



INSTITUTE OF  
**PUBLIC  
ACCOUNTANTS®**

## **Pre-Budget Submission 2019-20**

30 January, 2019

## Introduction

The Institute of Public Accountants (IPA) welcomes the opportunity to present our pre-Budget submission for the 2019-20 financial year. We look forward to working with the Government on its economic agenda set against a constantly changing environment.

The IPA is one of the three professional accounting bodies in Australia, representing over 35,000 accountants, business advisers, academics and students throughout Australia and in over 80 countries worldwide. In 2015, the IPA merged with the Institute of Financial Accountants of the UK to form the largest accounting body representing the small business/SME sectors in the world.

The IPA takes an active role in the promotion of policies to assist the small business and SME sectors, reflecting the fact that approximately three-quarters of our members work in these sectors or are trusted advisers to small business and SMEs. The IPA pursues fundamental reforms which will result in boosting productivity and in easing the disproportionate regulatory compliance burden placed on small business.

The IPA remains strongly of the view that immediate and tangible incentives must be offered to entrepreneurs and innovators to encourage their entry into and long term engagement with the Australian small business sector. The Federal Government should implement policies that will drive business activity and entrepreneurialism across all industry sectors. A strong and vibrant small business sector can play an active role in contributing to the economic growth of the Australian economy and help in addressing some of the challenges ahead.

In August 2015, the IPA Deakin SME Research Centre launched the first Australian Small Business White Paper which contained numerous recommendations to boost small business productivity which is essential to maintaining Australia's overall standard of living. In September 2018 the IPA Deakin SME Research Centre launched the second Australian Small Business White Paper which continues to examine the declining state of productivity in Australia and makes recommendations to address this through increasing small business innovation, competition and participation.

As mentioned in our pre-Budget submission last year, we undertook a national roadshow of urban and regional centres to gain insights and feedback from small business people; and conducted a survey to reach as many small business people as possible. Again, we held a small business summit at Parliament House which was attended by numerous stakeholders including the then Minister for Small Business, Shadow Minister, the Treasury, Dept of Industry, Innovation & Science, ACCC, ASIC, ATO, ASBFEO, Deakin University, industry and the private sector.

In addition to building on the initial recommendations from the first White Paper, we have included research, analysis and recommendations in the second White Paper on:

- Productivity of small business – the White Paper examines the technical efficiency of the Australian business sector.
- Job creation and job destruction – based on various factors of Australian employing SMEs over an extended period of time.
- Taxation of SMEs – including their overall contribution to tax collection and how to optimise the tax system.
- Competition policy – following on from the Harper Review, including access to justice.
- Access to finance – including financing principles and alternative sources of finance. In both White Papers we recommended the introduction of a loan/credit guarantee scheme. In this respect we note the Government’s announcement in November 2018 to establish the Australian Business Securitisation Fund (ABSF) and the Business Growth Fund, based on overseas models. As noted in our White Papers, Australia was only one of 47 developed countries without such a fund to assist small businesses to access affordable finance. The IPA made a submission on the ABSF; and we note that legislation is expected to be introduced in early 2019. For these reasons we have not repeated our recommendations on access to finance for small business in this current pre-Budget submission.
- Internationalisation and free trade – benefits for the small business sector in a changing and challenging environment.
- Innovation policy – incremental innovation can be achieved across the economy without ‘scaring off’ consumers.
- Family firms – and their contribution to the economy.
- Regulatory overload – including through the use of regtech, which can shift the conversation from the amount of regulation to the way we deal with it.

A copy of the full version of the second White Paper, the abridged version and the infographic can be found on the IPA website,

[www.publicaccountants.org.au/whitepaper](http://www.publicaccountants.org.au/whitepaper).

For the sake of brevity we have not repeated large sections of the White Paper in this pre-Budget submission. However, if more research and analysis is required please refer to the website noted above.

We emphasise that major reform cannot always be achieved in a short time frame and we urge the Government to take a longer term view based on a clear, determined and well communicated path for the Australian economy and Australian society.

