

The importance of small business to the economy

- 1.1 Small businesses have been described as the 'engine room' of the Australian economy.¹ They are critical in generating economic growth and employment opportunities in most sectors of the economy. The overwhelming majority of jobs in the agricultural and construction sectors are in small businesses.²
- 1.2 An important role of Government is to promote investment conditions that enable the small business sector to thrive. The Australian Government stated upon delivering the 2015 Budget:

Helping more small businesses become profitable, sustainable and competitive will ensure they are in the best position to hire new employees, providing more jobs, including for Australia's youth and older workers.³

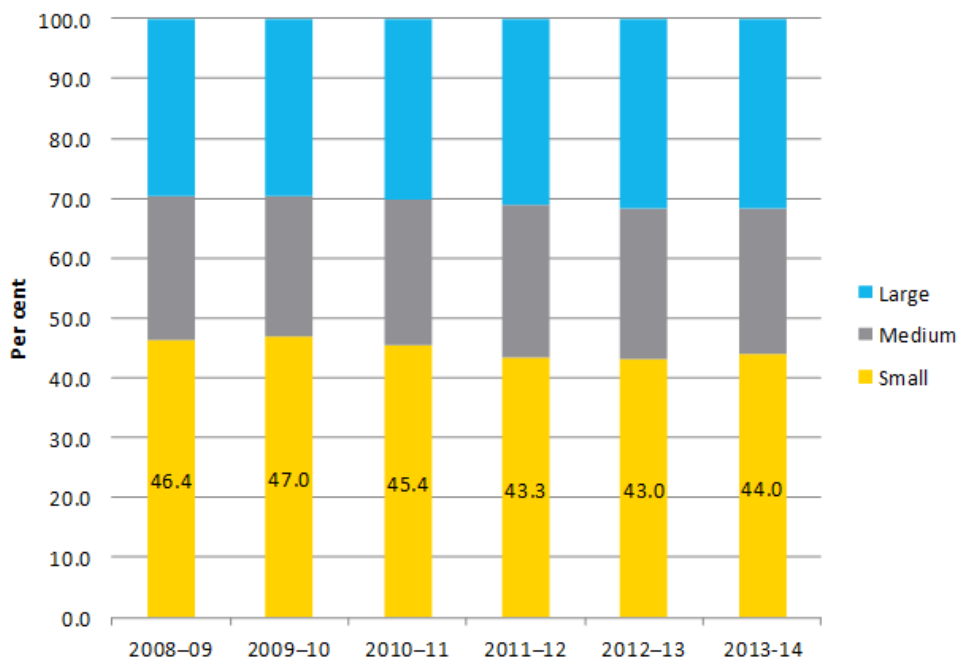
- 1 Australian Government, 'The engine room of the Australian economy: Small businesses drive growth and create jobs', May 2015 <<http://www.budget.gov.au/>>, viewed 12 January 2016. See also the Hon. Wayne Swan, 'Small business: the engine room of our economy', *Address to the COSBOA National Small Business Summit*, Brisbane, 8 July 2010 <<http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=speeches/2010/022.htm&pageID=005&min=wms&Year=&DocType=1>>, viewed 12 January 2016.
- 2 Ellis Connolly, David Norman and Tim West, Reserve Bank of Australia, 'Small Business: An economic overview', *Small Business Finance Roundtable*, 2012, p. 4 <<http://www.rba.gov.au/publications/workshops/other/small-bus-fin-roundtable-2012/pdf/01-overview.pdf>>, viewed 16 December 2015.
- 3 Australian Government, 'The engine room of the Australian economy: Small businesses drive growth and create jobs', May 2015 <<http://www.budget.gov.au/>>, viewed 12 January 2016.

1.3 Small businesses account for the vast majority of Australian businesses, nearly half of all employment in the private non-financial sector, and over one-third of production.⁴ The 2015 budget papers state that:

96 per cent of all Australia's businesses are small businesses, employing over 4½ million people and producing over \$330 billion of our nation's economic output per year.⁵

1.4 Figure 1.1 shows that at the end of June 2014, small businesses accounted for 44 per cent of total employment in Australia (4.7 million of the 10.7 million Australians employed).

Figure 1.1: Share of total employment by firm size



Source ABS, Australian Industry, Cat. No. 8155.0, Table 5.

