXATION

Taxation reform – to encourage entrepreneurs to start, run and keep their businesses in Australia – is an essential ingredient in ensuring a stable economic future for Australia.

We therefore recommend that the federal government should:

- Renew its commitment to a comprehensive tax reform process
- Realign our tax system to reduce its heavy reliance on individual and corporate income taxes
- Explore changes to the GST
- Explore the use of a parliamentary forum (such as a committee) to seek further stakeholder views on tax reform
- Investigate the potential implications of adopting tax incentives for new businesses, such as those operating in countries such as Singapore
- Explore options with the states and territories to either remove payroll taxes or ensure the laws and the way they apply are consistent across the country
- Ensure the smooth implementation of the single touch payroll regime
- Establish clear policy objectives for small business tax concessions
- Reform the tax system so that it provides targeted assistance towards stress points in a business life cycle, such as the start-up phase or during a temporary setback
- Remove incentives to complex business structures and consider the creation of a simplified small business entity.

In addition, we recommend a holistic review of small business tax concessions to ensure they are consistent and work collectively to support small businesses through all stages of a business life cycle.

We recommend that professional advisers should constantly promote the in-house facilitation process as a potentially effective, cost-efficient means of resolving tax disputes.

We also recommend a whole-of-government approach for small business assistance programs (accountants are well placed to deliver such programs, as they already act as advisers to small businesses).

4. RECOMMENDATIONS RELATED TO FINANCE PRINCIPLES AND ALTERNATIVE FINANCING

Given the importance of SMEs as significant contributors to (and drivers of) GDP, we recommend that the federal government should:

- Review its current policy settings for SME finance to ensure it follows world's best practice (as specified by the G20 and OECD)
- Provide appropriate incentives that encourage financial institutions to urgently re-examine their finance offerings for SMEs
- Initiate loan guarantee schemes
- Allocate priority funding to vocational education courses to enhance SME owners' financial literacy, business strategy and management skills
- Provide incentives (such as tax deductibility for education costs) to SME owners for financial literacy and business management education
- Fund research initiatives to support the work of the OECD in developing a generally-accepted definition of SMEs
- Support initiatives for the introduction of a new bank that services the specific financing needs of the SME sector
- Pass legislation allowing proprietary companies to take advantage of equity crowdfunding.

There is a need for clarity relating to the operations and legal aspects of crowdfunding in Australia.

Governments and financial institutions can address the finance gap through alternative finance models such as more asset-backed loans (including the recognition of intangible assets as collateral), project financing and leasing.

Governments, financial institutions and industry groups should also encourage SMEs to use alternative sources of finance as a means of bridging the SME finance gap.

5. RECOMMENDATIONS RELATED TO WORKPLACE RELATIONS

Small businesses owner-managers benefit from a workable workplace relations framework that delivers consistency and stability. They need to know how to operate optimally within the workplace relations system, but the system itself will not provide competitive advantage. However, how human resources (HR) are managed within the owner-managers' firms will be an important driver of (sustainable) competitive advantage.

We therefore recommend that:

- Continued effort is required to ensure small business owner-managers understand their legal rights and responsibilities with regard to workplace relations, for the purposes of managing their workforce in a fair, equitable manner and in a way that is conducive to a sustainable, productive work environment. To achieve this:
  - Easy-to-understand regulatory material needs to be readily available.
  - Small business owner-managers should be given the opportunity to make anonymous enquiries regarding workplace relations matters (to encourage more accurate, timely information flow).
- Regulators, at all levels of government, should continue to address and remain vigilant to compliance burdens. Regulatory requirements need to be simplified and associated cost-burdens minimised where they are unable to be removed.

6. RECOMMENDATIONS RELATED TO NET EMPLOYMENT DYNAMICS OF AUSTRALIAN SMES

Our analyses demonstrate that start-ups and young firms are important drivers of net employment in Australia and, when considering the effects of age and innovation together, we find that these factors significantly contribute to job creation and are important sales growth and performance differentiators.

Our results show compelling evidence that the innovation capability of start-ups and young firms underpins the observed firm-employment dynamics, significantly influencing employment outcomes in the Australian economy.

We therefore recommend that:

- An important policy objective is to identify start-ups and young firms that have innovation capabilities early, as these firms contribute significantly to net job creation.

7. RECOMMENDATIONS RELATED TO INNOVATION

Given that innovative firms (particularly start-ups) are known to create more jobs than other business categories, governments in Australia should do everything they can to assist businesses to understand the value of innovation and, where appropriate, provide financial and other incentives to encourage innovative thinking within the small business community.

We recommend that federal, state, territory and local governments should:

- Provide more support for research and development by small and medium-sized firms
- Promote better linkages between research universities and industry
- Provide more support for firms to adapt existing technologies and innovation
- Develop and implement measures to help the spread of existing innovations to a broader range of firms
- Encourage firms to adopt 'continuous improvement' methods to embed incremental innovation.

The federal government, in particular, should:

- Provide tax breaks for companies acquiring new technologies not developed in-house
- Develop a 'matching' service to promote collaborative relationships between multinational corporations and Australian businesses, both domestically and abroad
- Provide a tax allowance for companies that invest in intellectual property protection (through patents, copyright, trademarks, design rights etc) in-house
- Provide tax allowances for companies that generate licensing income for in-house new technologies
- Rigorously continue with its 'patent box' initiatives, as outlined in its current reform agenda
- Further develop government procurement initiatives to ensure small business procurement targets are met and exceeded by 2022
- Allocate funds for further research into youth entrepreneurship in Australia.

8. RECOMMENDATIONS RELATED TO COMPETITION POLICY

To fully give effect to the new competition law provisions for the benefit of small business, we recommend that the ACCC should:

- Bring cases on the new provisions as quickly as possible to provide clarity on how they will apply in practice
- Apply the amended misuse of market power provision to exploitative practices as well as exclusionary practices
- Produce tailored guidance for small businesses on the new concerted practices provision
- Produce separate guidance on concerted practices for industry associations and their members.

The small business community should also consider lobbying the ACCC for a class exemption in relation to identified common commercial transactions that are technically at risk of breaching competition law but are unlikely to do so in practice.

In addition, the benefit of the Harper Reforms (and competition policy generally) could be enhanced for small businesses through an improvement in access to justice for small business. We therefore recommend that:

- Changes are made to facilitate representative private

damages actions
- Procedural changes are made to encourage private actions for damages, as the market would be less reliant on the ACCC to bring action
- Higher penalties be imposed on firms that break competition law, creating a greater deterrence effect
- Encouragement is given to compensation schemes for those who have suffered as a result of a breach of competition law
- Online tools and materials be made available to assist in the early resolution of competition law disputes
- The introduction of online court processes be considered, particularly for simpler cases.

Many of these recommendations are applicable to broader access to justice issues in Australia.

9. RECOMMENDATIONS RELATED TO FAMILY FIRMS

Family firms are a major component of the SME community and contribute significantly to GDP. To address financing needs, some larger family firms list on the Australian Stock Exchange (despite the ASX tightening the listing criteria to discourage small-cap businesses from applying to go public).

We recommend that:
- State and federal governments should encourage more research on family firms and their role in contributing to the wealth of the economy
- The ASX should consider removing the recent barriers caused by changes to the listing rules, thus encouraging family firms to take up the option of listing (an alternative may be to consider resurrecting the former 'Second Board', allowing smaller-cap companies to list and thus have another financing option).

10. RECOMMENDATIONS RELATED TO INTERNATIONALISATION

There is much to be done to help Australian SMEs raise their game in the international marketplace. Evidence shows a weak international performance by SMEs, but also grounds for optimism.

In terms of government policy interventions, we recommend:
- A targeted approach, aimed at those SMEs that seek to internationalise but have not yet done so, and those that are already exporting and seek to expand their international reach into new markets
- A higher priority on facilitating SME exports in the six most internationally active industries, including 'mining', 'agriculture', 'manufacturing', 'wholesale', 'information media', and 'professional'
- Greater emphasis on encouraging small and self-employed firms to participate in foreign markets by providing targeted export incentives, support for network and international collaboration, business matching opportunities, and facilitating access to finance
- Increased support for growth and innovation to boost the number of exporters and accelerate their international activities
- More support for SMEs in terms of detailed information provision, such as tailored advice and a mentoring program for firms internationalising in different geographical markets, in-depth discussion forums and network events.

11. RECOMMENDATIONS RELATED TO SME OWNERS' MENTAL HEALTH AND PERFORMANCE

As research on this issue is ongoing and still in progress, the IPA-Deakin SME Research Centre is unable to provide details on findings or recommendations at the time of writing.

The Centre is of the view, however, that mental health and wellness is a significant area of concern for all businesses, not just SMEs. In this sense, we feel a sense of responsibility to inform readers of the extent of mental health issues impacting SMEs and their advisers.

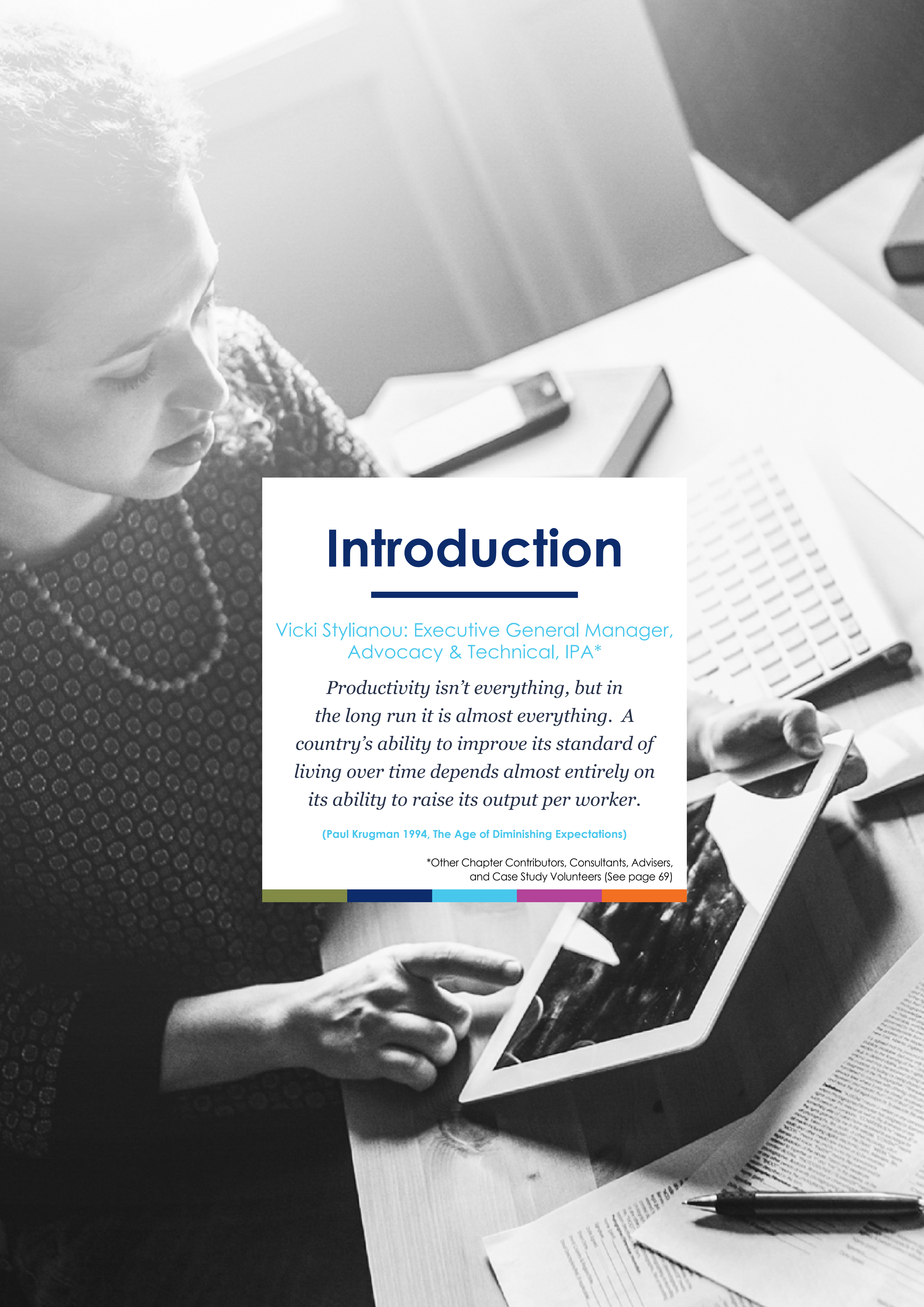
We also believe it is important to articulate the current work undertaken by the Centre to identify the real mental health issues impacting IPA members and their clients, and the potential mechanisms that can be utilised to assist businesses, their owners and advisers in their struggle to cope with day-to-day mental health challenges.

12. RECOMMENDATIONS RELATED TO CYBERSECURITY

To avoid or defend against the high risk of cyberattacks, we recommended that SMEs should:
- Increase their awareness of the need to apply adequate checks and balances to prevent or mitigate potential security exposures to their operations
- Increase their awareness of the significant risk they face from cybercrime, including the risk of their systems being used as a 'stepping stone' into connected systems in the supply chain.

Governments and technology companies also have a role to play in simplifying techniques for 'hardening and shielding' websites from cybercrime, so that such techniques are accessible to SMEs (and particularly small businesses).

A range of online 'cloud-based' host sites should also be established, so that SMEs can migrate their IT systems into a secure cloud environment.



Introduction

Vicki Stylianou: Executive General Manager, Advocacy & Technical, IPA*

Productivity isn't everything, but in the long run it is almost everything. A country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker.

(Paul Krugman 1994, The Age of Diminishing Expectations)

*Other Chapter Contributors, Consultants, Advisers, and Case Study Volunteers (See page 69)

Revitalising the Australian economy: navigating the headwinds

This is the second *Australian Small Business White Paper* produced by the IPA-Deakin SME Research Centre. When the first *Small Business White Paper* was released in 2015, we stated that its principal purpose was to present policy options for Australia to deal with the emerging economic challenges that were confronting the Australian economy. We posed the fundamental proposition that, while the Government grapples with ways to address Australia's budgetary problems, a much more profound and urgent challenge was emerging – a productivity crisis. In the three years since we made that statement, developments have accentuated this challenge, creating a greater imperative for urgent government action.

These challenges have been compounded by a global environment that has seen the election of Donald Trump as US President, the uncertainty in Europe and possible contagion effects attributable to Brexit, rising protectionism, the implications from the rise of China as a super power (including geopolitical issues and the so-called 'trade war'), ongoing technological advances with the advent of the Fourth Industrial Revolution, continuing demographic shifts, transnational cybercrime, the impacts of climate change and continuing refugee crises. At the same time, our world has continued to become increasingly interconnected and interdependent with scientific, technological and logistical advances in countless countries simultaneously driving economic growth globally.

These events have all combined to create an environment of even further uncertainty and change. What we need to consider is the impact of these events on the Australian economy and the need to develop appropriate domestic policy responses.

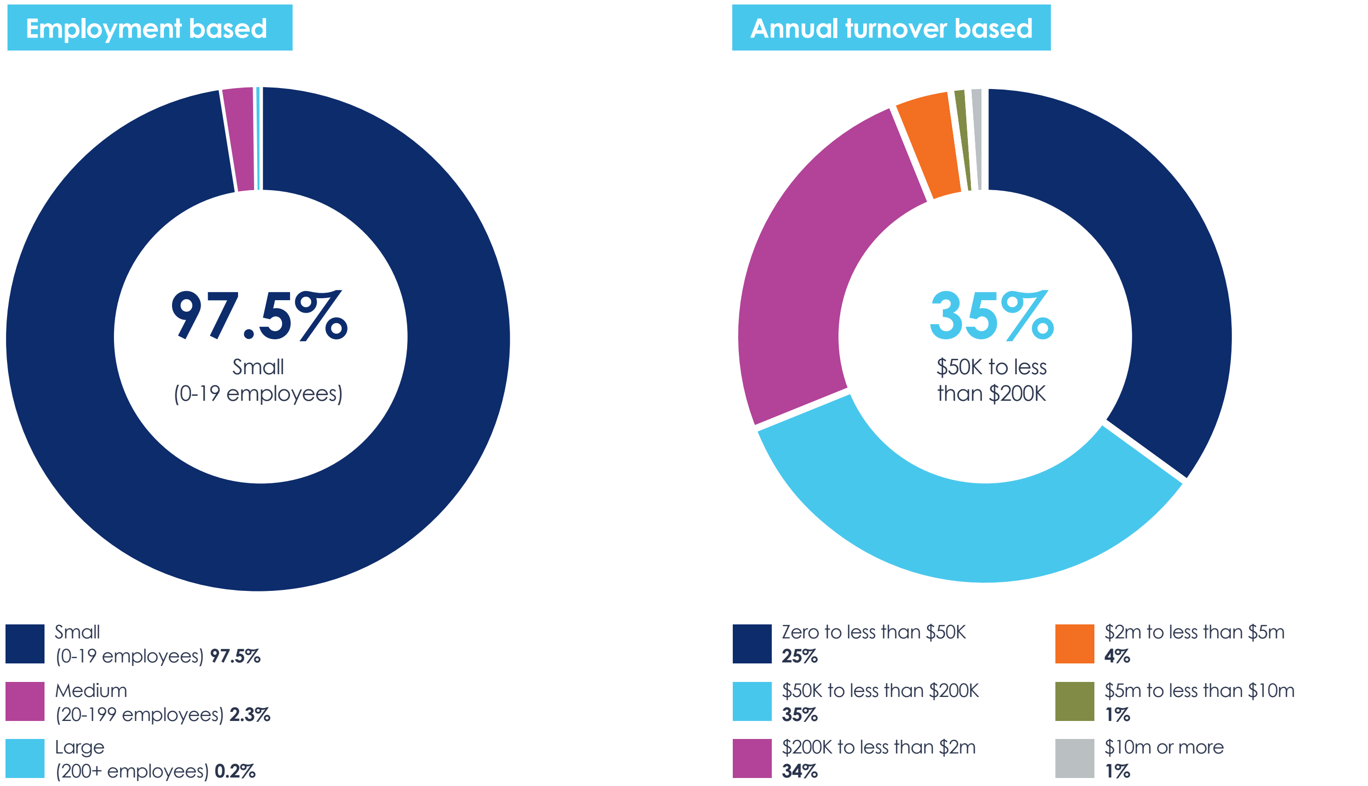
Being a small, open economy, Australia is particularly susceptible to the rise in global protectionism. This could damage future economic growth and undermine the global rules that underpin our trade and investment status. Moreover, at a time when productivity remains stagnant, Australians should be concerned about the potential serious consequences of stagnant productivity on the Australian economy and future living standards.

These economic 'headwinds' continue to strengthen and present potential challenges for the Australian economy going forward.

Successfully navigating these headwinds will be essential to maintain, if not boost, Australian productivity growth, improve national income and raise living standards. The challenges for Australian policymakers are increasing, making the need for action immediate.

Small business continues to be the engine room of economic growth. The latest ABS Business Counts data for 30 June 2017 indicates that, of the 2.24 million businesses in Australia, there were 2.18 million (97.5%) micro and small businesses (those with less than 20 employees) (figure 1, left panel). Of these, there were 1.4 million (61.2%) micro businesses that did not employ any staff. Small business contributes one-third of GDP, employs 44% of all workers and generates 40% of new jobs. The annual turnover for 60% of these small businesses is less than $200,000 (figure 1, right panel).

FIGURE 1:
Australian business counts by size, as at 30 June 2017



Source: ABS 2018, Counts of Australian Businesses, including Entries and Exits, Jun 2013 to Jun 2017, Cat. no. 8165.0, Table 13 and 17.

However, if small business is to prosper, some things need to change. Innovation processes are less common in small businesses, with 60% engaged in innovative activity compared to 67% for medium-sized businesses and 80% for large businesses. Small businesses also report slower rates of productivity improvements compared to large firms (28% compared to 36%). While small businesses represent 44% of all businesses that export goods, they only account for 0.5% of exports by value[1]. Despite increases in the number of small businesses that are 'born global', significant scope exists for them to become more dynamic, innovative and efficient.

Recent research by the OECD and others[2] indicates that small business can play an important role in lifting national productivity growth and, more importantly, national living standards through a variety of ways, including improved diffusion of knowledge, products, processes and technologies across businesses.