In particular, the IPA is especially keen to ensure that bold tax reform becomes a priority for the Government and the IPA will continue to voice its disappointment with the stalled tax reform process. A piecemeal approach is sub-optimal and may even prove harmful to long term reform.

In addition, the IPA urges the Government to continue its effort on innovation policy despite setbacks with communicating the benefits. The Small Business White Paper contains recommendations on innovation policy which can be applied to increase productivity and with flow on benefits for the whole economy.

The IPA believes the time has come for all Australians to stand up and put the public interest ahead of political and self-interest. The public interest will be central to the policy development and advocacy effort of the IPA well into the future.

We would be pleased to discuss our recommendations in more detail with the Government and the Treasury. Please address all further enquiries in the first instance to Vicki Stylianou ([vicki.stylianou@publicaccountants.org.au](mailto:vicki.stylianou@publicaccountants.org.au)).

Yours faithfully



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## Small Business: Big Vision recommendations

Below are the aspirational recommendations of the IPA:

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 channelled 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 Australian Government should facilitate small businesses joining global value chains to remain competitive and access global markets.

The focus of the 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

## Understanding productivity in the Australian economy

This section 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 25<sup>th</sup> 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 25<sup>th</sup> 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.

## 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)<sup>1</sup>, 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.

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<sup>1</sup> IPA-Deakin SME Research Centre (2018a).

### ***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 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.

## 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.

In addition to the White Paper recommendations (below) we have added another relating to Division 7A.

- The Government announced in the 2017 Federal Budget that amendments would be made to Division 7A incorporating recommendations from the 2014 Board of Taxation's final report on the 'Post Implementation Review of Division 7A of Part III of the Income Tax Assessment Act 1936' (BOT report). The start date was to have been 1 July 2018, although the Government in the 2018 Federal Budget deferred the start date to 1 July 2019.
- Treasury released a Consultation Paper in September 2018, to seek stakeholder views on proposed amendments to Division 7A. The consultation paper draws on but includes significant departures from the recommendations in the BOT report. If legislated in its current form, there is potential for a substantial increase in compliance costs and tax payable by business entities using trusts for business purposes.
- Some key elements of the proposed new regime outlined in the Consultation Paper include:
- New "simplified" single ten-year loans with interest charged at the Reserve Bank overdraft rate for small business (which is higher than the current Division 7A rate – for September 2018 it was 8.3% compared with 5.20% for the current Division 7A rate).

- Not adopting the amortisation model with principal repayments at the 3, 5, 8 and 10 years as recommended by the BOT report and instead requiring annual interest and principal payments.
- Regardless of when a repayment occurs during the income year, interest will be for the full year.
- The transitioning of both 7 and 25 year loans under Division 7A into the new regime. The BOT report had recommended grandfathering (preserving) 25 year loans under the existing arrangements.
- Both existing 7 and 25-year loans will be subject to the new higher overdraft interest rate as from 1 July 2019.
- Existing 7 year loans will keep their current outstanding term when transitioned into the new regime, but existing 25 year loans must be put on new 10 year complying loan arrangements prior to the lodgment day of the company tax return for the 2021 income year.

Both pre-4 December 1997 loans (with the benefit of a two year grace period) and unpaid present entitlements (UPEs) arising on or after 16 December 2009 must be put on new complying ten year loans. The proposal does not address pre-16 December 2009 UPEs (which appear quarantined under the proposed new regime). The removal of the concept of distributable surplus such that there is no limit to the amount that may trigger a deemed dividend under Division 7A.

The extension of the review period for Division 7A to 14 years after the end of the income year in which the loan, payment, or debt forgiveness are triggered, or would have triggered, a deemed dividend.

The BOT report's recommendation for a once-and-for-all election to exclude loans from companies (including UPEs owing to companies) from the operation of Division 7A (the 'business income election') is not included in the proposed regime. The Consultation Paper has taken a selective approach, removing the ability to choose to be excluded from the Division 7A regime, while introducing many of the integrity aspects.