4 Ellis Connolly, David Norman and Tim West, Reserve Bank of Australia, 'Small Business: An economic overview', *Small Business Finance Roundtable*, 2012, p. 1. See also Australian Government, Department of Industry, Innovation Science, Research and Tertiary Education, *Australian Small Business Key Statistics and Analysis*, p. 1. <<http://www.treasury.gov.au/PublicationsAndMedia/Publications/2012/sml-bus>>, viewed 16 December 2015.

5 Australian Government, 'The engine room of the Australian economy: Small businesses drive growth and create jobs', May 2015 <<http://www.budget.gov.au>>, viewed 12 January 2016.

The role of government in supporting small business

1.5 This inquiry is premised on the importance of the small business sector to generating economic growth and employment opportunities, and the need to promote the sector to expand these opportunities. It recognises that government has an important supporting role to help small businesses to invest and employ.

1.6 The majority of small businesses in Australia fail within their first three years.⁶ However, the role of government role is not to prop-up or bail out a failing small business. As the Small Business Minister, the Hon. Kelly O'Dwyer MP, was quoted in November 2015:

Small business don't expect handouts but they do expect government to get out of the way. They expect government to make it easier for them to set up small business.⁷

1.7 The Committee believes that the role of government in encouraging new and existing small business should be to:

- promote an economic climate in which small businesses can invest and employ staff with confidence;
- establish a regulatory framework in which small businesses can comply as efficiently as possible with their obligations including employment law, taxation and superannuation;
- invest in human capital, providing training opportunities for Australian workers and entrepreneurs to ensure that small businesses have employees with the requisite skills and traits to compete; and
- seek to change negative employer attitudes to disadvantaged groups and facilitate opportunities for people in these disadvantaged groups to find employment opportunities with small businesses.⁸

6 Australian Government, Department of Social Services, 'A New System for Better Employment and Social Outcomes', *Final Report*, February 2015, pgs 35 and 177, <https://www.dss.gov.au/sites/default/files/documents/02_2015/dss001_14_final_report_access_2.pdf>, viewed 12 January 2016. The ABS reported in March 2015 that of the 294 210 new business entries during the 2010–11 financial year, only 50 per cent were still operating in June 2014. 'The number of Australian businesses have increased', *Media Release*, <<http://www.abs.gov.au/ausstats/abs@.nsf/mediareleasesbytitle/950EC94DB899312ECA2573B00017B8F4?OpenDocument>>, viewed 12 January 2016.

7 The Hon. Kelly O'Dwyer MP stated in Waters, C, 'Kelly O'Dwyer says government needs to get out of the way of small business', *Sydney Morning Herald*, 2 November 2015, <<http://www.smh.com.au/small-business/kelly-odwyer-says-government-needs-to-get-out-of-the-way-of-small-business-20151029-gklt1c.html>>, viewed 14 January 2016.

- 1.8 This inquiry is concerned with how well the Australian Government is currently performing these roles and what could be done to improve these efforts.

What is a ‘small business’?

- 1.9 There is no settled definition of ‘a small business’ within the Australian Government. As Table 1.1 shows, government agencies use different definitions depending on their policy focus and objectives. While a case has been made that a standard definition of ‘small business’ is desirable,⁹ it has also been noted that some of the definitions currently used would exclude many businesses covered by other definitions.¹⁰

Table 1.1 Examples of small business definitions

Metric	Threshold	Institution	Purpose
Employees	Less than 15	Fair Work Australia	Unfair dismissal laws
	Less than 20	Australian Bureau of Statistics	Business surveys
		ACCI and Sensis	Business surveys
		Reserve Bank of Australia	Business liaison
		Australian Securities and Investments Commission	Annual financial reports
Legal structure	Unincorporated	Reserve Bank of Australia	Analysis of financing conditions
Revenue	Less than \$2 million	Australian Taxation Office	Taxation
	Less than \$50 million	Australian Prudential Regulatory Authority	Prudential supervision
Individual loan size	Less than \$1 million	Australian Prudential Regulatory Authority	Prudential supervision
	Less than \$2 million	Reserve Bank of Australia	