It is for these various reasons that, as noted in the Foreword to this white paper by Andrew Conway, we look to Small Business: Big Vision to frame our 'reform agenda' to tackle these strengthening headwinds confronting the Australian economy.

After all, more prosperous small businesses are good for the Australian economy.

Given the breadth of issues affecting small business in Australia, the white paper selectively focuses on high priority issues. These include:

- Understanding productivity in the Australian economy (chapter 1)
- Regulatory overload (chapter 2)
- Taxation (chapter 3)
- Finance principles and alternative financing (chapter 4A)
- The case for crowdfunding in Australia (chapter 4B)
- Workplace relations (chapter 5)
- Net employment dynamics of Australian SMEs (chapter 6)
- Innovation (chapter 7)

[1]Australian Small Business and Family Enterprise Ombudsman (ASBFEO) (2016).
[2]Andrews et al (2015, 2017).

- Competition policy: will the new laws benefit small business? (chapter 8)
- Family firms (chapter 9)
- Internationalisation (chapter 10)
- SME owners' mental health and performance (chapter 11)
- Cybersecurity and Australian SMEs (chapter 12)

The respective chapters in this second important white paper make the case for reform and include policy recommendations to tackle existing and emerging headwinds.

PRODUCTIVITY – IS CRITICAL FOR IMPROVING AUSTRALIAN LIVING STANDARDS

Productivity growth is vital to improving per capita incomes and living standards, especially over the longer term. Indeed, as stated by Nobel Laureate Paul Krugman:

Productivity isn't everything, but in the long run it is almost everything. A country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker.[3]

As stated in the first *Small Business White Paper*, productivity is about how well businesses, industries or countries combine resources to produce goods and services. This includes resources such as raw materials, labour, skills, capital equipment, land, intellectual property, managerial capability, technology, financial capital, knowledge and ideas.

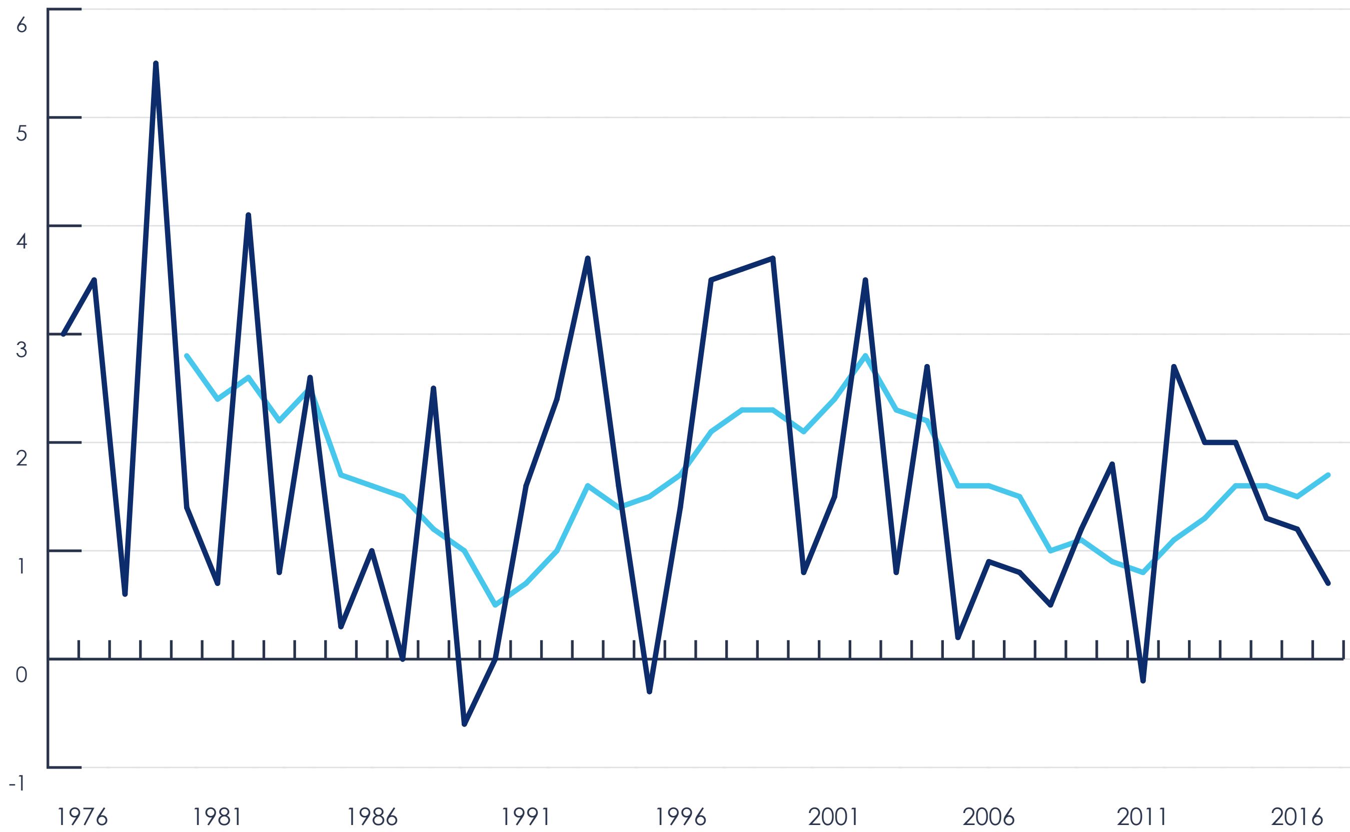
Productivity growth not only leads to higher living standards, but also enables society to choose from a wider range of options for improving living standards and wellbeing. Simply put, growth in productivity is vital for growth in national income and living standards into the future.

Productivity growth in Australia is measured by the ABS and others using one or two interrelated measures. The first is labour productivity, which is defined as output per unit of labour input (typically measured in terms of hours worked). The second is multifactor productivity (MFP), which is a residual measure after taking out the contribution made by the increased use of capital inputs per unit of labour input in production (termed 'capital deepening'). MFP is generally interpreted as a measure of the efficiency with which labour and capital inputs combined are used in productivity. Most analyses typically assess changes in productivity growth rates over time rather than focusing on the underlying level of productivity.

PRODUCTIVITY – HEADWINDS ARE GATHERING

As shown in Figure 2, the long term trend in Australian labour productivity growth has been steadily declining over the last half-century.

FIGURE 2:
Australian labour productivity* growth, 1976 to 2017 ***Labour productivity is defined as GDP per hour worked.**



Source: ABS 2017, Australian System of National Accounts, 2016-17, Cat. No. 5204.0, Table 1.

[3]Krugman, P (1990).

The declining trend is more clearly indicated by the downward revisions to the 30-year average growth rate made by the Commonwealth Treasury in its successive intergenerational reports, falling from 1.75% in its 2002 03 report to 1.5% in the 2015 report[4].

More recently, as noted by the Productivity Commission (PC) in its report *Shifting the Dial, 5 Year Productivity Review*[5] released in August 2017, annual productivity growth has been 'flat' for over a decade.

However, sluggish productivity growth in the Australian economy is not unprecedented, nor is weak national income growth. The recent strong growth in Australia's terms of trade boosted growth in Australian national income to the envy of most other developed countries and gave rise to the mining boom. Unfortunately, the mining investment boom is now behind us. Looking ahead, it is growth in the non-mining sector that will largely determine the prospects for Australian incomes and living standards.

The declines in productivity growth partially reflect the effects of longer term structural changes in the Australian economy that have seen a decrease in the relative importance of many traditional 'goods-producing' industries such as manufacturing and agriculture, and an increase in many service sector industries. The lower rates of measured growth in labour productivity in many of the service sector industries compared to the generally higher rates in the traditional goods producing industries has contributed to the decline in national labour productivity growth identified in the intergenerational reports[6]. This trend is expected to continue, as stated by the PC in its *Shifting the Dial* report[7]. In other words, this long term trend in labour productivity is expected to continue unless significant productivity-enhancing reform is undertaken and undertaken now.

The use of capital in production (capital deepening) has been the main source of longer term labour productivity growth in the Australian economy over the last century, accounting for roughly 60%. This means that each use of Australian output tends to be produced using less labour than it did 50 years ago. MFP growth accounted for the remaining 40% of historical labour productivity growth.

More recently, MFP has underpinned labour productivity growth in most industries, with 9 of the 16 industries for which MFP is reliably measured experiencing positive average MFP over the current productivity cycle (i.e. 2007-08 to 2016-17). This contrasts with the previous productivity slowdowns that have been generally broad-based[8].

Yet productivity headwinds are strengthening and have the potential to make it harder for Australia to maintain, let alone improve, living standards into the future.

Governments have an essential role to play in addressing these headwinds.

PRODUCTIVITY – GOVERNMENTS HAVE A VITAL ROLE TO PLAY IN BOOSTING PRODUCTIVITY AND LIVING STANDARDS

Governments play a significant role, directly and indirectly, in the effective operation of the Australian economy. Governments set the rules by which markets operate. They regulate and enforce the rules, levy taxes, and provide or fund significant services and infrastructure for the community. These rules, taxes and expenditures affect business profitability and may create artificial incentives for them to alter their behaviour in search of higher returns which can result in unintended consequences or excessive compliance costs.

Governments also exert significant influence on wider productivity in the private sector. The PC notes that governments can exert influence on both MFP performance and capital deepening over time, both of which are desirable sources of productivity growth.

Given the myriad of ways and mechanisms that governments, directly and indirectly, impact productivity growth, it is essential that their initiatives and actions are selected, funded and managed as efficiently and effectively as possible to ensure the significant potential benefits are realised.

New and improved policies are also important. For example, significant scope exists to improve productivity growth in the delivery of education and skills development, as would updating regulatory settings to reflect the current economic realities.

The first white paper contained an extensive chapter on ways to develop human capital, and both white papers contain chapters on ways to improve the regulatory environment and Australia's productivity performance.

As noted in this white paper and elsewhere, technology simultaneously creates and destroys jobs. To the extent that technological shifts require more advanced or new skills from workers, there is a role for government to ensure education and labour market policy settings enable upskilling and retraining. The first white paper makes a significant case for government to support vocational training, which has an important role to play in this process.

Government also has a role to play in enabling research and providing access to data. We note that recent improvements

[4]The Treasury (2015).
[5]Productivity Commission (2017b).
[6]The Treasury (2015).
[7]Productivity Commission (2017b).
[8]Productivity Commission (2017b).

in data collection and research, such as the development of the BLADE (Business Longitudinal Analysis Data Environment) framework, which was boosted by funding in the 2017-18 Budget, offers great potential for improving productivity growth through better targeting of government policy and the effectiveness of government programs at the firm level.

Australia should follow the lead of New Zealand in promoting more collaboration between the public sector, private sector and academia to improve the contribution of policy to increasing productivity growth 'by connecting people, shaping research agendas and sharing research'. This will improve the evidence base needed for robust policy development.

PRODUCTIVITY – INVESTMENT WILL ALSO NEED TO PLAY AN ESSENTIAL ROLE GOING FORWARD

Given that past investment has fuelled the capital deepening that has been an important source of historical productivity growth, investment needs to play an essential role going forward to underpin productivity growth and maintain living standards.

Prospects for two of the key main industries that contributed to this historical capital deepening – manufacturing and mining – are likely to be more subdued going forward than has been the case historically. If this occurs, future Australian productivity growth will be harder to sustain without capital deepening in other areas of the economy or through improvements in MFP (requiring a significant and sustained reform effort).

Furthermore, as noted in the Federal Budget 2017-18, non-mining business investment remains a key uncertainty for growth since the end of the mining boom. Despite lower official interest rates and surveys indicating above-average business confidence, investment remains muted. This implies that businesses are likely to be waiting for improved business conditions and greater certainty before making significant new investments.

The longer term structural change towards service sector industries that are more reliant on labour have reduced measured labour productivity growth. These industries also tend to rely more on investment in intangible capital, such as research and development (R&D), information and communications technology, brand equity and organisational capital, all of which affect productivity and are harder to quantify. However, studies cited by the PC suggest that investment in intangibles is significant but 55% (2012-13 study) of such investment is not treated as investment in the national accounts; and that average annual growth in intangible investment was about 130% that of tangibles since 1974-75. The difference in investment between tangibles and intangibles could also contribute to the differences in productivity observed across firms. The productivity chapter in this white paper discusses the productivity of firms in greater detail.

The IPA-Deakin SME Research Centre suggests that research is needed on how best to improve the measurement of investment in intangibles, especially in the services sector, in the national accounts.

The weak outlook for investment, as discussed above, is supported by the International Monetary Fund (IMF), which observed in 2017 that the prolonged periods of uncertainty and sluggish private investment after the Global Financial Crisis have further held back productivity growth, especially in the advanced economies, and that this slow growth is likely to make challenges such as the aging population harder to address.

The OECD, in its 2018 policy paper *The Long View: Scenarios for the world economy to 2060*[9], also referred to slowing global growth, limited income convergence and rising fiscal pressures as being the long-term baseline projection. However, structural policy reforms can brighten the outlook substantially in all countries (including Australia). For instance, reforms through 2030 to make product market regulation in OECD countries as friendly to competition as in the five leading countries can raise living standards by over 8% in aggregate (and up to 20% in some countries). For this reason, it is imperative that Australia ensures that the benefits of the recent Harper reforms (which came into operation in November 2017) flow through to small business. This topic is discussed in detail in the competition policy chapter in this white paper.

GLOBALISATION – PRESENTS SIGNIFICANT OPPORTUNITIES FOR AUSTRALIAN BUSINESSES

Globalisation is, for better or worse, a fact of modern life.

Technological changes have made the world a smaller place. Given our relatively small size, globalisation offers great potential to Australian businesses and for improving Australian living standards.

Globalisation, according to the United Nations, is a multi-dimensional process characterised by the acceptance of a set of economic rules for the entire world designed to maximise profits and productivity by universalising markets and production, and by obtaining the support of the 'state' with a view to making the national economy more productive and competitive. A

[9] Guillemette and Turner (2018).

simpler definition is that globalisation refers to all those processes by which people of the world are incorporated into a single world society, global society[10]. It can also be seen as the worldwide movement toward economic, financial, trade and communications integration.

One in five Australian jobs are trade-related and one in seven rely on exports. Over 50,000 Australian businesses export, contributing $337 billion in export income in 2016. Exporting firms, on average, employ more people and pay higher wages than firms focused on the domestic market alone. Trade liberalisation delivers $8,448 extra income per year for the average family[11].

While these figures sound impressive, have we made the most of the opportunities presented by internationalisation? According to the Bertelsmann Stiftung 2018 *Globalisation Report, Who Benefits Most from Globalisation?*[12], Australia's internationalisation has developed similarly to the median for all 42 countries assessed in the report. Low commodity prices have reversed some of the structural changes since 2012 that arose from the mining boom, which has resulted in a decrease in trade. This report notes further that Australia is in the middle in terms of per capita income gains from internationalisation.

Australia has very low tariff rates by international standards. This has helped to increase the competitiveness and flexibility of domestic Australian markets. Despite this, Australia is ranked 95th for ease of trading across borders in the 2018 World Bank's *Doing Business* survey[13]. This indicates that further significant improvements are possible.

Australia needs to improve its performance against these and other measures if it is to seize the opportunities presented by international developments.

These opportunities exist by exploiting the 'complementarity' of our economy with those of our rapidly developing regional neighbours. That is, Asian economic growth relies on what Australia produces. China and India together make up more than 60% of Asia's economic activity. By 2030, Asia will produce more than half of the world's economic output and consume more than half of the world's food and 40% of its energy. By then, over 600 million more people will live in Asian cities. These countries will not only need Australian minerals and energy but also the services we provide to fuel this growth.

At the same time, Australia is looking beyond Asia to find new opportunities in South America, Africa and the Middle East[14].

The Australian government will need to maximise economic growth in the region by facilitating the ability of Australian businesses to tap into global value chains; and to increase our relatively low investment in Asia, which may be hindering our ability to tap into these global value chains. This includes manufacturing businesses. Manufacturing makes up $44 billion or 13% of our exports. More than four out of five of all manufacturing businesses are SMEs. They rank fifth among advanced economies for business innovation. This should be applauded, encouraged and improved through government policy settings. Services make up a growing share of our exports, $75 billion or one-fifth of exports in 2016. For instance, Australia is the third largest provider of education to international students[15].

Technological progress, urbanisation and rising incomes are leading to an increase in the share of services in economic activity across the globe. Australia has an opportunity to capitalise on the growing demand for tradable services, particularly from Asia. Our comparative advantage in services is in financial services and personal and recreational services. The aging population is another opportunity. There are already more people over 65 years of age in Asia than the whole population of the United States. Aged care services, health services, nursing, asset management and insurance services could all represent opportunities from this demographic change. However, in these industries there are often high domestic barriers to entry, which our trade agreements will need to overcome if these opportunities are to be realised.

The Trans-Pacific Partnership (TPP), which was a major free trade agreement between 12 countries, was being negotiated at the time of the last white paper. Since then, the United States withdrew after the election of Donald Trump as President. However, due to efforts by Australia and Japan, the TPP has been reinvented as the TPP-11 which was signed by all 11 countries in March 2018, with tabling in the Australian Parliament in the same month. The agreement will operate as a platform which others can join if they meet the high standards. Australia is committed to expanding the TPP membership over time. The TPP has been promoted as the 'gold standard' in free trade agreements in terms of its extensive coverage (including for the first time, a chapter devoted to SMEs) and the standards to which member countries must adhere. Australia needs to ensure substantial market access covering goods and services market openings and regulations on foreign investment.

China's One Belt One Road (OBOR) initiative presents further opportunities for Australian businesses. It is the Silk Road of the 21st century. 'Belt and Road', which was proposed by China and unveiled by Chinese leader Xi Jinping in 2013, is a development strategy and framework,

[10] Albrow and King (1990).
[11] Department of Foreign Affairs and Trade (2017).
[12] Weiß, Sachs and Weinelt (2018).
[13] World Bank (2013).
[14] Department of Foreign Affairs and Trade (2017).
[15] Department of Foreign Affairs and Trade (2017).

that focuses on connectivity and cooperation between countries, primarily in Eurasia. It comprises two main components: the land-based 'Silk Road Economic Belt'; and the ocean-going 'Maritime Silk Road'. The strategy underlines China's push to play a much bigger role in global affairs, and to export spare production capacity in areas such as steel manufacturing. There are numerous opportunities for Australian businesses to take advantage of the OBOR.

More recently in 2018, Australia has joined the United States and Japan to establish an alternative to OBOR, which also seeks to build infrastructure in emerging economies. The United States has announced plans for a new development finance institution to bring together its response to OBOR.

Australia has expertise in infrastructure development, funding and management. As a result, it could benefit from both projects. SMEs play a vital role as part of the global value chains which undertake these projects. We must ensure that they are supported to enable them to realise these opportunities.

Government needs to seek out ways to further increase the recognition of Australian qualifications and licensing in overseas markets, thereby creating new opportunities for Australian businesses to export professional and other services and to increase the value of Australian qualifications to international students. Government also needs to broaden services exports beyond education and tourism and look at factors other than cost that influence the ability of Australian service providers to compete internationally. This has been extensively considered in the literature on barriers to export and was discussed in the first Small Business White Paper.

In terms of international collaboration, the United Nations 2030 Agenda for Sustainable Development presents further opportunities. Its 17 Sustainable Development Goals (SDGs) seek to reduce poverty, protect the environment, and promote gender equality, responsible consumption and production, decent work and economic growth, quality education, peace, justice and strong institutions, industry, innovation and infrastructure and partnerships to achieve these goals. In addition to opportunities for Australian SMEs, the SDGs provide a useful, consistent and aspirational framework to inform policy development in Australia and other countries across the world. 'Humane Entrepreneurship' has emerged as a useful tool for achieving the SDGs. It is built on the premise that countries and organisations should extend their priorities beyond the profit margin; and shift their focus onto their people, the environment and society. Human-oriented businesses are deemed to perform better, produce better products and satisfy their customers.

While Asian economies are largely growing, we note that, in the developed world, the headwinds are gathering as productivity gains associated with past technological advances have largely been exhausted, while the benefits for productivity from current and future technological advances have not yet been realised. Real wage growth is not expected to improve in developed economies unless productivity increases. Other constraints on global growth include aging populations, especially in Japan, China and the European Union; high public debt and low official interest rates; and China's slowing economy as it matures (which the OECD estimates will peak at 27% in the 2030s and then slowly decline).