### ***Recommendation***

We recommend that further consultation be undertaken to revisit ways to minimise the operation of Division 7A to businesses that use corporate profits to fund business activities. The BOT report includes a number of recommendations designed to ease the compliance burden associated with the rules that govern distributions from private companies and to lower the cost of working capital for private businesses.

We welcome further consultation on the reform of Division 7A, but understandably given the current political environment we believe the proposed start date of 1 July 2019 is unrealistic given significant differences in the policy direction being proposed.

### ***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 in every way 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 guideline which sets 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 SBCGT 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.

## 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<sup>2</sup>.

### ***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

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<sup>2</sup> Fox and Smeets (2011); Ichniowski and Shaw (2003); Lazear (2000).

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 human resources (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 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 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.

## Net employment dynamics of Australian SMEs

Since its inception in 2013, the IPA-Deakin SME Research Centre has been tracking the economic behaviours of small-to-medium-sized enterprises (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<sup>3</sup>, 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 by lowering the crime rate, decreasing welfare dependency, improving standards of living, and so on.

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

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<sup>3</sup> Henrekson and Johansson (2010).

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<sup>4</sup> 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<sup>5</sup>. 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 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

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<sup>4</sup> See Syverson (2011); Foster, Haltiwanger and Krizan (2001).

<sup>5</sup> See Cowling, Kiaterittinun, Mroczkowski and Tanewski (2018).

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.

## **Innovation**

Given that innovative firms (particularly start-ups) are known to create more jobs than any other business category<sup>6</sup>, 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<sup>7</sup> 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.

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<sup>6</sup> Cowling, Tanewski, and Mroczkowski (2017)

<sup>7</sup> IPA-Deakin SME Research Centre (2018b).

- 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.

## 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*<sup>8</sup>, 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)<sup>9</sup>. 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.

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<sup>8</sup> IPA-Deakin SME Research Centre (2015).

<sup>9</sup> Harper, I, Anderson, P, McCluskey, S and O'Bryan, M (2015).

## **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 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 5 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*<sup>10</sup>.

- 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.

## 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.<sup>11</sup> In many countries, including Australia, family firms account for a significant component of GDP<sup>12</sup>, 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%”*.<sup>13</sup>

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.<sup>14</sup> Interestingly, during 2014, 2015 and 2016, Australia was one of a few developed countries that experienced considerable growth in listings<sup>15</sup>. Moreover, a recent study undertaken by the IPA-Deakin SME Research Centre<sup>16</sup> 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.<sup>17</sup> This is consistent with preliminary results from a current study undertaken by the IPA-Deakin SME Research Centre in 2017<sup>18</sup> that found that 15% of firms listing in 2015, and 16% in 2016, were family firms.

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<sup>10</sup> Organisation for Economic Co-operation and Development (OECD) (2018).

<sup>11</sup> Pounder (2015).

<sup>12</sup> Mroczkowski and Tanewski (2007).

<sup>13</sup> Osunde (2017).

<sup>14</sup> Deloitte (2017).

<sup>15</sup> Deloitte (2017).

<sup>16</sup> Mroczkowski, Tanewski, and Kiaterittinun (2017).

<sup>17</sup> Mroczkowski and Tanewski (2007).

<sup>18</sup> Mroczkowski and Tanewski (2007).

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.

### ***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.

## **Internationalisation**

The role of international trade is crucial to the development of national economies in many countries, including Australia<sup>19</sup>. 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

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<sup>19</sup> Organisation for Economic Co-operation and Development (OECD) (2017).

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 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.

1. Findings from the longitudinal study by the Australian Bureau of Statistics suggest the majority of small and young firms are still more domestically oriented, compared with larger 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.
2. 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. 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 tailored-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.
3. 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.
4. 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 Australian Bureau of Statistics 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.

5. 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.