Source *Ellis Connolly, David Norman and Tim West, ‘Small Business: An economic overview’, Reserve Bank of Australia, May 2012, p. 1.*

- 8 Australian Government, Department of Social Services, ‘A New System for Better Employment and Social Outcomes’, *Final Report*, February 2015, p. 29, <https://www.dss.gov.au/sites/default/files/documents/02_2015/dss001_14_final_report_access_2.pdf>, viewed 12 January 2016.
- 9 Parliamentary Joint Committee on Corporations and Financial Services, ‘Access for Small and Medium Business to Finance’, 2011, p. 5.
- 10 Ellis Connolly, David Norman and Tim West, Reserve Bank of Australia, ‘Small Business: An economic overview’, *Small Business Finance Roundtable*, 2012, p. 2.

1.10 Apart from these metrics, a 'small business' may also be identified from qualitative operational characteristics. The Productivity Commission, for example, has made the following observations:

A small business is usually not just a larger business on a smaller scale but one that operates in a fundamentally different way. The issue of what constitutes a small business has been well examined. In qualitative terms, a small business typically has the following three fundamental characteristics:

- it is independently owned and operated, that is, it is not part of a larger corporation or controlled by another firm
- the owner manager is the principal decision maker
- the owner manager contributes most, if not all, of the operating capital.

Other characteristics common to the way a small business operates include:

- a small number of individuals work in the business – sometimes from the same family
- a simple management structure, usually with no specialised finance, personnel or regulatory/legal managers or systems
- limited resources, including finance, staff and skills – this often requires the owner manager to fulfil all regulatory obligations, leaving them time poor
- a small market share with a greater propensity to only supply the local market, or operate within a single state or territory.¹¹

1.11 In its 2013 research report, *Regulator Engagement with Small Business*, the Productivity Commission argued that a definition of small business should be determined by individual policy makers and regulators. It recommended that:

Governments should not impose upon regulators a single definition of small business as this could lead to inflexibility and higher costs for some businesses and for the community more generally. Policy makers and regulators are best placed to define small business in ways that are practical and appropriate for their regulatory area.¹²

11 The Productivity Commission, 'Regulator Engagement with Small Business', *Research Report* September 2013, p. 30, <<http://www.pc.gov.au/inquiries/completed/small-business/report/small-business.pdf>>, viewed 12 January 2016.

12 The Productivity Commission, 'Regulator Engagement with Small Business', *Research Report*, September 2013, p. 22, <<http://www.pc.gov.au/inquiries/completed/small-business/report/small-business.pdf>>, viewed 12 January 2016.

- 1.12 In its submission to this inquiry, the Australian Industry Group suggested that a definition of small business based on employment size would be of most use to the Committee:

There are a few different definitions that you can use. The ABS data always uses employment size, whereas the tax office looks at turnover size. Given your purposes are from the employment side of business and that many of the concerns and barriers raised are in the industrial relations area, employment size would appear to be more relevant for what you are looking at.¹³

- 1.13 The Committee took the approach that submitters and witnesses should define 'small business' as they see fit. It was mindful that a strict definition may have excluded interested parties from participating in the inquiry.

'It's the economy...'

- 1.14 This report is principally focussed on the regulatory, attitudinal and circumstantial issues that weigh on small business owners when making a hiring decision and on job seekers in their search for work with a small business. It is also important to recognise that macro-economic conditions can be a significant barrier to small businesses employing staff. If consumer confidence is low, small businesses will not invest or employ. As one submitter put it:

The biggest inhibitor to job creation is always a lack of aggregate demand in the economy.¹⁴

- 1.15 Recent survey findings indicate that small business is experiencing lower profit margins and a lack of customer demand for its goods and services.¹⁵ Economic indicators suggest that the Australian economy is experiencing a slower than expected transition from investment in mining to investment in non-resources activity.¹⁶ In its submission to this inquiry, the Commonwealth Department of Employment described Australia's current economic situation as follows:

13 Ms Julie Toth, Chief Economist, Australian Industry Group, *Committee Hansard*, Melbourne, 13 July 2015, p. 25.

14 Unions Tasmania, *Submission 24*, p. 2.

15 Australian Chamber of Commerce and Industry, *Submission 22*, p. 13.

16 See also Dr Martin Parkinson, 'Looking ahead: Challenges and opportunities for Australia', *Address to the Committee for Economic Development of Australia*, 27 November 2014 <<http://www.treasury.gov.au/PublicationsAndMedia/Speeches/2014/CEDA-27112014>>, viewed 12 January 2016.