Overall, international developments present further opportunities for Australian business, including SMEs.

GLOBAL TRADE – CAN BENEFIT THE AUSTRALIAN ECONOMY ACROSS THE BOARD

The Australian domestic market is small compared to many international markets. Future economic and population growth in the region will only further increase the size of these markets. For example, it is estimated that Asia's total infrastructure investment needs will exceed $26.2 trillion by 2030, which is roughly 15 times the current size of the Australian economy.

Australian businesses and the Australian economy have long gained benefits from accessing these markets through trade, investment and other strategic partnerships.

Yet there remains significant untapped potential for Australian businesses to improve engagement in these potentially lucrative markets.

To do this, Australian businesses need to be internationally innovative and competitive as well as having management that can identify and exploit these opportunities.

Domestic policies can help or hinder the international competitiveness of Australian businesses. Excessive or poorly-targeted regulation can reduce the competitiveness of Australian business or result in unintended collateral damage.

International policies can also indirectly present opportunities for Australian businesses and the Australian economy. For instance, by encouraging APEC countries to improve their productivity growth — whether by supporting education and training, competition, good governance and market openness, including in services, through helping to improve investment settings, regulatory frameworks, taxation systems, management of natural resources, workforce participation by women or the design and management of national budgets — the ensuing economic growth would increase demand for the goods and services that Australia produces[16].

Australian domestic and international policies need to support or reinforce each other to strengthen the resilience and competitiveness of Australian businesses through innovation, science and technology and an environment that facilitates improvements in productivity and a desire to drive exports. SMEs can play a vital role in this process.

Domestic policy must reflect this global reality. It is pleasing, therefore, that the federal government has reinforced its initiative to assist Australian businesses, including over 50,000 SMEs, to access international markets, through Austrade and EFIC ('Finance for Australian Exporters'). It has stated that it will also partner with the private sector through Asialink Business, chambers of commerce and other programs. In the first *Small Business White Paper*, we noted the need to increase the utilisation of free trade agreements (FTAs), otherwise there would be no point in having them. It is, therefore, pleasing to see that the government has responded with a new FTA portal and other online resources to enable small businesses and others to more readily access the benefits of our trade agreements.

Despite the potentially significant benefits to the Australian economy from increasing internationalisation, we cannot ignore adverse impacts on certain parts of society, thereby potentially further exacerbating the already uneven distribution of income in Australia. In its 2018 report *Rising inequality? A stocktake of the evidence*[17], the PC states that inequality has risen (slightly) in Australia over the last three decades. It suggests that governments need to ensure regional resilience, adequate training and education, greater labour mobility, greater diffusion of knowledge and innovation, if we are to continue to reap the benefits and address the challenges.

Other global challenges abound, including increasing urbanisation, environmental degradation and the rising demand for sustainable food sources, water and energy. It is not inconceivable that these could become political, economic and security disruptors over the longer term. For Australia, and for any of our trading partners, these issues have the potential to undermine regional stability, contribute to conflict and affect economic interests. For instance, the OECD estimates that 60% more food will be needed by 2050 with growing demand by middle classes for more resource-intensive food like meat; and the United Nations estimates that, if no changes are made to the way water is used, demand will outstrip supply by over 40% by 2030. In addition, the United Nations estimates that the world needs to create around 40 million new jobs every year, just to keep pace with the growth of the global working age population.

The situation becomes more complex when given the increasing influence of non-state actors on global issues, including multinational companies, private interests, civil society groups, celebrities and others, who can influence large numbers of people through the forces of social media.

Despite not being able to challenge these global trends, we nonetheless need to position and prepare ourselves to take advantage of the tremendous opportunities that these trends present, particularly in ways that benefit all Australians and not just a lucky few. A failure to do so will be to the detriment of us all.

Navigating these headwinds, while taking advantage of global trends and regional opportunities, will define Australia in the coming decades.

GLOBAL TRADE – AUSTRALIA NEEDS TO RESIST THE GROWING INTERNATIONAL PROTECTIONIST SENTIMENT

Global economic growth has generally been relatively slow since the Global Financial Crisis.

After decades of falling levels of international protectionism, recent developments have moved in the opposite direction. Protectionism is rising in G20 countries, as indicated by the World Trade Organisation (WTO) register of the annual incidence of application of protectionist measures.

There is also debate about whether Brexit will create increased protectionism. The Committee for Economic Development of Australia (CEDA) believes it will result in more open markets in the United Kingdom. There are numerous countries, including Australia, lining up to do a trade deal with the United Kingdom.

This recent trend back towards global protectionism brings significant risks for world economic growth and, with it, for the Australian economy.

Australia is not immune from this trend towards increasing protectionism. The increasing role played by the Australian Anti-Dumping Commission is a case in point, a move which has bipartisan political support. CEDA, in its November 2017 report *Australia's Place in the World*[18], correctly refers to this as 'creeping protectionism'.

A return to protectionism in Australia is neither inevitable nor desirable. While Australia may not be in a strong position to alter the policies of other countries, it can influence its own

[16] Department of Foreign Affairs and Trade (2017).
[17] Productivity Commission (2018).
[18] Committee for Economic Development of Australia (CEDA) (2017).

policies. Just because other countries resort to increased protectionism, Australia does not have to follow.

An apparent US 'trade war' with China could mean a significant reorganisation of world trade, although the PC, in its 2017 Research Paper, *Rising Protectionism: Challenges, Threats and Opportunities for Australia*[19], indicates that economic activity in Australia is unlikely to be significantly affected in the longer term. However, transitional costs for Australia could be material, especially to established value chains involving US firms. The worst-case scenario considered is that Australian GDP would decrease by 1% cent annually, with the loss of 100,000 jobs, and the average household would be $1,500 per year worse off. In addition, uncertainty is likely already affecting global trade and investment and in ways that cannot be readily captured.

The uneven distribution of impacts across households explains why the broad support of the community to open markets cannot be taken for granted. Australia should resist any political pressure towards protectionism and work with like-minded countries to keep markets open[20].

The OECD, in its 2018 policy paper *The Long View: Scenarios for the world economy to 2060*[21], estimates that slipping back on trade liberalisation and returning to 1990 average tariff rates would depress the long-run living standards by 14% for the world as a whole and as much as 15-25% in the most affected countries.

To help prevent Australia progressing down this protectionist path, and to ensure that domestic policies and the international agreements that we sign are in the national interest, government needs to be more open and honest with Australians about the policies being developed and their likely impact, and as well as dealing with any significant adjustment costs. The PC recommended that Australia should adopt better consultation processes in negotiating preferential trade agreements, including widening stakeholder groups' access to draft treaty text on a confidential basis during negotiations. It also recommended that governments should pursue broader policies to strengthen economic resilience and workforce adaptability to changes underway in the global economy, many of which are driven by new technologies. There is a need to build community confidence in trade and foreign investment policies and structural adjustment policies to respond to the human costs of technological change. These recommendations are a continuation of those made in our first white paper.

Other recent reports have made recommendations on how Australia can succeed in a changing global economy. Their recommendations fall under three broad categories relating to:

- continuing open international engagement
- broader domestic policy
- community engagement.

Resisting protectionism and continuing to work towards freer markets, while making trade work for all by minimising adjustment costs and ensuring the benefits are widely shared, is the best path for Australia. Higher living standards depend on it.

GLOBAL GOVERNANCE – REFORM IS IMPERATIVE

The WTO is no longer playing the role it once did in advancing a 'rules based' world trading order. With 164 members, all with divergent interests and levels of development, getting consensus has become very difficult. Countries that were once keen supporters of free trade and the WTO, such as the United States, are no longer as enthusiastic as they once were.

No matter how desirable, the current global political realities mean that a multinational approach to international trade reform is effectively defunct.

Given this scenario, the best prospect for maintaining and improving Australia's competitive position and to open new markets and help grow our economy lies in bilateral and regional trade agreements. New agreements need to be as broad and comprehensive as possible, covering competition policy, investment and intellectual property rights as well as non-tariff barriers and other behind-the-border measures that prevent Australian firms from accessing foreign markets.

Broad preferential trade agreements such as the TPP-11 are preferable to individual bilateral agreements with specific countries. These broader agreements provide greater scope for ultimately improving the international trading architecture and institutions such as the WTO, G20 and IMF.

However, these broad agreements need to be flexible and adaptable enough to enable other countries to easily join.

The best way for Australia to proceed in these challenging times is to lead by example and continue its international leadership role. For example, Australia played an influential role in leading to the WTO's Trade Facilitation Agreement, which will reduce red tape and compliance costs for exporters, potentially boosting global trade by up to $1 trillion per year. Historically, Australia has been known for 'stepping up' – we played a key role in the formation of the United Nations, APEC and the G20.

[19] Productivity Commission (2017a).
[20] Productivity Commission (2017a).
[21] Guillemette and Turner (2018).

Opportunities for trade and commerce rely on a stable global system based on mutually agreed rules. Stable global conditions at home and abroad provide the best platform for Australia and the world to prosper.

INNOVATION – IS CRITICAL TO IMPROVING AUSTRALIAN PRODUCTIVITY GROWTH

Successful innovation is critical to improving productivity and living standards.

Firms that develop new knowledge, processes or goods and services can gain a competitive and financial advantage from doing so.

However, these innovations can also indirectly produce wider economic benefits when new knowledge, processes or goods and services are spread across other parts of the economy (and indeed internationally). The broader ‘spillover effects’ can produce significant economic and social benefits in their own right, including in ways unrelated to the original innovation.

A case in point is the development of Wi Fi which was originally developed by the Commonwealth Scientific and Industrial Research Organisation (CSIRO) to remotely control telescopes.

Innovation is a risky, iterative process that involves research, development and commercialisation.

Government policy needs to address all aspects of the innovation process. It should not be just aimed at fostering new innovation. It should also be about encouraging the broadest dissemination and uptake of new knowledge, processes and goods and services by other parts of the economy to ensure the widest possible economic benefits. Robust competition and intellectual property frameworks established by government are, for example, crucial for facilitating knowledge spillovers between firms.

Governments undertake and fund significant innovation in Australia. Public sector institutions such as the CSIRO, Australian universities and co-operative research centres undertake significant R&D in Australia. They also provide significant assistance to private business in their research, development and commercialisation activities.

Innovation policy can play an important role in addressing the decline in Australian MFP that has been linked to declining knowledge-based capital investment over the past two decades[22].

Australian government expenditure on innovation policy, through an array of different programs, is significant. In 2015-16, the Australian Government alone spent almost $10 billion on innovation. The Australian Government has a large number of small innovation programs, with 74 programs collectively accounting for less than 2% of its $10 billion in expenditure in 2015 16.

It is essential that innovation policies encourage socially worthwhile innovations, while getting the maximum value for Australian taxpayers; as well as working together in a harmonised fashion.

The small size of many of the innovation programs arguably reduces their effectiveness and increases the cost to taxpayers of their administration. There is significant merit in adopting the OECD’s 2017 recommendation that the Australian Government consolidate its 150 innovation programs to make them more effective and to give taxpayers better value for money.

One of the flagship innovation policies of the Australian Government is the ‘R&D Tax Incentive’, which accounted for almost one third of all Australian Government spending on innovation policy in 2015 16.

The 2016 Ferris, Finkel and Fraser review[23] found that the R&D tax incentive, as part of a mix of innovation policies that sought to improve the quality and quantity of R&D investments in Australia, played a key role in improving productivity and economic growth.

However, the report went on to find that the incentive fell short of meeting its stated objective of encouraging additional R&D and producing spillovers. To this end, the report made six recommendations, including rewarding collaborative research and having a better focus to support innovative investments by limiting cash refunds and imposing an intensity threshold. The OECD supports this in its 2018 policy report, *The Long View: Scenarios for the world economy to 2060*[24], where it estimates that boosting R&D intensity in all OECD countries to the level of the five leading countries raises aggregate living standards by over 4% by 2060. These measures could be adopted to make this important policy more efficient and effective.

Other government innovation polices would also benefit from tighter focusing and being made more efficient and effective. The Australian National Audit Office (ANAO) 2017 report Design and Monitoring of the National Innovation and Science Agenda (NISA)[25], evaluated the process leading to the December 2015 NISA package of 24 measures, costing $1.1 billion over four years. The government announced that “innovation and science are critical for Australia to deliver new sources of growth, maintain high-wage jobs and seize the next wave of economic prosperity”. This statement was based on four main pillars being: culture and capital; collaboration; talent and skills; and government as an exemplar. Even though the ANAO found that much of the advice on which the agenda was based was general in

[22]Productivity Commission (2017b).
[23]Ferris, Finkel and Fraser (2016).
[24]Guillemette and Turner (2018).
[25]Australian National Audit Office (ANAO) (2017).

nature and did not present quantitative or in-depth analysis of problems, or how expected impacts or outcomes would be measured, it also found that monitoring and reporting arrangements for the agenda have, in most respects, been effective.

It is imperative that NISA (or its equivalent) be implemented and that government and all relevant stakeholders play a role in Australia's innovation agenda. The innovation chapter in this white paper goes further with recommendations.

Significant technological changes are occurring that present ample opportunities for Australian firms to innovate. The Internet of Things, big data, robotics and the combination of artificial intelligence with genomics and biotechnology, will drive further innovation in medical treatments, smarter cities, low emissions energy, the creation of new industries and new jobs. Our 'net employment dynamics' chapter discusses job creation and job destruction, including these themes in the context of start-ups. Australia must not miss the opportunities that new technologies present.

While Australia has a solid reputation, by international standards, for both high-calibre researchers across multiple disciplines, as well as research institutions, a perceived weakness of the Australian innovation system lies in the inability to successfully commercialise world-class research outcomes. Arguably also, information regarding research outcomes and innovations generally is not well disseminated across the wider Australian economy.

Yet countries such as Singapore and Israel which face similar barriers to Australia, such as small domestic markets, do well by these measures.

Small and medium businesses play a critical role in this diffusion process and in ensuring that markets are competitive. Government should encourage the wider uptake of new ideas and products. Accordingly, government policy should recognise and support the vital role played by SMEs.

Australian businesses also need to develop more of an innovative mindset that encourages upskilling and the learning of new skills and overcoming an excessive risk-aversion outlook. Our domestic market, while small, offers high margins relative to many international businesses. Australian firms that rely solely on the domestic market might be overtaken by more innovative and competitive rivals from overseas. Offering world-class products and services will help to ensure that Australian businesses are internationally competitive. Studies show that distance imposes enormous costs on the export of goods, so trading with our closer markets in Asia makes good economic and business sense.

Another key failure of the Australian innovation system – one that goes to the core of the effectiveness of the Australian innovation ecosystem – is the lack of strong, effective connections between the government-funded research institutions and the private sector. Australia has among the lowest proportion of firms that collaborate with Universities and other non-commercial research organisations in the OECD. Addressing this issue will require, as stated in *Industry Insights Globalising Australia 2018* by the Office of the Chief Economist from the Department of Industry, Innovation and Science[26], CEOs and government leaders to reflect deeply on the values, purpose and principles that influence their choices of technology, the design of new systems and the resulting impact on organisations and individuals, and not just rely on better consultation, incentives for partnership or more lobbying.

The effectiveness and sustainability of the Australian innovation ecosystems could be further improved by developing sufficient critical mass to underpin current (and increased) investment in incubators and accelerators to ensure existing success occurs on a larger scale.

There is hope – Australia has a strong foundation for a successful innovation policy. We are a G20 economy. We have six universities in the world's top 100 (exceeded only by the United States and United Kingdom). We have world-class scientific and research institutions. We produce more than 7% of the world's most highly-cited research publications, despite having less than half a per cent of the world's population.

Improving the effectiveness of innovation in Australia, however, is not just about government lifting its game. The private sector also has an essential role to play.

All of this can contribute to addressing the decline in Australian MFP growth that has been linked to declining knowledge-based capital investment over the past two decades[27].

TAXATION – THE TAX SYSTEM NEEDS TO BE SUSTAINABLE

As noted in the first white paper, major taxation reform remains significant unfinished business.

The IPA has repeatedly advocated for the need for major and bold tax reform by moving from transaction taxes on property to broad-based land tax and addressing the internationally uncompetitive company tax rate (the OECD average is 24% and the average in Asia is 21%) and for reform of the GST. The tax chapter in this white paper continues the case for reform.

FISCAL SUSTAINABILITY — GOVERNMENTS ARE CURRENTLY LIVING BEYOND THEIR MEANS

Australia has performed well on various indicators of inequality, thanks to our tax and transfer system.

However, this tax and transfer system needs to be sustainable in the long term. The growth in

[26] Office of the Chief Economist (2018).
[27] Productivity Commission (2017b).

government services has outpaced the growth in average incomes (e.g. the National Disability Insurance Scheme (NDIS), school funding, the aging population putting pressure on health services etc). Total government payments to households and individuals from 1995 to 2014 grew roughly at 121% of the rate of income growth (as measured by GDP). This excludes transfers relating to active labour market programs and unemployment benefits[28].

This situation is clearly unsustainable. Escalating public expectations do not help. Improvements in the efficiency with which services are delivered will help deliver fiscal sustainability, but tough decisions will need to be made. Either taxes have to grow or expenditure growth will need to be reined in, or both.

WORKPLACE RELATIONS – TOUGH LOVE IS NEEDED

Workplace relations reform remains untackled by government.

Previous governments from both sides of politics – Keating with the *Industrial Relations Act 1993* and Howard with the *Workplace Relations Act 1996* – moved the responsibility for determining matters affecting the employment relationship to the employer and employees at the workplace or enterprise level. Since then the Rudd Government's *Fair Work Act 2009* unwound some of these reforms.

Subsequent reviews, including by the 2012 Fair Work Act Review Panel and the 2015 PC inquiry report, *Workplace Relations Framework*[29], have identified areas where the current system could improve, including rectifying the procedure over substance process.

The OECD, in its 2018 policy paper, *The Long View: Scenarios for the world economy to 2060*[30], states that a reform package to improve labour market policy settings in OECD countries up to those of leading countries raises the aggregate employment rate by 6.5% by 2040, mostly via higher youth and female employment. The package raises living standards by 10% by 2060 and helps alleviate future fiscal pressures related to aging.

In the meantime, there is constant discussion and debate about the 'gig economy' and disruptive technology and what these mean for the 'future of work', including the potential need to introduce a 'universal wage'. These topics are widely debated by numerous commentators.

The workplace relations chapter in this white paper tackles some of the tough issues.

CYBERCRIME – NO-ONE IS SAFE

Technology has helped to make the world a smaller, more interconnected place.

This interconnectedness provides great benefits to Australia and to Australians. However, it also provides great risks that need to be effectively managed.

The launch of the National Cyber Security Strategy in 2016 and the establishment of the Home Affairs portfolio are moves in the right direction.

However, Australia is not immune to such attacks. These attacks could come from state and non state actors. In fact, CEDA goes so far as to talk about the 'military uses of cyber space' and that Australia is currently under-prepared for cyber war. The Australian Cyber Security Centre's October 2017 threat report noted that networks in Australia have been compromised by rudimentary techniques exploiting known vulnerabilities. The cybersecurity industry offers huge potential for Australia to become a leading provider.

These themes are discussed further in the cybersecurity chapter, which was prepared by the Cyber Security Centre at Deakin University, where cutting-edge research is being undertaken.

POLITICAL WILL IS NEEDED – OTHER COUNTRIES HAVE HAD THE COURAGE TO ACT

The reform ideas developed in this white paper to tackle the strengthening headwinds confronting the Australian economy are outlined and developed in the following chapters.

Tacking these emerging headwinds requires sustained ongoing action from Australian governments.

We must ensure that resulting policies have broad public acceptance as well. Otherwise we are faced with sound policies being considered politically unpalatable and a lack of political willingness to tackle big reforms will continue to the detriment of all Australians.

Even though we acknowledge the impact of minority governments and lack of power in the Senate, there appears to be a lack of political will to even make the case for reform.

If New Zealand and other countries can undertake significant worthwhile reforms to improve the competitiveness of their economies, to improve their productivity growth and to raise future living standards, surely Australia can too.

[28]Productivity Commission (2017b).
[29]Productivity Commission (2015).
[30]Guillemette and Turner (2018).

Chapter One

Productivity

Professor Marc Cowling: Brighton University (UK),
Professor George Tanewski: Deakin University

Understanding productivity in the Australian economy

This chapter considers:

- **The basic production relationships between labour, capital and the creation of value-added, and differences in the 'state of technology' available.**
- **Differences in the technical efficiency levels, in aggregate and at a more disaggregated level by firm size, industry sector and across firm age classes.**
- **Differences in technical efficiency arising from softer strategic, managerial and operational factors.**

PRODUCTIVITY FINDINGS

- Many parts of the Australian economy are characterised by firms with decreasing (or, at best, constant) returns-to-scale. This means scaling up may not impact productivity in any meaningful way, or indeed may reduce productivity. In turn, this would imply that typical businesses need to focus on being smarter at their current levels of operation rather than seeking to expand.
- Loss-making businesses account for around one-third of the total business stock and these firms may benefit from growth due to their under-utilisation of current resources. Alternatively, the wider economy may benefit from reallocating the unproductive resources held in these businesses.
- There are large differences in the way businesses organise their production to yield the same level of output, which may indicate that specific classes of firms suffer from capital or labour constraints.
- Labour-intensive classes of firms include: those in the bottom 25th percentile of value-added creating businesses, loss-making businesses, medium-sized firms, and younger firms below 6 years in age.
- Capital-intensive classes of firms include: those in the top 25th percentile of value-added creating businesses, profitable businesses, large firms, and firms over the age of 5 years.
- The 'state of technology' available to different classes of firms varies considerably across the economy.
- High 'state of technology' classes of business include: new firms and younger firms more generally, small firms, profitable firms, and those creating average levels of value-added.
- Low 'state of technology' classes of firms include: old firms, medium-sized businesses, and loss-making businesses.
- Financial services appears to be the most productive industry in the economy and mining the least productive.
- Other relatively productive industry sectors include: agriculture, forestry, fishing, rental, hiring, real estate, transport, postal, warehousing, and construction.
- Other relatively unproductive industry sectors include: administrative and support services, manufacturing, public administration and safety, and other services.

EFFICIENCY FINDINGS

- The average level of efficiency in the Australian business sector is 0.81% and the median level is 0.85%. This implies that value-added in the business sector could potentially be increased by 15% to 19% using the same amount of capital and labour inputs and state of technology.
- Businesses in the lowest single class of firms (administrative and support services, 3-5 years old, A$1 million – $2 million) are operating, on average, at 14.5% efficiency and businesses in the highest single class (financial and insurance services, 0-2 Years old, A$5 million - $10 million), on average, are operating at 96.5% of their efficient level given inputs.
- Of the 62 classes of business operating above 90% efficiency, new firms are represented in 25 of these classes.
- Of the 62 classes of business operating above 90% efficiency, two industry sectors account for 29 of these classes. These are: financial and

insurance services (11 classes); transport, postal and warehousing (11 classes).

- Of the five classes of business operating below 30% efficiency, four are in mining, with sales of A$1 million - $2 million.
- Of the 12 classes of business operating below 40% efficiency, ten are in mining.
- Overall, the three industry sectors with the highest average efficiency rates are (highest first): financial and insurance services; transport, postal and warehousing; construction.
- Overall, the three industry sectors with the lowest average efficiency rates are (lowest first): mining; manufacturing; electricity, gas, water and waste.
- The 'state of technology' in common usage within the business sector is highest among: younger firms (0-5 Years old), small firms, and profitable firms.
- The 'state of technology' in common usage within the business sector is lowest among: old firms (10 years plus), medium-sized firms, and loss-making firms.

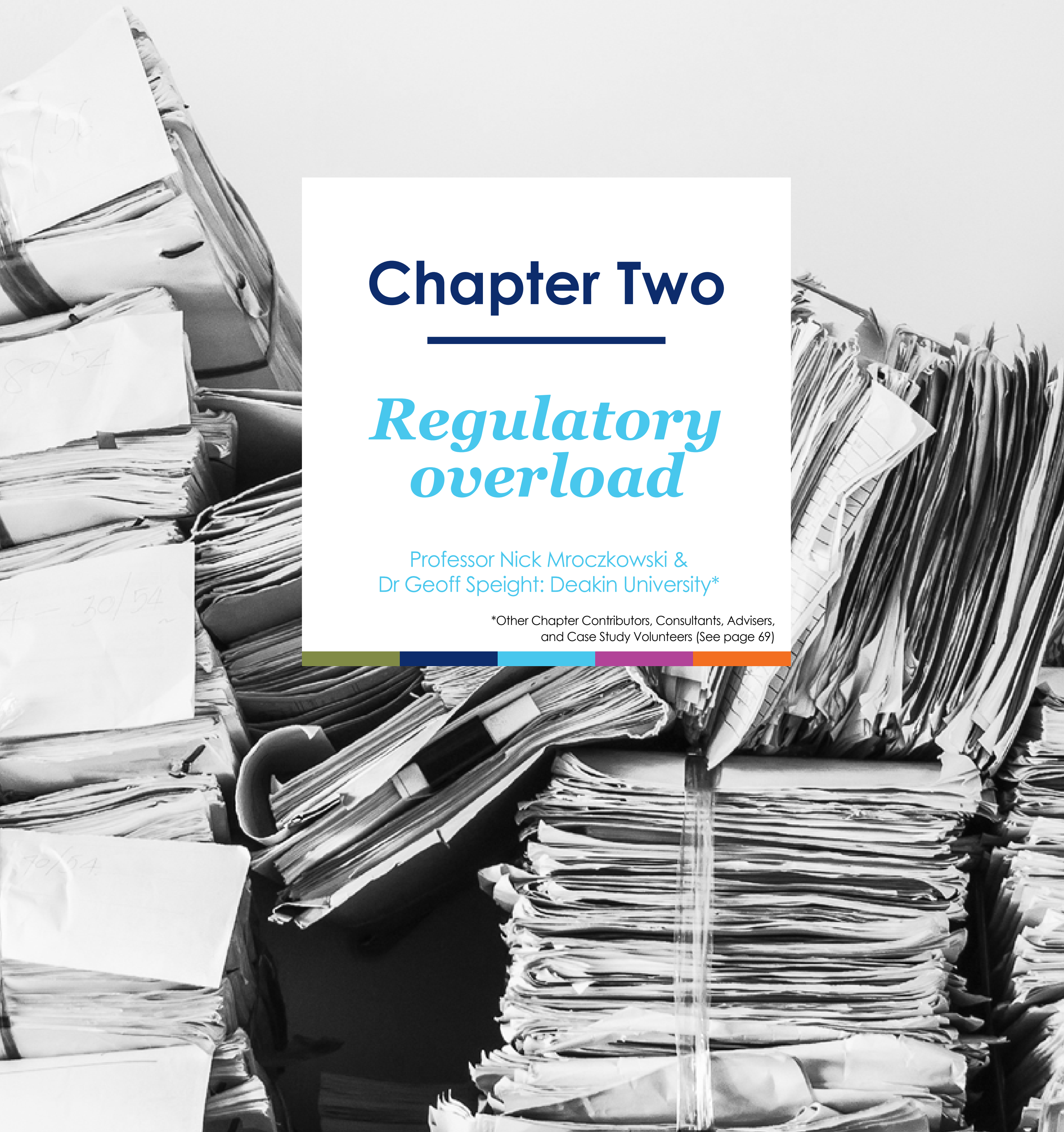
PRODUCTIVITY RECOMMENDATIONS

- Introduce initiatives to improve managerial capabilities in SMEs
- Review capital market efficiency to address the problem of 'zombie companies' (those businesses that require bailouts to survive), where too much capital is currently held
- Review the regulatory framework around insolvency resolution (Australia has the fourth-longest insolvency resolution time in the OECD) as this creates resource misallocation and reduces growth opportunities for efficient firms.

EFFICIENCY RECOMMENDATIONS

- Encourage business start-ups to stimulate efficient, dynamic resource reallocation
- Conduct a sector review of the mining industry
- Conduct a competition review of the mining, manufacturing, and electricity, gas, water, and waste industries
- Introduce initiatives to enhance the technological absorption rates in 'older' firms
- Speed up the roll-out and increase the coverage of high-speed broadband and enable SMEs to connect their premises all the way with fibre-optic cables
- Introduce supply-chain efficiency initiatives
- Introduce initiatives to enhance firms' marketing capabilities
- Ensure the education system produces enough STEM (science, technology, engineering and maths) graduates, and that the business sector is capable of absorbing them at an efficient rate.

THE 'STATE OF TECHNOLOGY' IN COMMON USAGE WITHIN THE BUSINESS SECTOR IS HIGHEST AMONG: YOUNGER FIRMS (0-5 YEARS OLD), SMALL FIRMS AND PROFITABLE FIRMS



Chapter Two

Regulatory overload

Professor Nick Mroczkowski &
Dr Geoff Speight: Deakin University*

*Other Chapter Contributors, Consultants, Advisers, and Case Study Volunteers (See page 69)

Regulatory overload

The IPA-Deakin SME Research Centre continues to be concerned about the impact of regulations developed by lawmakers in Australia, and in offshore jurisdictions, which can impair the ability of small business owners to focus on growing their businesses.

Reducing regulatory burdens will relieve small business owners of onerous compliance tasks. Regulatory imposts remain one of the key problems cited by small business (i.e. as time-consuming and unnecessary requirements that impair their ability to spend more time on innovation and on growing their enterprises).

This negative sentiment is corroborated by research conducted by the Australian Bureau of Statistics (ABS), which shows that an increasing number of small business owners are concerned about the way regulators do not appear to consider the impact of new regulations on business owners' ability to build their businesses.

Further corroboration of the impact of regulatory imposts on small-to-medium enterprises is supported by recent research undertaken by the Centre (2017)[31], using an extensive ABS data set covering the period 2006-2014.

HEADLINE FINDINGS

- Surveys undertaken by industry, financing and professional bodies show an increasing number of small businesses continue to be concerned with the impact of laws and regulations on their ability to run their business and innovate.
- Recent studies show that Australia has a complex regulatory structure for charities and the not-for-profit sectors that needs urgent attention.
- The federal government has been attempting to consolidate regulatory bodies to achieve efficiencies and reduce the cost of regulation. This process has impacted accounting and audit standard-setting.
- Risk-based regulation should be considered as a preferred approach for dealing with regulatory challenges.
- Concerns about the compliance with accounting standards by charities and not-for-profits have led to proposals for 'proforma' reporting.
- Accounting standard-setters are currently reviewing accounting frameworks to determine whether the way in which accounting standards currently apply to a range of small entities ought to change.
- The use of special purpose financial reports for regulatory lodgements is also being reviewed, with the possibility of removal and replacement with a third tier of reporting.

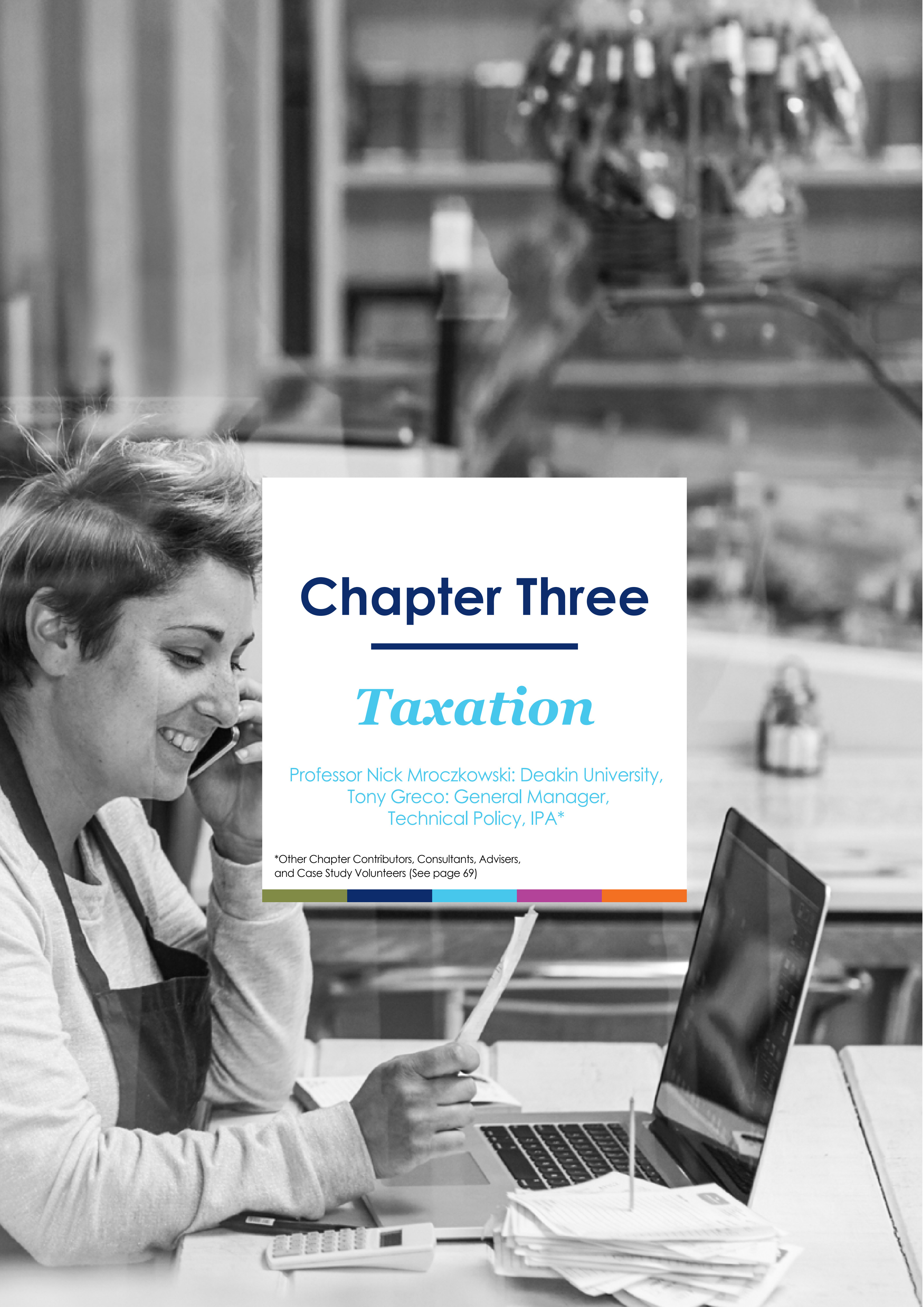
RECOMMENDATIONS

- The federal government should continue to emphasise the need for 'risk-based' regulation, so individuals and entities that are at a 'low risk' of non-compliance are not subjected to inappropriate and unnecessary regulatory scrutiny.
- The federal government should continue to contribute to the work of the OECD in enhancing global awareness of good regulatory practice.
- The federal government should continue to conduct periodic reviews of regulatory agencies/bodies and statutory boards to ensure that public interest is well served.
- The federal government should continue to use the Office of Best Practice Regulation (OBPR) to ensure that laws and regulations take account of the needs of small business. The government should also strengthen the use of small business regulation impact statements.
- The federal government should ensure that company extracts and financial statements lodged with the regulator are made freely available. We refer to our recent consultation on this proposal.
- The federal government should take all necessary steps to consolidate corporate and other registers so that small business owners are able to deal with one portal for all their compliance needs. We refer to our recent consultation on this proposal.
- The federal government should pursue all necessary measures to implement one regime

[31] IPA-Deakin SME Research Centre (2018a).

for registration and regulation of charities and not-for-profits. We refer to our recent consultation on this proposal.

- The federal government should consider the role of regtech (technology-based solutions applied to regulatory compliance) and facilitate the introduction, development and application of regtech solutions (especially by small business) as a means of easing the regulatory burden.
- The Australian Accounting Standards Board (AASB) should continue to review existing accounting frameworks to ensure they reflect the needs of the community and maintain the integrity of the measurement and recognition requirements contained in international financial reporting standards.
- Preparers of special purpose financial statements will need to review the format of their financial statements following changes made by international accounting standard-setters to the conceptual framework.



Chapter Three

Taxation

Professor Nick Mroczkowski: Deakin University,
Tony Greco: General Manager,
Technical Policy, IPA*

*Other Chapter Contributors, Consultants, Advisers, and Case Study Volunteers (See page 69)

Taxation

The passage of tax reforms through the United States Congress under the Trump administration has created an opportunity to again raise questions about the status of tax reform in Australia. Wholesale reform is possible, with the aim of re-designing a tax system that is no longer fit for purpose.

Reform has stalled in Australia, in part because most tax discussions have been the subject of political trench warfare. Partisan arguments over reforms will usually result in no change unless a government has the necessary numbers in both houses of the federal parliament to successfully shepherd through reform.

Some Australian companies or individuals may choose to base their corporate operations overseas while this domestic policy skirmish continues. Policy debates create uncertainty, and this needs to be borne in mind by all sides of politics.

Reforming the tax regime may assist in keeping businesses in Australia. Encouraging entrepreneurs to start, run and keep their businesses in Australia by dealing expeditiously with taxation reform is an essential ingredient when contemplating how best to ensure a stable economic future for the country. Achieving the necessary reform requires Australia's political leaders to set aside a piecemeal approach to tax policy.

HEADLINE FINDINGS

- Federal Treasury has stated that the impact of the US tax law changes will become evident over time. As capital markets have become increasingly global and business locations increasingly mobile, governments are using the lowering of corporate tax rates as a means of driving economic growth. The US reforms have the potential to accelerate tax competition, making Australia's current corporate tax rate increasingly uncompetitive internationally.
- Australia is yet to get closure on a comprehensive taxation debate.
- The federal government and the federal opposition remain reluctant to address the goods and services tax (GST) as a part of reform.
- Singapore offers an example for corporate tax reform designed to encourage the establishment and growth of new businesses.
- Incompatibilities remain to be addressed between payroll tax and land taxes.
- Australian schools do not appear to place sufficient emphasis on developing an understanding of the tax system.
- There is a need for a holistic review of policy objectives in relation to small business tax concessions (given the multitude of such concessions).

RECOMMENDATIONS

- The federal government should renew its commitment to a comprehensive tax reform process – a new process to draw on all the work already undertaken (including the Henry Tax Review and Tax Forum) in formulating a blueprint to prepare our economy for the challenges ahead. The government should realign our tax system to reduce its heavy reliance on individual and corporate income tax.
- The federal government and federal opposition should explore changes to the GST.
- The federal government should explore the use of a parliamentary forum (such as a committee) to seek further stakeholder views on tax reform. Such an inquiry should also use the Parliamentary Budget Office to model various scenarios.
- The federal government should investigate the potential implications of adopting tax incentives for new businesses, such as those operating in countries such as Singapore.
- The federal government should explore options with the states and territories to either remove payroll taxes or, at the very least, to ensure the laws and the way they apply are consistent across the country.
- The federal government should ensure the smooth implementation of the single touch payroll regime.
- The in-house facilitation process for resolving taxation disputes should be constantly promoted and recommended by professional advisers as a potentially effective and cost-efficient means to resolving tax disputes.
- The federal government should establish clear policy objectives for small business tax concessions. (What is it that we want to

achieve?) Clearly-defined policy objectives would assist in ensuring that tax concessions are appropriately targeted to achieve the desired outcomes.

- Small business tax concessions need to be consistent, with the policy objectives as defined. A holistic review of all the current concessions needs to be undertaken to ensure the suite of tax concessions work collectively to support small businesses through all stages of a business life cycle. Small business tax concessions must be benchmarked against the policy objectives to ensure they are well-targeted and remain so. The IPA-Deakin SME Research Centre supports the independent self-initiated review of small business tax concessions conducted by the Board of Taxation. The consultation guidelines which set out the principles for evaluating and improving the current suite of tax concessions for small business is an appropriate basis for undertaking a holistic analysis.
- A whole-of-government approach is required for small business assistance programs. Accountants are well placed to deliver such programs, as they already act as advisers to small businesses.
- The tax system should provide targeted assistance towards stress points in a business life cycle, such as the start-up phase or during a temporary setback. Most tax concessions (excluding the Small Business Capital Gains Tax concession and refundable R&D concession) are merely timing benefits that bring forward tax deductions to reduce the amount of tax payable, which is only useful if the taxpayer is in a tax paying position. If a small business is in the start-up stage or undergoing a temporary downturn, the bringing forward of deductions may not provide essential cash flow benefits other than more carried-forward losses. Loss-carry-back for corporate entities is one way the tax system can assist taxpayers deal with a temporary setback. Non-corporate entities, while problematic, may also require similar relief to assist with the survival of viable businesses.
- To avoid incentives towards complex business structures, consideration should be given to the creation of a simplified small business entity. Our current tax rules provide an incentive for small businesses to use complex structures. Tax outcomes depend on business structures, and multiple structures are needed to achieve tax outcomes that would be otherwise unavailable through a single entity.

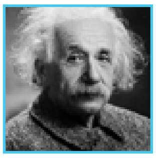
Morgan Stanley

"YOU MUST PAY TAXES. BUT THERE'S NO LAW THAT SAYS YOU GOTTA LEAVE A TIP"

Morgan Stanley

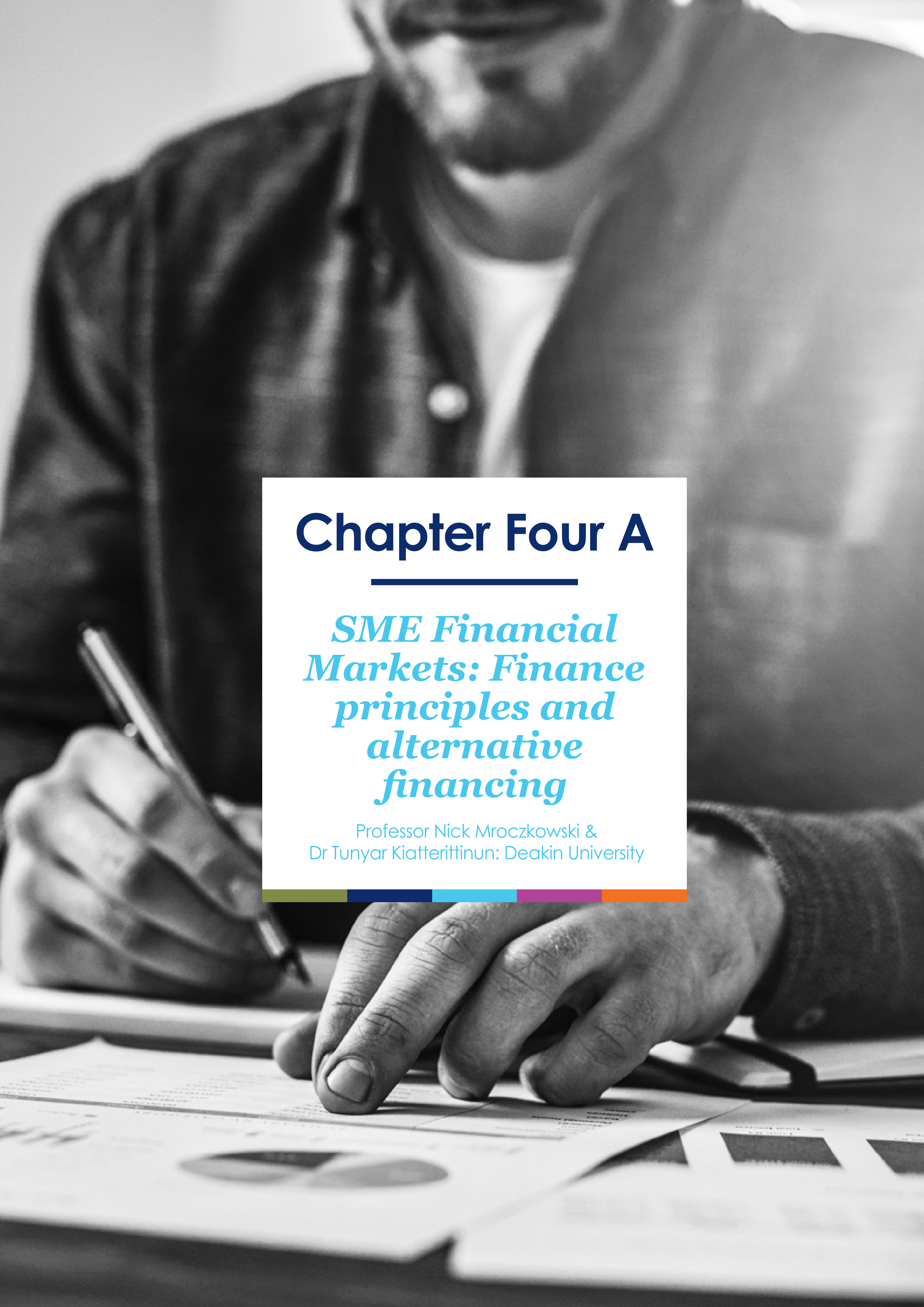
"I SHALL NEVER USE PROFANITY EXCEPT IN DISCUSSING HOUSE RENT AND TAXES"

Mark Twain



"THE HARDEST THING IN THE WORLD TO UNDERSTAND IS THE INCOME TAX"

Albert Einstein



Chapter Four A

SME Financial Markets: Finance principles and alternative financing

Professor Nick Mroczkowski &
Dr Tunyar Kiatterittinun: Deakin University

Finance principles and alternative financing

In the first *Small Business White Paper*[32], the IPA-Deakin SME Research Centre (then known as the IPA Deakin University SME Research Partnership) provided theoretical and practical support to a government-backed loan guarantee scheme for SMEs; and highlighted various forms of equity-based finance for SMEs, including venture capital, for which we also recommended a publicly-supported venture capital fund. In the current white paper, we note that credit conditions and access to debt capital continue to play out as major constraints for SMEs[33] in Australia and, with the exception of some state-based financing initiatives, Australia is still counted among the few developed countries that do not have a government-backed loan guarantee scheme for small businesses.

The significance of SMEs in contributing to economic growth and prosperity is well documented in countless private surveys, in an almost endless list of contributions from investigatory journalists, and in a plethora of scholarly articles[34]. While governments around the world have long recognised that the SME sector is the engine room that drives their respective economies[35], more intervention by governments is needed in some countries (including Australia), to mitigate or remove significant constraints impacting small-to-medium enterprises. Counted among the more prominent constraints identified by Australian business owners are the lack of access to debt financing, high taxes and ongoing regulatory imposts[36].

The IPA-Deakin SME Research Centre maintains that the financing issues confronting SMEs, as observed in the first *Small Business White Paper* (and briefly reiterated in the second), continue to be problematic for SMEs, on both the demand side and the supply side. This suggests that sub-optimal lending persists in the SME sector in Australia. On the demand side, SMEs continue to compete with their larger counterparts in highly-competitive debt markets.

HEADLINE FINDINGS

- OECD reports (supported by the G20) explore innovation in SME finance.
- There is a need to broaden the terms of traditional lending to SMEs.
- Alternative options for SME finance, such as asset-based lending, are growing in popularity.
- There is an urgent need for governments to revisit loan guarantee schemes for SMEs.
- Financial literacy: training in finance and related disciplines helps achieve better financing outcomes for SMEs.
- There is an urgent need to develop a generally-accepted definition of an SME.

RECOMMENDATIONS

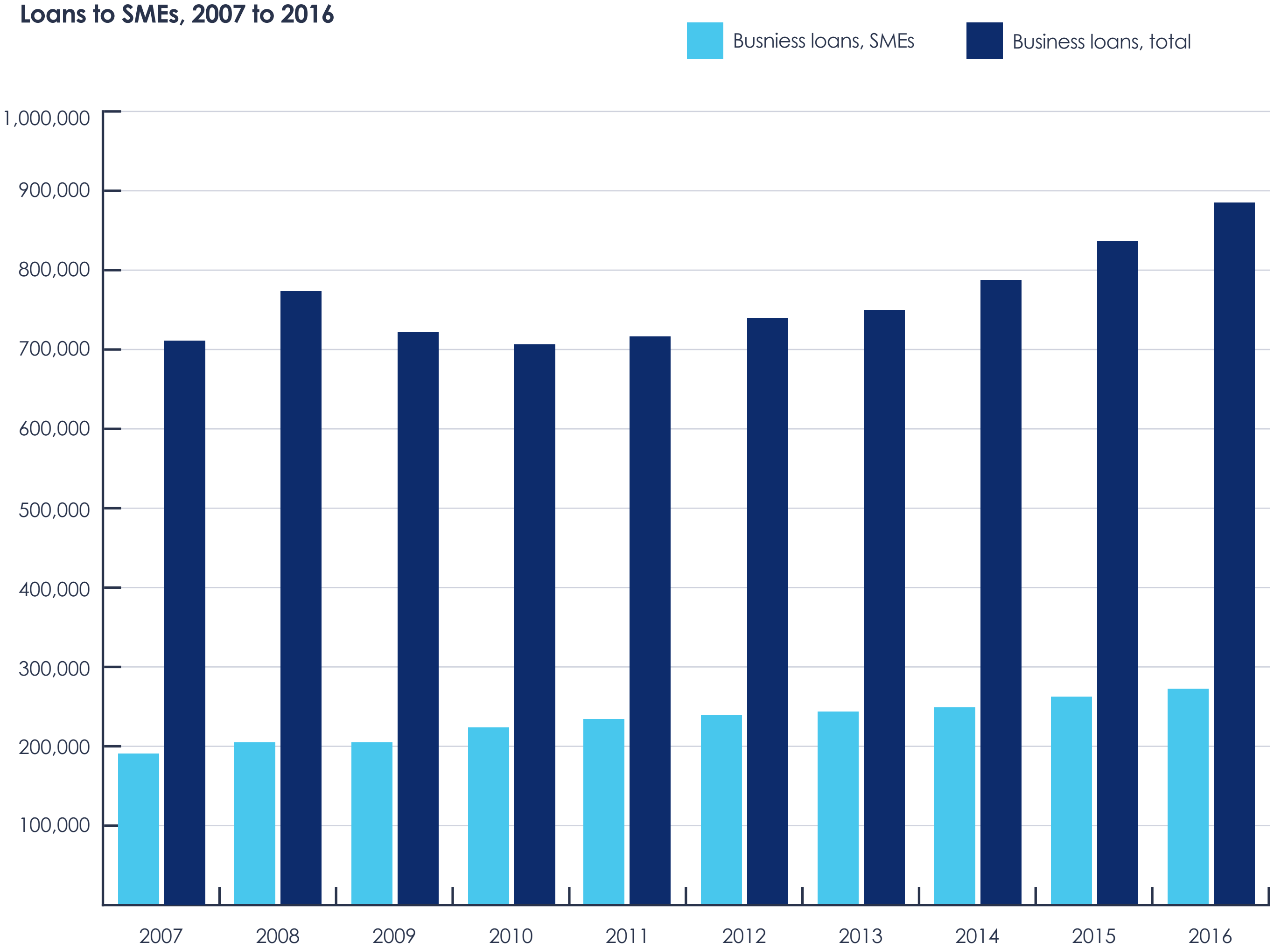
- The federal government must review its current policy settings for SME finance to ensure it is following world's best practice, as specified by the G20 and OECD.
- Given the importance of SMEs as significant contributors to (and drivers) of GDP, the federal government should provide appropriate incentives that encourage financial institutions to urgently re-examine their finance offerings for SMEs. These should include the provision of varying options allowing SMEs access to funding for starting up a business and for working capital. While the primary role of financial institutions is to generate returns for shareholders, given that there is significant industry concentration in the banking industry in Australia, banks have a dominant role in financial markets impacting all businesses. Accordingly, the IPA-Deakin SME Research Centre is of the view that banks and similar institutions have wider obligations

[32] IPA Deakin University SME Research Partnership (2015).
[33] Scottish Pacific Business Finance (2017), p13.
[34] An excellent review of the SME finance literature is provided in Kersten, Harms, Liket and Maas (2017)
[35] Scottish Pacific Business Finance (2017).
[36] Scottish Pacific Business Finance (2017).

towards ensuring the financial health of the business community.

- Loan guarantee schemes must urgently be initiated for Australia to be in step with similar initiatives in offshore jurisdictions.
- Vocational education courses must receive priority funding from the federal government to enhance SME owners' financial literacy. The IPA-Deakin SME Research Centre also supports practical education in areas encompassing business strategy and management, which should also form part of the educational offerings.
- Incentives for further financial literacy and SME business management education, such as tax deductibility for educational costs, should be offered to SME owners via the tax system. Registered Training Organisations (RTOs) could partake in government incentives and play a more active role in encouraging SME operators to improve their knowledge in business management and finance.
- The federal government should seek to fund research initiatives to support the work of the OECD in developing a generally-accepted definition of SMEs.
- The federal government should support initiatives for the introduction of a new bank that services the specific financing needs of the SME sector.

FIGURE 3:
Loans to SMEs, 2007 to 2016



Source: OECD (2018), Financing SMEs and Entrepreneurs 2018: An OECD Scoreboard, OECD Publishing, Paris. http://dx.doi.org/10.1787/fin_sme_ent-2018-en. Accessed 4 June 2018.

CASE STUDY: Quickstep and the NSW and federal governments

Quickstep Holdings Limited ('Quickstep') is an Australian publicly-listed company at the forefront of advanced composites manufacturing and technology development.

Quickstep is currently the largest independent aerospace-grade advanced composite manufacturer in Australia, partnering with some of the world's largest defence and aerospace companies, including Lockheed Martin (USA), Northrop Grumman (USA), Boeing Defense (USA) and BAE Systems (UK), as well as Victorian-based Marand Precision Engineering.

Quickstep's advanced manufacturing headquarters are in Bankstown NSW. The company also has a global Research &Development (R&D) centre and a demonstrator-manufacturing facility within Deakin University's Waurn Ponds campus in Victoria. It currently employs 230 people, with 210 working at the Bankstown site. The majority of Quickstep's revenue is attributable to defence export sales, with its Bankstown operation 100%-export focused.

Quickstep is a major supplier to the global Joint Strike Fighter (JSF) F-35 program, manufacturing and supplying a range of centre fuselage and vertical tail composite parts for the F-35 aircraft. The company is also the global supplier of composite wing flaps for the C-130J transport aircraft program. It has long-term contracts in place for both major programs, which have required a significant investment in 'state of the art' capital and equipment to manufacturer high-precision parts.

Quickstep recently completed a planned $10 million capital expansion of the Bankstown facilities, taking the total investment made at the Bankstown site to over $30 million since it officially opened in 2012.

Funding for this substantial investment in plant, equipment and people was achieved through a number of mechanisms involving capital raising via shareholders and new investors, and with the strong support of the NSW and federal governments and Quickstep's key customers.

FUNDING SUPPORT

Quickstep was originally established as a R&D business in 2001 to develop advanced composite manufacturing process technologies. The company was, at the time, based in Western Australia (WA). It publicly listed on the Australian Stock Exchange in 2005.

Quickstep commenced its journey from WA to NSW in 2009, when it secured its first manufacturing contract for the supply of composite components to the JSF program.

The move from Coogee WA to Bankstown NSW was undertaken with assistance from the NSW Government, through funding support for the establishment of Quickstep's aerospace manufacturing facility in Bankstown. This funding helped Quickstep to move into vacant buildings that were previously the home of Boeing Australia, before that company consolidated all of its manufacturing in Port Melbourne, Victoria. The government funding supported Quickstep in the refurbishment of the vacated site, the purchase and commissioning of new manufacturing equipment and the recruitment and training of a new workforce.

This was a win-win situation for Quickstep and the NSW Government. Quickstep established a new advanced manufacturing facility to support its recently-secured export contracts and meaningful employment was founded for a number of ex-Boeing staff.

Quickstep now has a long, enduring relationship with the NSW Government and sees it as a key partner in the company's success and ongoing growth. The NSW government has also been a strong advocate for Quickstep within government circles and with existing and new customers, both domestically and internationally.

Getting established was, however, not the only issue for Quickstep. It was now a participant in the world's largest defence program, and thus needed to be able to fund the operational expenses related to supplying export parts for the JSF and C-130J programs as well as needing to add further capital to support the future ramp-up of JSF volumes.

This is where the Australian Government came in with support, in the form of a multi-option finance facility through the Export Finance and Insurance Corporation (Efic). This included a performance bond facility for technology export contracts and an export working capital guarantee to support growth in the existing aerospace contracts.

The combined funding packages from the NSW and federal governments were instrumental in ensuring Quickstep's participation in both of the two defence export projects, allowing the company's transformation from an R&D organisation into one that can manufacture advanced composite parts and sell its technical capabilities to the world.

The package of work carried out by Quickstep within these two projects will sustain the 200+ new jobs created, and will enhance the company's reputation as an international manufacturer and distributor of advanced composites.

LESSONS FOR SMES

Collaborating and partnering with government can provide substantial benefits for SMEs in Australia, both from a funding perspective and in advocacy for your company across government and within industry. Both the state and federal governments have a number of initiatives and support programs designed to assist and grow Australian businesses. SMEs are well advised to seek these out.

Government initiatives available include support for:

- business start-ups
- R&D
- commercialisation and growth
- international market access
- business improvement
- staff recruitment and training
- export market sales

Government support and partnering come with obligations for SMEs, mainly centred on creating and sustaining meaningful jobs for Australians and delivering economic value to the community, both of which are good things for SMEs and Australia as a whole.

Chapter Four B

SME Financial Markets: The case for crowdfunding in Australia

Professor Nick Mroczkowski and Professor George Tanewski: Deakin University,
Professor Marc Cowling: Brighton University (UK)

The case for crowdfunding in Australia

In the first *Small Business White Paper*, we provided a brief account of an emerging form of finance for SMEs now commonly known as *crowdfunding*. Government initiatives for the introduction of crowdfunding as a legal, permissible form of financing in Australia commenced in 2014/15 (for public companies) and 2017 (for proprietary companies). In response to these initiatives, the Institute of Public Accountants prepared and lodged two detailed submissions to government proposals issued in 2015 and 2017 respectively[37].

IF EXPERIENCES IN THE UNITED KINGDOM AND THE AMERICAS CAN BE TAKEN AS A GUIDE, EQUITY CROWDFUNDING WILL RAPIDLY DEVELOP INTO A MAJOR SOURCE OF FUNDING FOR THE SME COMMUNITY IN AUSTRALIA

Given that equity-sourced funding has now officially commenced in Australia, as of 1 September 2017 for public companies, and that legislation is currently being drafted for proprietary companies, the IPA-Deakin SME Research Centre believes it is important to revisit this source of funding, which the Centre maintains will be an important measure for bridging the so-called financing gap for SMEs.

Indeed, it was pleasing to see that the new crowdfunding legislation got off to a good start, given that, at the time of writing, "Australia's first equity crowdfunding deal closed successfully".[38]

HEADLINE FINDINGS

- Equity crowdfunding is one of the fastest-growing types of crowdfunding in many countries (particularly European countries, the United States and China).
- Australia has recently paved the way for equity crowdfunding by passing legislation for public companies, and by inviting comments for proposed legislation for private companies to be permitted to partake in equity crowdfunding activities. These measures put Australia in step with other jurisdictions that have, for some time, relied on crowdfunding as a primary source of SME financing.
- If experiences in the United Kingdom and the Americas can be taken as a guide, equity crowdfunding will rapidly develop into a major source of funding for the SME community in Australia.
- Crowdfunding has been acknowledged by many economies as a finance mechanism that circumvents traditional bank lending and, thus, has become instrumental in bridging the SME financing gap.
- There are still legal and practical issues to be addressed before legislation for proprietary companies is passed.
- Crowdfunding, as an industry, is emergent and remains hugely immature in many countries. There is, as yet, little consolidation of platforms and, while a number of crowdfunds will quickly develop, the industry is still characterised by a growth of new entrants, high levels of innovation and several experimental formats in offerings to investors.
- Trends relating to venture capital (VC) as a source of funding suggest a shift from funding seed capital to funding 'later stage' financing needs.

RECOMMENDATIONS

- There is a need for clarity relating to the operations and legal aspects of crowdfunding in Australia, particularly around the rights and obligations of existing shareholders and the new categories of 'first time' and secondary crowdfunding shareholders.
- Changes in financing via the VC route provide opportunities for governments and financial institutions to address the finance gap through alternative finance models such as, for example, more 'asset backed' loans (including the recognition of intangible assets as collateral), project financing and leasing.
- Governments and other bodies, such as financial institutions and industry groups, should encourage SMEs to use alternative sources of finance as a means of bridging the SME finance gap.
- The federal government should endeavour to pass legislation, as a matter of urgency, allowing proprietary companies to take advantage of equity crowdfunding.

[37]Institute of Public Accountants (2015); Institute of 38Public Accountants (2017). Australian Fintech (2018).

Chapter Five

Workplace relations

Dr Vince Giuca: Partners-In-Business Institute,
Professor George Tanewski: Deakin University

Workplace relations

The small business sector is an important employer of labour and contributes significantly to the Australian economy. However, the sector is diverse. While not all small private-sector businesses employ people, 798,000 (or almost 38.0%) are employers of labour, employing 4,731,000 (or over 44.0% of all employees).

Small business owner-managers who employ labour face many challenges in managing their human resources (HR), especially if they want to grow their businesses. An important distinction to make relates to whether an owner-manager is growth-oriented. This will significantly impact how the business is likely to be managed in a sustainable way, noting that small businesses have a higher failure rate than their larger counterparts.

While the workplace relations system is sometimes seen as imposing unnecessary compliance costs on small businesses, the system provides for flexible work arrangements that are not necessarily accessed by small business owner-managers. It also provides owner-managers with key standards or benchmarks, so they can readily determine what to offer their people in terms of pay and other terms and conditions of employment. These are readily available and easier to understand than in the past.

Businesses that rely on paying their people (minimum) award terms and conditions are less likely to succeed. HR are an important source of superior productivity and competitive advantage. Business owner-managers who do not demonstrate that they value their people are less likely to achieve such results[39].

HEADLINE FINDINGS AND RECOMMENDATIONS

- The small business sector is often perceived in the business and political media as a homogeneous group. It is, however, very diverse and a critical distinction needs to be made between growth (entrepreneurial) and non-growth-oriented owner-managers. While the latter group is numerically significant, growth-oriented entrepreneurs, in the main, do the heavy lifting when it comes to new job creation. New and small businesses are subject to vulnerabilities – that is why the survival rates are relatively low for such businesses. The longer they survive and the more they grow, the more sustainable they become. Growth-oriented businesses have the opportunity to contribute more significantly to employment growth.
- In broad terms, the workplace relations system appears to work reasonably well. Some will undoubtedly be critical, often on political or ideological grounds, while others will see merits in the current arrangements, perhaps with some changes. This is inevitable for an area that is highly contested and has seen many significant changes since its inception nationally following federation. Whenever fundamental changes have ensued, the impact has been felt at the coal-face, by employers and employees who have had to turn to third parties for assistance in interpreting and operationalise system changes. Whether the changes are worth the resulting confusion and instability (and money) is often not known for some time. Even then, it often turns on political and ideological considerations.
- Owner-managers of small businesses, including entrepreneurs, will benefit from a workable workplace relations framework that delivers consistency and stability. Such owner-managers are time-poor and lack resources to deal with too many ongoing changes, particularly of a significant nature. Such owner-managers, especially the entrepreneurial types, are looking for (sustainable) advantages to outdo their competition. These players will need to know how to operate optimally within the workplace relations system, but the system itself will not provide competitive advantage. However, how HR are managed within the owner-managers' firms will be an important driver of (sustainable) competitive advantage.
- Continued effort is required to ensure small business owner-managers understand their

[39] Fox and Smeets (2011); Ichniowski and Shaw (2003); Lazear (2000).

legal rights and responsibilities with regard to workplace relations, not necessarily at an expert level, but for the purposes of managing their workforce in a fair, equitable manner and in a way that is conducive to a sustainable, productive work environment. To achieve this:

  - Easy-to-understand regulatory material needs to be readily available. For example, the continued effort of the Fair Work Ombudsman (FWO) to work collaboratively with agencies such as the Australian Small Business and Family Enterprise Ombudsman and other small business and associated bodies is very important to ensuring the relevance of information for small business owner-managers.
  - Small business owner-managers should be given the opportunity to make enquiries regarding workplace relations matters anonymously (to encourage a more accurate, timely information flow).

- Penalty rates are a highly contested area of the workplace relations landscape. They were introduced as a deterrence against the use of longer, unsociable working hours by employers, as well as to compensate employees for working such hours. Over time, consumer preferences have changed to longer trading hours in the retail and hospitality sectors. The Fair Work Commission (FWC) has addressed this issue recently and, through transitional arrangements, is aligning Sunday penalty rates with existing Saturday rates. This seems to be a sensible approach as it removes inconsistencies for undertaking any weekend work. However, it is unlikely to present businesses (including small businesses) with any distinctive competitive advantage, as all businesses across these sectors would be similarly impacted.
- The main direction and operation of federal unfair dismissal provisions appear to be fulfilling important fairness and justice standards and need to remain. We note that the Productivity Commission, in its recent review of the workplace relations framework, did not see any evidence to justify removing such provisions. Importantly, it concluded that unfair dismissal provisions are not playing any significant role in employers' hiring and firing decisions.
- Due to resource constraints experienced by small business owner-managers, it is important that regulators, at all levels of government, continue to address and remain vigilant to compliance burdens. Regulatory requirements need to be simplified and associated cost-burdens minimised where they are unable to be removed (such as with the wording and administration of awards and the inspectorate role of the FWO).
- While improvements to the workplace relations systems will continue to be important in addressing any anomalies and modernising outdated provisions, substantive and sustainable improvements to business productivity and competitiveness are more likely to arise from changes made at the firm level. Major differences in productivity and competitive advantage will be shaped, to a large extent, by what happens in specific workplaces and not so much by legislative or governmental changes at the national level.

THE MANAGEMENT OF HUMAN RESOURCES IN THE WORKPLACE IS A VITAL INGREDIENT IN A FIRM'S ABILITY TO SURVIVE AND ATTAIN COMPETITIVE ADVANTAGE

CASE STUDY

ABC Hairworkshop

The Issue: Difficulty in Obtaining Good Quality Staff

ABC Hairworkshop is a hairdressing business that was based in a large city in New South Wales, has recently closed its doors. Both principals of the business decided that finding, hiring and retaining young committed employees with passion for the industry is a serious obstacle.

Nyugen Ha*, a young highly trained stylist and one of the two owners, argues the biggest reason for exiting the business is that "it's been really difficult to find and retain competent and committed staff". As the business is located in quite a large city, she suggests that it is easier for people to get work in firms that have standard regular hours. She has also found it hard to find apprentices and believes that a three year apprenticeship has become a major obstacle.

The business was first opened in July 1996 by John Tory*, and at the time, there were two other employees. From being a silent investor in the business, Nguyen joined in a full-time role in 2007. By 2012, in addition to the two owners, the business had grown to 12 employees. This level of employment was maintained for the next four years. Just before ceasing, the business employed one full-time employee, an apprentice, and two casuals.

Nguyen does not see penalty rates as an obstacle and points out that ABC Hairworkshop pays well above the award rate. According to her,

"I don't see that [penalty rates] as the heart of the issue, that is just a political thing. All of that is political and is of no consequence to the actual businesses or employees because if you are good at what you do you will be paid what you're worth. … Most successful hairdressers, in our industry, they pay people above the award wage and penalty rates don't come into that but it is finding the right people, firstly, that is the biggest struggle we have."

However, from Nguyen's point of view, flexible working hours impose a burden on small businesses such as hers because there is often a mismatch between the hours casuals want to work and what is necessary to retain clients, especially around working during the peak, busy times, which includes Saturdays.

As with many small business owners, lack of resources and time is a constant theme that emerges and ABC Hairworkshop is no different. Nguyen expresses the frustration in obtaining clarity regarding workplace relations regulations. She gives an example where one of her full-time staff wanted to go part-time but this would have a hugely negative impact on her business as she really needed a full-time person in that particular senior role.

Nguyen contacted Fair Work Australia, the Fair Work Ombudsman and Worksafe but was unable to obtain a definitive answer about what she should do. ABC Hairworkshop was not a member of an industry association. Fortunately, and after some time and effort, the matter was resolved amicably with a mutually satisfactory arrangement.

However, according to Nguyen, the unfair dismissal laws are "far too loose and for private enterprise they can't cope with the cost of it and small business can't cope with the cost." She argues that while ABC Hairworkshop was never subject to unfair dismissal claims, it was the possibility of this happening that provided the biggest concern for both business owners. Nguyen explains,

"Unfair dismissal, it is hard … if you have an under-performer you have to manage that with required time. … that costs you money, that costs you time but you can't get rid of them if they are ineffective. You have to go through the process, you have to manage them and make sure they're complying and then it comes down to he said, she said but then the writing is on the wall and then they make a decision if they get a job somewhere else and then they go."

Nguyen finishes on a rather pessimistic note saying that "the conclusion we have come to is having more staff or having a bigger business is no longer viable today. Basically, work for yourself and that is it, and have no employees."

*Names have been changed at the request of contributors

CASE STUDY

Hancock Creative.

The Issue: The Power of Stories to Differentiate

Alecia Hancock started her business on her own with the help of a virtual assistant in October 2010 and shifted the business' focus to exclusively target the cause sector (not-for-profit and social enterprises) in 2015. Hancock Creative now specialises in helping these enterprises become more sustainable by learning how to market themselves in today's world. According to Alecia, many do not realise that solutions to their funding problems can often be addressed through social media.

Hancock Creative now employs eight people under a mix of full-time and part-time employment arrangements. Alecia points out that she normally has contractors as well, but at the moment everyone is employed on a permanent basis, stating that,

"Most of my team fall into the category of permanent part-time because we offer flexibility around families. A lot of our team have kids, some of them might work five days [a week] but work 9 to 3, for example."

While the business is based in Perth, it has a presence in Sydney and Brisbane. Alecia expects to double the size of the business over the next 12 months in a sustainable way.

Having limited resources and taking account of the difficulties of managing a fledgling growth oriented business, Alecia explains that she considered merging with another similar business but decided against that move. Instead, she assembled an advisory board that she is very happy with.

"What I have learnt … I am better off having an advisory board. So we have that now for the business, where we have experts and people that I can have those conversations with. Now that I have an operations manager as well we can have high level conversations internally. For a long time I felt that way that I may have needed a partner but now I don't really feel that anymore because I have plenty of people to bounce ideas off."

In addition, Alecia has a small legal firm on a retainer so that she can readily obtain answers to legal questions and stay up-to-date with regulatory issues relevant to her business. As a result, Alecia is not fazed by unfair dismissal laws in Australia, partly because she has ready access tolegal advice and, secondly, because the culture at Hancock Creative is focused on trust and transparency coupled with the active use of performance management. She explains that,

"I have had situations in the business where things haven't been working out. I am a fan of performance management where you have a lot of conversations before you let someone go where you kind of go 'hey, this is what is required'. … I usually have metrics - this is what good looks like, this is what less than good looks like, this is what really good looks like - where are we sitting right now. And then they can usually go 'right, I'm below the curve on a few of these' and we have weekly meetings for a while and it either resolves itself …"

She continues by arguing that her business is about creating the right work environment where work purpose and job design feature prominently in order to make work attractive. Alecia does not compete on salary because she knows she can't. Creating an attractive workplace culture is more important for attracting and retaining quality employees, so finding the right employees is not an issue at Hancock Creative.

On a positive note, Alecia concludes that perceptions of small business owners and the stories they tell about their businesses can be very powerful.

"Sometimes as small business owners we find the problems and look for the excuses and go 'we can't do this, we can't do that', instead I think shift that story and go 'what can we offer that no one else can that makes us more attractive'. Every business has that story and if you lead with the story and get people to follow you it's amazing what you can achieve."

Chapter Six

Job creation and job destruction

Professor Marc Cowling: Brighton University (UK),
Professor George Tanewski: Deakin University

Net employment dynamics of Australian SMEs

Since its inception in 2013, the IPA-Deakin SME Research Centre has been tracking the economic behaviours of SMEs in Australia, analysing and highlighting in its 2015 *Small Business White Paper* the performance of these businesses in relation to financing, innovation, skills and human capital, competition, and regulation. This chapter extends the 2015 white paper analysis further by focusing on the net employment of Australian SMEs and its relationship to size, age and innovation.

While evidence in the literature suggests that employment growth is generated by a few rapidly growing firms in a number of developed economies[40], these high-growth firms are not necessarily small and young. More importantly, to date there is limited evidence on better understanding employment growth in Australia in relation to firm characteristics such as size, age, innovation and other firm factors.

This chapter addresses the gap in the literature by focusing on these specific SME firm characteristics and their contribution to Australia's net employment between 2006-07 and 2013-14, by using the Australian Bureau of Statistics' (ABS) Business Longitudinal Data.

SMEs are an important contributor to the Australian economy and are a major source of employment for Australians. SMEs often provide more employment opportunities for unskilled workers, thus they help to drive down the unemployment rate, which can have positive flow-on effects to Australian society in general.

For decades, economic policy-making and research has been influenced by the assumption that business growth is independent of firm size. More recently, however, economic research has questioned this assumption by demonstrating that small firms grow faster than larger firms and that smaller enterprises are a more important source of job creation in the economy. Indeed, a body of research on employment shows that employment growth is actually dependent on the size of the enterprise, with some empirical evidence indicating that job growth is inversely related to firm size.

Notwithstanding this inverse relationship between employment and firm size, we also note from the Productivity chapter in this white paper that there are significant, persistent productivity differences between different SME firm size and age classes that possibly affect both firm survival and growth. Moreover, the extant literature[41] reports that the entry, exit, expansion and contraction of firms are significantly associated with various measures of productivity and profitability.

The concept of 'creative destruction' – a term coined by Austrian-American economist Joseph Schumpeter in 1942 – is an important feature of competitive markets that are dominated by small firms. The concept describes what happens when new entrepreneurial small businesses challenge existing incumbents, driving productive 'churn' whereby inefficient firms exit and the efficient grow. The efficient reallocation of resources between these growing and shrinking firms is critical to aggregate productivity growth and employment.

Accordingly, this chapter examines net employment among SME firms by considering whether size, age and innovation (and the type and processes of innovation) are important determinants of net job creation among SMEs in Australia. The content of this chapter draws from an academic paper written by members of the IPA-Deakin SME Research Centre[42]. Understanding these SME firm dynamics will assist in formulating better policy outcomes regarding job creation in the SME sector.

HEADLINE FINDINGS

- This chapter shows that both business size and age are significant determinants of net

[40] Henrekson and Johansson (2010).
[41] See Syverson (2011); Foster, Haltiwanger and Krizan (2001).
[42] See Cowling, Kiaterittinun, Mroczkowski and Tanewski (2018).

employment, particularly among start-ups and young firms.

- As firms become older, they contribute significantly less to net employment, whereas younger firms (i.e. less than 5 years old) have a significant impact on net employment, contributing on average to around 15% in net employment.
- Start-ups and young firms that innovate, particularly those associated with the introduction of new marketing methods, contribute on average to between 7 and 9% in net employment.
- Another significant determinant of net employment is government financial assistance, contributing on average approximately 3% to job creation.
- Our analyses demonstrate that start-ups and young firms are important drivers of net employment in Australia and, when considering the effects of age and innovation together, we find that these factors significantly contribute to job creation and are important sales growth and performance differentiators.
- Our results show compelling evidence that the innovation capability of start-ups and young firms underpins the observed firm-employment dynamics, significantly influencing employment outcomes in the Australian economy.
- An important policy objective, therefore, is the early identification of start-ups and young firms that have innovation capabilities, as these firms contribute significantly to net job creation.

Chapter Seven

Innovation

Professor Nick Mroczkowski and
Dr Geoff Speight: Deakin University*

*Other Chapter Contributors, Consultants, Advisers, and Case Study Volunteers
(See page 69)

Innovation

Given that innovative firms (particularly start-ups) are known to create more jobs than any other business category[43], federal, state, territory and local governments in Australia must do everything within their scope to assist businesses in understanding the value of innovation and, where appropriate, to provide financial and other incentives to encourage innovative thinking within the small business community.

There is still an apparent lack of appropriate acknowledgement by small businesses of the importance of innovation to the growth of their enterprises. The IPA-Deakin SME Research Centre[44] has noted that the Australian Bureau of Statistics reports that only one in seven small businesses see innovation as important. That statistic alone illustrates that more needs to be done to create and promote incentives for small businesses to improve their prospects of future success.

HEADLINE FINDINGS

- Innovation is a key driver of productivity, jobs creation and economic performance.
- Innovation policy should include measures that encourage the diffusion and uptake of existing innovations by a broad range of firms, as well as encouraging new innovations per se.
- Federal, state and local governments in Australia have a series of grant schemes available for small businesses seeking to grow.
- Government agencies have extensive small business education programs designed to assist small businesses working within the innovation space.
- Public policy to support innovative SMEs should increasingly consider value capture and business model innovation generally.
- Businesses in Australia experience a wide range of barriers to innovation. This suggests policy to support innovation needs to be flexible and broad-based.
- Talent, not technology, is the key. If wider skill requirements are not addressed, there are likely to be bottlenecks created downstream in the innovation process.
- Technical skills across the workforce, and particularly interdisciplinary skills that bridge areas of expertise, are particularly important for innovation and are often subject to market failures.
- Patent box initiatives are gathering momentum in offshore jurisdictions.

RECOMMENDATIONS

- Governments should provide more support for research and development by small and medium-sized firms.
- Better linkages should develop between cutting-edge research universities and industry. Typically, only large firms have the resources to fund university-level research and development.
- Governments should provide more support for firms to adapt existing technologies and innovation.
- Measures should be developed and implemented to help the spread of existing innovations to a broader range of firms.
- Encouragement should be given to firms to adopt 'continuous improvement' methods to embed incremental innovation, as this will generate large productivity improvements quickly.
- The federal government should provide tax breaks for companies acquiring new technologies not developed in-house.
- A 'matching' service should be developed to promote the building of collaborative relationships between multinational corporations and Australian businesses, both domestically and abroad.
- The federal government should provide a tax allowance for companies investing in intellectual property protection (through patents, copyright, trademarks, design rights etc) in-house.
- The federal government should provide tax allowances for companies that generate licensing income for in-house new technologies.
- The federal government should rigorously continue with its patent box initiatives, as outlined in their current reform agenda.
- The federal government should further develop government procurement initiatives to ensure small business procurement targets are met and exceeded by 2022. These programs should be based on programs that are running in the United States.
- The federal government should allocate a pool of funds for further research into youth entrepreneurship in Australia, so policy decisions made in this area are based on research evidence.

[43]Cowling, Tanewski, and Mroczkowski (2017)
[44]IPA-Deakin SME Research Centre (2018b).

CASE STUDY

Research and development tax incentives

Prepared by Arthur Athanasiou, Partner, Thomson Geer

This case study deals with a so-called Research & Development (R&D) 'R&D consultant' who persuaded a small business taxpayer to register for R&D tax incentives and, with the consultant's assistance, prepared what was considered to be all the necessary paperwork required to complete the registration process. Substantial payments were received by the taxpayer from the Australian Taxation Office (ATO) after lodging all the tax returns under the consultant's oversight, after which time the consultant received a sizable commission.

Unfortunately, an audit by both AusIndustry and the ATO revealed that the R&D activities conducted, and the incentive benefits received, were both illegal. The taxpayer had to repay substantial amounts to the ATO.

After further checking the credentials and activities of the 'consultant', the taxpayer found that they had engaged in similar activities in the past with other unwitting taxpayers, and had since simply vanished.

Let's see how certain unscrupulous individuals have unwittingly caused innocent, trusting taxpayers to become involved in R&D tax schemes, for which the refundable offset would not have been payable, but still claimed, and by which a commission was paid to the consultant.

For the sake of the case, let's call the taxpayer 'Mark' and the unscrupulous consultant 'Jeff'.

Mark had worked hard in his tertiary studies and gained degrees in biomechanics and computer science. He became interested in how smartphones and smartwatches were dramatically changing the landscape in relation to personal fitness and well-being. Through a mutual acquaintance, he met Jeff who, after a series of discussions, persuaded Mark that developing a smartwatch application could have further and broad commercial applications, with the development supported by the government through incentives in the tax system, and the profits from selling the application to consumers potentially enormous.

Jeff told Mark that, as with all things government, there'd be a lot of "red-tape", and that he would look after everything, including establishing a company to undertake the necessary R&D activities. All Mark had to do would be to sign a number of forms. Mark would then get involved after Jeff had gotten everything off the ground to consult. Jeff said he would procure the assistance of "code-writers" in Asian countries to finalise and commercialise the application. All the way through the process, expenditure would be incurred, and Jeff was authorised to lodge all tax returns and take a commission for his involvement.

Mark noticed that Jeff had prepared what appeared to be standard documents, such as business plans, commercial agreements, market surveys and analyses, timesheets, completion certificates and standard invoices that were used to charge costs from the company established by Jeff for Mark, to Jeff personally. Mark was a little naive, and it seemed all too 'streamlined', but he nevertheless went along with the process.

Apart from seeing regular lodgements about eligible R&D activities, and some cash received after lodging ATO documents prepared, there was little else for Mark to do. Jeff assured Mark that, just registering the R&D activities with AusIndustry meant the money the company received would never be checked by the ATO.

After two years, things had died down to the point where Jeff had virtually no contact with Mark. There were unpaid bills to the code-writers, and there were outstanding tax, BAS and AusIndustry lodgements. Mark thought he could just walk away and forget about everything.

Sometime later, Mark received letters from AusIndustry and the ATO wanting to check the progress of his core and supporting activities. He attended an interview with representatives from both bodies that lasted for three hours.

It was subsequently determined that Mark:

- failed to keep adequate records of his R&D-eligible activities to show he incurred eligible R&D expenditure
- did not maintain sufficient business records to verify the amount of R&D expenditure incurred, the nature of his R&D activities, and the relationship of the expenditure to the activities
- failed to retain documents that allowed him to apportion his expenditure between eligible R&D expenditure and other non-R&D activities
- did not maintain accurate records of timesheets and detailed narrations about what time was spent on research and developing the concept in accordance with the business plan.

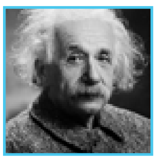
As a consequence of failing to properly substantiate his R&D activities, AusIndustry withdrew its registration and the Commissioner of Taxation subsequently issued amended assessments for income tax and to refund the amounts paid to Mark. This also included penalties and interest.

Mark then set about to contact Jeff, but the telephone number was disconnected and a quick Google search showed that Jeff had adversely affected others in the same way. Jeff had simply vanished. Mark would have liked, at least, a refund of the commissions paid to Jeff.

Here's the epilogue. The Commissioner promptly wound up the company in insolvency and appointed a liquidator. The accountants that Jeff appointed provided the liquidators with the company's most recent financial statements, showing that Mark owed money to the company, which came as a surprise to Mark.

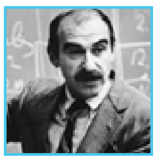
The Commissioner promptly issued Mark with an amended assessment, treating the loan to him as an unfranked company dividend. The amount payable brought Mark to the brink of insolvency, but he was able to ultimately resist the objection through a prolonged legal process.

The moral of the story is that people who profess to have a special knowledge of a very narrow part of the tax law, and who offer outcomes that seem too good to be true, need their credentials and their story thoroughly vetted and checked.



"IF YOU ALWAYS DO WHAT YOU ALWAYS DID, YOU WILL ALWAYS GET WHAT YOU ALWAYS GOT"

Albert Einstein



"CREATIVITY IS THINKING UP NEW THINGS. INNOVATION IS DOING NEW THINGS"

Theodore Levitt

"INNOVATION HAS NOTHING TO DO WITH HOW MANY R&D DOLLARS YOU HAVE. IT'S ABOUT THE PEOPLE YOU HAVE, HOW YOU'RE LED, AND HOW MUCH YOU GET IT"

Steve Jobs

Chapter Eight

Competition policy

Rachel Burgess: Deakin University

Competition policy: will the new laws benefit small business?

The much-awaited Harper Reforms came into operation on 6 November 2017. The key changes, from the perspective of small businesses, are the introduction of an 'effects test' for the misuse of market power, a prohibition on concerted practices, and the inclusion of a power for the Australian Competition and Consumer Commission (ACCC) to grant class exemptions.

HEADLINE FINDINGS

- The Harper Reforms are now in operation:
  - The law has widened in relation to restricting anti-competitive behaviour, as it now covers 'concerted practices' (something less than an 'arrangement or understanding').
  - The reforms introduce a more effective test for determining the misuse of market power.
  - The ACCC now has the power to grant class exemptions to practices that do not harm competition or where the benefit outweighs any harm.
- The reforms have the potential to benefit small business if access to justice can be achieved. Consideration needs to be given to:
  - encouraging private actions for damages (representative or otherwise) for breaches of competition law
  - encouraging voluntary compensation schemes to provide redress to those harmed
  - increased penalties for breach as a means of deterrence
  - other affordable, simple solutions such as online tools and materials and alternative dispute resolution (ADR) for simpler competition law cases.
- Clearer guidelines are needed to help small businesses (and their industry bodies) understand the changes to the law.
- Consistent definitions of 'small business' and 'franchise', 'franchisee' and 'franchisor' are needed so SMEs do not need to apply different thresholds when dealing with different laws (or parts of the law).

Since the 2015 *Small Business White Paper*[45], a number of changes have been introduced to competition policy and law that will benefit small businesses. These changes have mostly arisen out of recommendations (Harper Reforms) made by the *Competition Policy Review Final Report* (the Harper Review)[46]. This chapter makes further recommendations regarding the way in which the Harper Reforms should be implemented – that is, to be effective for small business, as well as raising issues that the IPA-Deakin SME Research Centre considers are still outstanding.

RECOMMENDATIONS

To fully give effect to the new competition law provisions for the benefit of small business, we recommend:

- The ACCC should bring cases on the new provisions as quickly as possible to provide clarity on how they will apply in practice. Additional government funding may be required to achieve this.
- The ACCC should apply the amended misuse of market power provision to exploitative practices as well as exclusionary practices.
- Separate tailored guidance should be available for small businesses on the new concerted practices provision, including practical examples. This is an extremely complex legal area and small businesses are unlikely to understand when conduct is (or isn't) a 'concerted practice'.
- The ACCC should produce separate guidance (which does not take an overly cautious approach) on concerted practices for industry associations and their members. The introduction of a concerted practices

[45] IPA-Deakin SME Research Centre (2015).
[46] Harper, I, Anderson, P, McCluskey, S and O'Bryan, M (2015).

prohibition is particularly relevant to industry associations, where small business competitors meet to discuss legitimate matters (but the risk of crossing into illegitimate matters may be high). An overly restrictive approach to concerted practices vis-à-vis associations risks stifling the important work that associations do on behalf of their SME members.
- The small business community should consider lobbying the ACCC for a class exemption in relation to identified common commercial transactions that are technically at risk of breaching competition law but are unlikely to do so in practice. This could significantly improve legal certainty for small businesses.

In addition, the benefit of the Harper Reforms (and competition policy generally) could be enhanced for small businesses if there is an improvement in access to justice for small business. We therefore recommend that:

- Changes are made to facilitate representative private damages actions. For small businesses that are not able to bring private actions themselves, we need to understand why there are so few representative actions for breach of competition law and make changes to enhance this ability. Use of the Federal Court 'fast-track' procedure for simple competition law cases would be beneficial.
- Procedural changes are made to encourage private actions for damages, as the market could be less reliant on the ACCC to bring action. Although small businesses are unlikely to be in a position to bring actions themselves, larger competitors could, and the risk of a private claim may itself deter anti-competitive conduct. Significant reforms have taken place in Europe and the UK in the last five years to encourage private damages. Australia needs to consider similar reform.
- Higher penalties be imposed on firms that break competition law, creating a greater deterrence effect. The level of penalties imposed in Australia is very low compared with many overseas jurisdictions. This is supported by the recent OECD report *Pecuniary Penalties for Competition Law Infringements in Australia 2018*[47].

- Encouragement is given to compensation schemes for those who have suffered as a result of a breach of competition law. This may be achieved by enhanced use of the section 87B procedure or a separate compensation scheme process.
- Online tools and materials be available to assist in the early resolution of competition law disputes, either with or without the use of online alternative dispute resolution procedures.
- The introduction of online court processes be considered, particularly for simpler cases.

Many of these recommendations are applicable to broader access to justice issues in Australia.

WE NEED TO ENSURE THAT THE BENEFITS FROM THE HARPER REFORMS FLOW THROUGH TO SMALL BUSINESS

[47]Institute of Public Accountants (2015); Institute of Public Accountants (2017). Australian Fintech (2018).

CASE STUDIES

Leases

When applying an arm's length view of the main issues, from the perspective of a reasonable and business-savvy person, on the 'fairness' of a retail lease contract/dealing, there are presently four recurring categories that the retail shop leases (RSL) legislation does not cover adequately:

- End of lease provisions (lease expiry and continuation of business)
- Duplication of permitted use
- Demolition clauses and limited compensation
- Market rent reviews at lease option (excluding QLD and NSW).

END OF LEASE PROVISIONS

Any contract for lease has, as its primary essential terms, commencement and expiry dates.

The core issue, particularly in shopping centres, is that the level of capital investment in attaining the landlord's approval for fit-out design cannot be reasonably amortised over the term of the lease.

This leaves the lessee wholly vulnerable at lease-end, as they have a remaining debt facility over the fit-out, from which they cannot walk away. This is leveraged by the landlord to enter into a renewal of the lease at rental rates that would otherwise not be achieved in a fair and open market.

Added to the amortisation of the initial fitout is the loss of the business goodwill that again may be leveraged by the landlord in taking the opportunity to lease these premises to direct competitors who are prepared to pay a premium in rent with the knowledge of the incumbent lessee's goodwill value and no consideration required for the value of the business.

Landlords are strategically positioning themselves to benefit directly from the goodwill established from the lessee's investment in capital and effort.

This scenario is common industry practice, with landlords' planning and facilitating predatory competitor outcomes, usually without the knowledge of the Lessee and up to two years prior to the lease expiry.

CASE STUDY 1 : PHARMACY1

Pharmacy 1 is a business that has been located in the same premises for 18 years, with its second 10-year lease expiring in two years' time.

The business is professionally run and has never breached its lease. It employs 21 people (full-time and part-time), including pharmacists, pharmacy assistants and retail shop staff.

The business turns over several million dollars and is valued as an asset accordingly.

The landlord, without prior notice, wrote to the owners advising that Pharmacy 1 will not be offered a new lease in two years.

Within days of this notice, the owners are contacted by a national pharmacy discount chain (which has no previous ties to this community) advising that it will be taking over the premises in two years.

The lessee has not been offered the opportunity to negotiate to match the new commercial terms. The new lessee will gain significant goodwill, without fair and reasonable consideration to Pharmacy 1 as a long-standing, successful business.

OUTCOME

With the restrictions of having to move the pharmacy at least 500 metres, and with no suitable premises prospectively available, this business will more than likely close in 18 months, realising a total loss in excess of $3 million. This figure is the equivalent of the joint owners' superannuation. It means the owners are likely to have to continue working well into their 70s.

DUPLICATION OF BUSINESS/PERMITTED USE

This is an area about which much has already been published, as a result of the Sumo Salad v Westfield disputes played out during 2016 and 2017. Sumo sought to have several of its commercial lease terms reviewed, based upon the mass duplication of similar types of business introduced into the respective shopping centres. These duplicate businesses bastardising Sumo's sales and significantly increased the occupancy cost for its stores.

The real issue relates to permitted uses being directly duplicated in close isolation, rather than across a broad retail category such as 'takeaway food'.

These direct duplications do not take into account the commercial landscape for the incumbent, which has usually paid a premium in rent and capital to achieve a suitable return on investment, based on the sales and market conditions of the time.

With the landlord introducing a direct competitor, it is effectively diluting the incumbent's business overnight, without regard to reviewing or adjusting the commercial terms to match the immediate change in the primary market and business opportunity.

Although retail leases will include clauses that provide the landlord with the right to lease premises to any type of business without exclusivity, there is no mechanism of fairness in the contract to bring these significant changes into review. This often leads to the failure of the incumbent which, in turn, results in the landlord's further opportunity to churn the previous lessee's site and goodwill, again without having invested in the benefit.

CASE STUDY 2 : PHARMACY2

This business has traded in the current location for the past 12 years and employs 19 staff, including pharmacists, pharmacy assistants and retail shop staff.

The business turns over several million dollars and is valued as an asset accordingly.

The business is two years into a 10-year lease and the owners seek to rebrand and refit the pharmacy, which will require an outlay of $500,000. Presently, there is only one pharmacy in this shopping centre.

The owners present their business case to rebrand and seek approval for their fit-out design. The landlord has significant input into the level of the fit-out, which adds to the capital expense of the project.

Three months after the pharmacy completes its rebrand and fit-out works, and is starting to realise the benefits in sales growth, the landlord introduces a second pharmacy into the centre.

Immediately, sales drop to levels below those achieved of the previous two years, before the $500,000 investment.

The lessee is now left with an unsustainable occupancy cost and a loan that cannot be supported.

At no stage did the landlord reasonably advise that it intended to duplicate the permitted use and, in fact, was party to the level of capital investment the business would incur through its fit-out design approval processes, which compounded the outcome.

In such cases, it is only reasonable and fair, if the landlord is party to a significant change in the trading market, that they also be held to review the corresponding commercial outcomes to allow profitable trade.

OUTCOME

The lessee is seeking rent relief from the landlord, and is trying to sell the business at a significant loss of several million dollars to clear the debt for the shop fit-out. It has already been put on notice by its bank in relation to loan covenants.

Regardless of the outcome from the landlord, without a sale of the business, the owner will have to sell the family home.

DEMOLITION CLAUSES

Presently, RSL legislation nationally does not provide adequate compensation to lessee's when the landlord seeks to repurpose a building with the demolition of the leased premises.

The current legislation only provides for the depreciated (or written down) value of the lessee's shop fit-out at the time of the demolition notice.

Firstly, this falls well short as, regardless of book value of a lessee's fit-out, there remains an operational in situ value of fixtures and fitout. Further, it does not take into account the financial facility or loans remaining over the fit-out.

Secondly, compensation does not provide for the value of goodwill the business has built from trading at the location. The situation is wholly uncommercial and unfair, and does not consider the costs (both financially and physically) in re-establishing the business elsewhere, if that is at all possible.

Regulated and licensed businesses, such as pharmacies and licensed post offices (or other franchises that depend on set trade territories) may not be able to secure an alternative location.

Particularly for pharmacies, for which 'location rules' are highly restrictive, a demolition notice has the likely effect of a multi-million dollar business being compensated for as low as only tens of thousands of dollars, and incurring losses that are unrecoverable.

MARKET RENT REVIEWS AT LEASE OPTIONS

Where a lessee has a lease that provides for options for further term(s), the industry norm is that the rent for the first lease period (year) of the new term will be reviewed to market.

Over the past 20 years, reviews of the RSL legislation have resulted in amendments so ratchet mechanisms that prevent market rent reducing from the current are now void.

The issue is that the process of the parties entering into negotiations or a determination on market rent is predicated on the lessee first exercising its right for the further lease term which, once acknowledged by the landlord, becomes binding on the parties.

The practice, if reasonable and fair, should involve the parties seeking to understand their respective outcomes as to the market rent before the lessee commits to the new term.

However, the RSL legislation is flawed in that there is no provision for the parties to resolve market rent before the lessee exercises its option. This has the risk of the lessee being locked into a rent (in an upswing market) that cannot be sustained.

Fortunately, we have been successful in recent reviews of the RSL Acts in Queensland and NSW to introduce 'early determination of market rent' provisions, which unfortunately leaves lessees in the remaining jurisdictions left in the antiquated situation of "signing the contract to buy the car, receiving the keys, and then being told the price".

It should be noted that, even in Queensland and NSW, the onus is on the lessee to fully understand their rights and the timing of early determination of market rent under these Acts. Most do not and the system unfairly leaves the lessee exposed to the process that favours the landlord.

A sound solution here is to have the process of market rent reviews at lease option determined prior to a lessee being bound to the option period, if the rent is unsustainable, as a mandatory minimum lease standard nationally.

CASE STUDY 3: LICENSED POST OFFICE (LPO)

The LPO (and sub-newsagency) has been trading in the same building for over 15 years and is approaching the last of their 5-year options for a further lease term.

The business is well run by a family (primarily husband and wife) with between two and four casual staff, depending on the time of year.

Prior to exercising their option for the further lease term, the lessee sought to understand and negotiate the rental the landlord was seeking as market rent.

The landlord, via its managing real estate agent, refused to respond. After several formal requests, the lessee was advised that the landlord will only advise the rent they are seeking after the lessee gives notice to exercise the lease option.

Effectively, the lessee is locked into a five-year term with no knowledge of what rent they may be liable for.

OUTCOME:

The landlord sought a market rent increase of 20%. The parties negotiated and a 10% increase was settled on, as the cost of the specialist retail valuer was a barrier for the lessee.

Chapter Nine

Family firms

Professor Nick Mroczkowski: Deakin University*

*Other Chapter Contributors, Consultants, Advisers, and Case Study Volunteers (See page 69)

Family firms

Family firms represent a significant component of the SME community and research studies suggest a resurgence of interest in family businesses in scholarly journals and in professional and industry publications.[48] In many countries, including Australia, family firms account for a significant component of GDP[49], with some scholars claiming that *"The family business is the most frequently encountered ownership business model in the world and their impact on the global economy is considered significant. It is estimated that the total economic impact of family businesses to global GDP is over 70%".*[50]

An emerging body of evidence also shows that family firms are continuing to take the public flotation route to fund further growth, particularly during periods where listings on security exchanges are growing.[51] Interestingly, during 2014, 2015 and 2016, Australia was one of a few developed countries that experienced considerable growth in listings[52]. Moreover, a recent study undertaken by the IPA-Deakin SME Research Centre[53] shows that many of the listings over the three-year period were family firms, which suggests that going public is still a popular route for family firms for a variety of reasons.

The first study in Australia to document similar findings showed that at least 17.1% of firms listing on the ASX during 2003 were family firms.[54] This is consistent with preliminary results from a current study undertaken by the IPA-Deakin SME Research Centre in 2017[55] that found that 15% of firms listing in 2015, and 16% in 2016, were family firms.

Given the apparent rise in interest in family firms within academic and other disciplines, along with evidence suggesting that listing continues to be a viable option for family firms to follow for a variety of reasons, the IPA-Deakin SME Research Centre has included a special feature in this white paper on family firms and the public flotation route.

WE NEED TO DEVELOP A GREATER UNDERSTANDING OF THE CONTRIBUTION WHICH FAMILY FIRMS MAKE TO THE AUSTRALIAN ECONOMY SO WE CAN SUPPORT AND ENCOURAGE THEIR GROWTH AND LONGEVITY

HEADLINE FINDINGS

- Family firms are a major component of the SME community and are continuing to be recognised as significant contributors to GDP in most countries in the world.
- There has been a resurgence of interest in family business, both in academic and industry circles.
- Australia has witnessed unusual growth in company listings on the ASX, particularly in 2015 where the growth in the number of listings far outperformed most other developed countries.
- Evidence shows that larger family firms are still partaking in the public float route to address their financing needs. This is despite the ASX tightening the listing criteria to discourage small-cap businesses from applying to list on the ASX.

RECOMMENDATIONS

- State and federal governments should encourage more research on family firms and their role in contributing to the wealth of the economy. One way this could be achieved is through grants and similar incentives.
- The ASX should consider removing the recent barriers caused by changes to the listing rules, thus allowing and encouraging family firms to take up the option of listing, as many firms listed on the ASX started as small family firms, some of which are now the largest firms listed on the ASX.
- An alternative to the above would be to consider resurrecting the former 'Second Board', which would allow smaller cap companies to list and thus have another option available in terms of financing.

[48]Pounder (2015).
[49]Mroczkowski and Tanewski (2007).
[50]Osunde (2017).
[51]Deloitte (2017).
[52]Deloitte (2017).
[53]Mroczkowski, Tanewski, and Kiaterittinun (2017).
[54]Mroczkowski and Tanewski (2007).
[55]Mroczkowski and Tanewski (2007).

Chapter Ten

Internationalisation

Professor George Tanewski: Deakin University,
Professor Robert Blackburn and
Dr Hang Do: Kingston University (UK)*

*Other Chapter Contributors, Consultants, Advisers, and Case Study Volunteers
(See page 69)

Internationalisation

The role of international trade is crucial to the development of national economies in many countries, including Australia[56]. As demonstrated in previous sections of this white paper, SMEs play a critical role in contributing to Australian employment and economic growth. But how significant are SMEs in the international trade of Australia?

This chapter focuses on the international activities of SMEs, particularly their exporting behaviour. It focuses on four areas related to internationalisation:

1. The main ways in which SMEs enter export markets
2. Types of SMEs that are most likely to be involved in exporting
3. Exporting performance of Australian SMEs
4. Policy implications.

HEADLINE FINDINGS

- There were 2,238,299 actively trading SMEs operating in Australia at the end of 2016-2017. These enterprises generated A$379 billion worth of industry value added to the economy and employed seven million people.
- Australian SMEs contributed 14% of the total export revenue of goods and 27.4% of service-sector exports (2015-2016).
- The number of firms engaging in direct import is 44% higher than that of exporters. The value of SMEs' exports is about 25% less than that of imports (2009-2013), suggesting an imbalanced trade situation in Australia.
- The current unstable global trade environment (arguably driven by global events and developments such as, for example, Brexit, China-US trade disputes, US withdrawal from the Trans-Pacific Partnership (TPP) etc) has heightened the level of uncertainty and market risk among Australian SMEs. However, such global disturbances may also bring about potential market opportunities.
- The bulk of Australian SMEs are domestically oriented: on average, between 2009 and 2014, 80% of SMEs were active in local markets while 12.5% were involved in overseas markets.
- The majority of Australian SMEs are found to follow the 'Uppsala model' of internationalisation, which suggests a staged approach to exporting, starting out in locations of geographic proximity, allowing an accumulation in knowledge and resources to draw upon when venturing further afield.
- More than one in 10 SMEs generated income from direct exports: with 7.5% of income generated by the direct export of goods and 4.8% by the export of services.
- Internationalisation among SMEs varies by business sector. The three sectors showing the highest levels of internationalisation are wholesale trade, information media, and professional, scientific and technical services.
- Larger and more mature firms have higher levels of engagement in international activities. Medium-sized firms are three times more likely to be active in foreign markets than the self-employed and twice that of small-sized firms. Approximately one half of all internationally-active firms have operated for more than 10 years.
- The most popular source of external finance is from the banks. The proportion of SMEs with loans increases with their turnover. However, Australian SMEs have increased their use of credit cards while all other forms of lending sources, including bank finance, have marginally declined.
- Innovation plays an integral role in exporting, both enabling and stimulating subsequent export behaviour. Australian exporters are twice as innovative as importers, particularly in terms of introducing new products or operational processes.

RECOMMENDATIONS

This Chapter draws on a range of research literature and Australian official government data to provide a basis for discussion on the performance of Australian SMEs and suggest pointers for Australian policy makers. Certainly, there is much to be done to help Australian SMEs 'raise their game' in the international marketplace. The evidence presented shows a weak international performance by SMEs but also grounds for optimism.

- Findings from the longitudinal study by the Australian Bureau of Statistics (ABS) suggest the majority of small and young firms are still more domestically oriented, compared with larger

[56] Organisation for Economic Co-operation and Development (OECD) (2017).

firms. In terms of policy interventions, a targeted approach is suggested, aimed at those SMEs that are seeking to internationalise but have not yet done so, and those that are already exporting and are seeking to expand their international reach into additional new markets. Hence, the strategy should be to build upon current successes and to increase the volume of direct exporters. Inevitably, such an approach requires some targeting of different categories of SME with specific types of support.

- Australian interventions should place more priority on facilitating SME exports in the six most internationally-active industries – including mining, agriculture, manufacturing, wholesale, information media, and professional services. These are the main sectors in terms of generating export revenue for the economy. However, as geographic sales of SMEs vary across sectors, this suggests that a tailor-made intervention for each sector is highly recommended to boost the rate of internationalising SMEs. Tailor-made interventions are much more likely to be relevant and effective and would encourage higher levels of take-up by SMEs.
- Size and age of enterprise are also important when designing and delivering support measures. As revealed in the longitudinal data (ABS), the significant difference in the level of international involvement between medium-sized and self-employed firms can be attributed to two reasons: their limited resources (which adds costs and risks in engaging internationalisation) and/or their lower levels of motivation to go beyond their local markets because of their resistance to grow (risk aversion). On the other hand, 'born globals' (who are highly motivated to internationalise) may encounter more challenges in accessing finance, compared with their counterparts, due to the higher risks involved and less-developed networks and lack of experience in the foreign market. Hence, more emphasis should be placed on encouraging small and self-employed firms to participate in foreign markets by providing targeted export incentives, support for networking and international collaboration, business matching opportunities, and facilitating access to finance.
- Innovation has been acknowledged in literature as a critical factor in enhancing internationalisation. Investment in innovation also contributes to developing competitive advantage for firms to outperform others in the international market, as well as to increase sales revenue. This is consistent with findings of the data collected by the ABS during 2009-2013. Evidence suggests that innovation is more intensive in Australian exporting SMEs than non-exporters. Hence, support for growth and innovation can be helpful to boost the number of exporters and accelerate their international activities.
- In the increasingly uncertain global environment, SMEs would benefit from clear guidance and signposting to identify and assess the risks of internationalisation. More support in terms of detailed information provision would be helpful, such as the provision of tailored advice and a mentoring program for firms internationalising in different geographical markets. In-depth discussion forums and network events, such as how to evaluate the impact of Brexit and opportunities for Australian SMEs, challenges emerging from the policies of the Trump Administration for those involved or seeking to trade in the USA, and how to gain best benefits from the TPP agreement, should be offered. This will not only help the government to understand SMEs' needs, but it will also build a bridge between SMEs and policy makers in designing specific instruments to support their internationalisation.

80% OF SMES ARE ACTIVE IN LOCAL MARKETS, WHILE 12.5% ARE INVOLVED IN OVERSEAS MARKETS

CASE STUDIES

Edible Blooms – a successful online business (Australia)

Founded in 2005, Edible Blooms[1] is a family business owned by sisters, Kelly Jamieson and Abbey Baker. From a small commercial kitchen and online store, the company has grown to a team of 50 employees in seven locations across Australia and New Zealand. Edible Blooms is now one of Australia's largest networks of gift delivery stores. Their products include gourmet chocolate bouquets, fresh fruits bouquets and hand-made gift designs.

THE KEY TO SUCCESS USE OF TECHNOLOGY

Edible Blooms' business concept was to grow fast from day one. Edible Blooms utilises the cloud-based business system to develop a strong online presence. Kelly commented "cloud-based systems allowed me to be on the go and work in different locations and to keep moving forward. I also made sure that I had a fully transactional website from day one. Looking at the financials for the business and the cost of rent in capital cities, it made sense to locate our premises near our suppliers and focus our marketing online"[2].

Edible Blooms takes advantages of Telstra technology solution[3] which enables the company to find customers online, responding faster, and improving the customer experience. The company also uses management software provided by Deputy (https://www.deputy.com/) and an invoice processing management system supported by Shoe-boxed company.

FOCUS ON QUALITY

Kelly places high priority on the quality of their products and services:

"We have a genuine approach to giving it a go and trying new things. At the same time, I believe one of the keys to success with a small business is quality and consistency. This is really important for ensuring that customers have peace of mind, especially when transacting online".

This value has been embedded well into their business. Kelly estimates 60% of their turnover come from returning customers.

Use of digital marketing and social media

Digital marketing and social media play an important role in Edible Blooms' marketing strategy. The company uses digital marketing such as Google AdWords, email marketing, and utilising marketing campaigns to find customers and social media such as Facebook and Twitter and engage customers. Kelly commented:

"Trust me, I understand the time and financial constraints business owners are under. But with the technological resources now available, it's possible to get a fantastic return on investment from modest inputs. Over the last five years Edible Blooms has been averaging double-digit growth with social media marketing playing a big part in that. Yet I've got precisely one employee handling all Edible Blooms' social communications, albeit with team members in outlets around Australia and New Zealand contributing ideas and content".[4]

[1] https://www.edibleblooms.com.au/
[2] According to Edinburgh group (2012) "Growing the global economy through SMEs", report.
[3] https://www.telstra.com.au/small-business/latest-offers/doyourthing
[4] https://business.nab.com.au/making-business-bloom-social-media-22230/

Drilling Systems – Scaling up with working capital support (UK)

Founded in 1988 in Bournemouth, Drilling Systems is a leading global supplier of drilling simulator systems and software. The company has grown to deliver more than 1000 training simulators across 50 countries. With the help of UK Export Finance[5], Drilling Systems have won a $1 million contract with Pan American Energy – an Argentine based firm specialising in oil and gas exploration and production, to scale up its training capabilities.

EXPORT WORKING CAPITAL SCHEME

The initiative was launched by UK Export Finance (UKEF), aiming to assist UK based exporters in gaining access to working capital finance both pre- and post-shipment in respect of specific export related contracts. There is no minimum or maximum value for the working capital facility. The scheme provides partial guarantees to lenders to cover the credit risks associated with export working capital facilities. Where a lender provides such a facility in respect of a UK export related contract, UKEF can guarantee up to 80% of the risk. This enables UK exports to have an opportunity to win an overseas contract that is higher in value than they can typically fulfil. Additionally, the scheme can be applied directly via main banks in the UK such as Barclays, HSBC, Lloyds Banking Group, Bank of Scotland, the Royal Bank of Scotland, National Westminster Bank, Ulster Bank, and Santander UK Plc.

In order to secure a $1 million contract with Pan American Energy, Drilling Systems has taken advantage of the Export Working Capital Scheme provided by UK Export Finance, to help it to prepare for an initial significant investment. This has enabled the company to have a bank funded working capital facility of £375,000.

The Chief Financial Officer of Drilling Systems, Stephen Dines commented:

"UKEF's Working Capital scheme was instrumental in enabling us to significantly scale up our activity with Pan American Energy. This opportunity enabled us to substantially increase revenue, strengthen our presence in Latin America and lay groundwork for further phases of business".[6]

[5] UK''s export credit agency and a ministerial department of the UK government
[6] https://www.gov.uk/government/case-studies/bournemouth-based-firm-strengthens-its-presence-in-latin-america

Global Diagnostic – Enterprise Ireland (Ireland)

Global Diagnostics is an international telemedicine enterprise, specialising in diagnostic imaging. Initially founded in 1995 in Western Australia, the founder and chairman, Dr Johnny Walker (no relation), started to expand his business to Ireland in 2007. The company provides a service whereby patients' scans can be sent digitally from anywhere around the world for expert medical assessment by trained radiologists, with the aim of greatly speeding up the time to diagnose and treat potential problems. Since relocating to Ireland, the company has grown substantially and now operates across Australia, the UK and Ireland.

THE KEY SUCCESS: NETWORKING

Walker originally brought the business to Ireland via a joint venture with Centric Health, which saved the business lots of costs and efforts for a new start-up in a foreign market. Ireland's generous 12.5 % corporate tax rate was one of the incentives for Walker to choose this market, in addition to sources of investment funds for growth available in Ireland.

As an Australian, Walker's challenge was to plug in to the indigenous business community. With the help of Enterprise Ireland, he has opportunities to expand his networking in Ireland, having the right contacts and meeting right people that make the business work. "As an Aussie coming to Ireland, from a social point of view it was fantastic", said Walker.

Through Enterprise Ireland (the government organisation responsible for the development and growth of Irish enterprises in world markets), Walker was invited to attend the class of 2009 Leadership4Growth mentoring programme at Stanford University in the US, which put him amongst a group of like-minded entrepreneurial CEOs who remain in contact to this day.

"That's where I've been blessed. The Stanford programme put me amongst my own, and we all rally to support each other," he says. "They talk about six degrees of separation but in Ireland that's more like half a degree; you all know each other. There's huge upside from a business perspective in terms of the network that you can build very rapidly".[7]

[7] https://www.enterprise-ireland.com/en/Start-a-Business-in-Ireland/Startups-from-Outside-Ireland/Case-Studies/Global-Diagnostics.html

Chapter Eleven

SME owners' mental health

Professor George Tanewski and
Professor Andrew Noblet: Deakin University

SME owners' mental health and performance

A growing body of evidence indicates that SME owners are particularly vulnerable to experiencing high levels of job stress, burnout and depression[57].

Research involving a small sample of Australian-based SME owners found that more than one in three respondents (37%) reported high or very high levels of psychological distress[58]. More recent research focusing on mental ill-health among SME owners indicated that the proportion of participants reporting 'moderate' to 'extremely severe' levels of depression and anxiety was higher than that found in the general population. In the case of anxiety, for example, the proportion of participants reporting 'severe' to 'extremely severe' was double that reported in the national data[59].

Given the far-reaching consequences of work-related strain (e.g. productivity, impaired functioning, follower distress, relationship breakdown) coupled with the critical role played by SMEs in the Australian economy, the high levels of strain among small business owners represents a serious workplace health issue and a major impediment to sustained business and overall economic success.

The heightened levels of stress experienced by small business owners has been attributed to a range of work and non-work factors, including long working hours, financial pressures, isolation, the obligation to work when sick, family and relationship problems, and work-family/life conflict[60].

However, dealing with these stressors is compounded by owners' unique position in the organisation. Being the most senior member of the organisation, and having ultimate responsibility for the fortunes of the firm, has been shown to impede the help-seeking behaviours of owners, undermining their ability to form open and mutually-supportive relationships with their employees[61].

While support from internal sources may be limited, information, guidance and other support provided by external sources may play a key role in protecting and promoting the wellbeing of small business owners. Accountants are a widely-trusted and particularly important source of support for SME owners, as their overall business and financial expertise is sought on a regular basis. Clients therefore often develop a trusting, long-term relationship with their accountant[62].

Anecdotally, there are also signs that the technical and moral support provided by accountants may prevent or reduce the impact of financial and business-related stressors, although there is a dearth of scholarly research examining this relationship.

An area that is particularly under-researched is the types of support offered by public accountants and the extent to which these can mitigate the work-related (e.g. business failure, financial pressures, work-family conflict) and non-work-related stressors (e.g. relationship breakdown, drug and alcohol misuse, mental health concerns) experienced by SME owners.

Indeed, the role of accountants is evolving towards a greater emphasis on business mentorship and guidance. There are, therefore, ample opportunities for integrating mental health promotion messages with more holistic business and financial planning services[63].

The IPA-Deakin SME Research Centre is currently working on a (pilot) project with the Institute of Public Accountants (IPA) and a group of researchers from Deakin University's Centre for Employee and Consumer Wellbeing (CECW) aimed at examining the role of accountants in supporting the mental health and performance of SME owners.

The primary objectives of the pilot project are to gauge the levels of wellbeing (i.e. psychological distress, burnout), performance (i.e. adaptive performance, perceived effectiveness) and help-seeking opportunities among a sample of SME owners recruited via the IPA and its members, with the aim of:

[57] Cocker et al (2012, 2013); iCare and Everymind (2017).
[58] Cocker et al (2013).
[59] iCare and Everymind (2017).
[60] Naughton et al (1987); Rauch and Frese (2007); Prottas and Thompson (2006); Everymind (2017).
[61] Rahim (1996); Tetrick et al (2000).
[62] Blackburn, Carey and Tanewski (2018); Carey and Tanewski (2016); Storey (2016).
[63] Blackburn, Carey and Tanewski (2018); Carey and Tanewski (2016); Storey (2016).

- identifying the types of business and non-business support that SME owner-clients receive from their accountants
- assessing the extent to which accountant support can moderate the influence of job stressors on the wellbeing and performance of SME owners.

HEADLINE FINDINGS AND RECOMMENDATIONS

As this chapter is based on research that is ongoing and still in progress, the IPA-Deakin SME Research Centre is unable to provide details on findings or recommendations at the time of writing.

The Centre is of the view, however, that mental health and wellness is a significant area of concern for all businesses, not just SMEs. In this sense, we feel a responsibility to inform readers of the extent of mental health issues impacting SMEs and their advisers.

We also believe it is important to articulate the current work undertaken by the Centre to identify the real mental health issues impacting IPA members and their clients, and the potential mechanisms that can be utilized to address these issues and assist businesses, their owners and advisers in their struggle to cope with day-to-day mental health issues.

A GROWING BODY OF EVIDENCE INDICATES THAT SME OWNERS ARE PARTICULARLY VULNERABLE TO EXPERIENCING HIGH LEVELS OF JOB STRESS, BURNOUT AND DEPRESSION

Chapter Twelve

Cyber security

Professor Matthew Warren,
Professor Nick Mroczkowski, and
Dr Geoff Speight: Deakin University

Cyber security and Australian SMEs

A good definition of cybersecurity is provided in the report *Cyber Security: Small Business Best Practice* by the Australian Small Business and Family Enterprise Ombudsman (ASBFEO)[64]. It is simply explained as those policies and measures that are implemented to prevent theft, fraud, misappropriation or loss of corporate data; which could, in turn, prevent the disruption of computer systems and any potential interference with the normal operations of the entity. In the event of a failure of these policies and procedures, cybersecurity also encompasses methods to mitigate the losses and expeditiously restore the functionality of disrupted systems.

Large organisations might have the resources to deal with cybercrime. SMEs face much the same threats, but may not have the mitigating resources of larger firms. Most solutions for cybercrime require the deployment of a level of resources and expertise beyond the scope of SMEs. Even the use of outside consultants or technical experts is beyond the financial resources of many small SMEs.

60%

OF SMALL BUSINESSES THAT EXPERIENCE A SIGNIFICANT CYBER BREACH GO OUT OF BUSINESS WITHIN SIX MONTHS

HEADLINE FINDINGS

Given the alarming findings tabled in the ASBFEO report, which are not dissimilar to the findings of the IPA-Deakin SME Research Centre, we reiterate the following ASBFEO key findings, which we fully endorse and which we believe need constant reinforcement within the small business and SME communities.

- Small business is the target of 43% of all cybercrimes.[65]
- 60% of small businesses that experience a significant cyber breach go out of business within six months.[66]
- 22% of small businesses that were breached by the 2017 Ransomware attacks were so affected they could not continue operating.[67]
- 33% of businesses with fewer than 100 employees don't take proactive measures against cybersecurity breaches.[68]
- 87% of small businesses believe their business is safe from cyberattacks because they use antivirus software alone.[69]
- Cybercrime costs the Australian economy more than $4.5 billion annually.[70]

RECOMMENDATIONS

To avoid or defend against the high risk of cyberattacks, it is recommended that SMEs consider the following:

- At the most extreme (somewhat obvious) end, business owners may consider not owning or operating a computer.[71] Of course, this is totally unrealistic and absurd in the current business environment, where technology drives almost every aspect of any business and, indeed, society in general. Everyone involved in business and society is, by default or otherwise, captured by technology. Thus, given that SME owners cannot escape the all-encompassing technology net, they need to be acutely aware of the perilous seas ahead if adequate checks and balances are not in place (i.e. to prevent or mitigate potential security exposures to their operations, particularly the significant risk of being a victim of cybercrime).
- SMEs, as a matter of urgency, must be made aware of the significant risk they face from cybercrime, including the risk of their systems being used as a 'stepping stone' into connected systems in the supply chain.
- Techniques for 'hardening and shielding' websites from cybercrime need to be simplified to be accessible to SMEs (particularly small businesses).
- A range of online 'cloud-based' host sites should be established so that SMEs can migrate their IT systems into a secure cloud environment. Typically, by managing a number of SME sites, a host site would have sufficient scale to adequately resource the security of the mother system to protect it from cyberattacks.

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64 Australian Small Business and Family Enterprise Ombudsman (ASBFEO) (2017b).
65 Sophy (2016).
66 Testimony of Dr Jane LeClair, Chief Operating Officer, National Cybersecurity Institute at Excelsior College, before the US House of Representatives Committee on Small Business (22 April 2015)
67 Australian Small Business and Family Enterprise Ombudsman (ASBFEO) (2017a).
68 Telstra (na).
69 MYOB (na).
70 Acumen Insurance Brokers (2017).
71 Australian Small Business and Family Enterprise Ombudsman (ASBFEO) (2017a).

*Other Chapter Contributors, Consultants, Advisers, and Case Study Volunteers

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INSTITUE OF PUBLIC ACCOUNTANTS HEAD OFFICE
Level 6, 555 Lonsdale Street, Melbourne
Victoria 3000 Australia

Post: GPO Box 1637 Melbourne VIC 3001 Australia
t: +61 3 8665 3100 **f**: +61 3 8665 3130
e: headoffice@publicaccountants.org.au

Digital Hub: pubacct.org.au

IPA Group Divisional Offices are located in the following cities:
Melbourne | Sydney | Brisbane | Adelaide | Perth
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For enquiries within Australia call 1800 625 625.
Internationl enquiries can be directed to IPA Head Office.