The Australian economy is in the midst of transitioning from the resources investment boom to a revival of non-resources activity. As a trading nation, Australia's economy is, to a large extent, dependent on world economic conditions. Currently, many of the key external drivers of Australia's economic activity remain weak. In particular, falling commodity prices have reduced the terms of trade.

The pace of this economic transition is slow, with growth in consumption spending below average and the growth of both private non-mining business investment and public demand subdued, while mining investment has continued to fall substantially.

The transition has been restrained by weak investor and consumer confidence, even though the world economic recovery is gathering strength...

The 2015-16 Federal Budget forecasts that real GDP will grow by 2.75 per cent in 2015-16. It notes that this is one quarter of a percentage point slower than expected 12 months ago in the 2014-15 Budget, as a sustained recovery in non-mining business investment is taking longer than expected. However, stronger non-mining business investment is expected to drive an increase in growth to 3.25 per cent in 2016-17.¹⁷

- 1.16 The Australian Industry Group's submission made the following assessment:

At a headline level, the Australian economy since 2010 can best be characterised as 'slower and lower', relative to the growth rates achieved in the decades prior to this one. This trend is evident across a range of key macroeconomic aggregate measures in 2015 including growth in real GDP, business profitability, productivity, employment, investment, interest rates, prices and incomes.¹⁸

- 1.17 While macro-economic conditions in Australia have been more subdued in recent times than at the peak of the mining boom, the Committee notes strong growth in Australian small business start-ups in 2013-2014. The

17 Department of Employment, *Submission 31*, pp. 1-2. See also Dr Martin Parkinson, 'Looking ahead: Challenges and opportunities for Australia', *Address to the Committee for Economic Development of Australia*, 27 November 2014.

18 Australian Industry Group, *Submission 17*, p. 1.

2015 budget papers show that 40 000 new Australian small businesses commenced in the 2013–2014 financial year.¹⁹

Conduct of the inquiry

- 1.18 On 23 March 2015, the Minister for Employment, Senator the Hon. Eric Abetz, asked the Committee to inquire into and report on *matters that inhibit or discourage job-creation and employment by private sector small businesses and/or provide disincentives to individuals from working for such businesses*. The Committee sought and received submissions from a range of stakeholders including small businesses, peak industry and union representatives and individuals identifying a variety of issues relevant to the Terms of Reference.
- 1.19 The Committee received 49 submissions, which are listed in Appendix A, and one confidential exhibit. All public submissions are available to view on the Committee’s website.
- 1.20 The Committee held nine public hearings at five locations across Australia. The witnesses and organisations that the Committee heard from are listed in Appendix B.
- 1.21 The Committee thanks all those who contributed to this inquiry.

Context of this inquiry

- 1.22 In presenting this report to the Parliament, the Committee is mindful of the Australian Government’s *National Innovation and Science Agenda*, which was released in October 2015. While this Agenda is not focussed on small business per se, clearly, small businesses will be critical to the innovative drive that will increase job opportunities and Australia’s standard of living.
- 1.23 Most of the new, innovative businesses that the federal government is seeking to promote through the Innovation Agenda will be small and medium sized enterprises. This report does not focus on issues of innovation or small businesses in Australia’s key sectors of competitive advantage. Nonetheless, it should be read in the context of the need to

19 Australian Government, ‘The engine room of the Australian economy: Small businesses drive growth and create jobs’, <http://www.budget.gov.au/2015-16/content/glossy/sml_bus/html/sml_bus-02.htm>, viewed 12 January 2015.

provide an efficient regulatory framework and skills base to provide for new, innovative small businesses in emerging industries.

Structure of the report

1.24 This report has three chapters:

- Chapter 2 discusses current Australian Government initiatives to promote small business and job creation in these businesses. It details a range of recent initiatives including streamlining compliance, reducing the tax burden, offering wage subsidies and grants, and strengthening of employment programmes and employment entitlements;
- Chapter 3 looks at the reasons why small businesses may be reluctant to employ more staff. It considers issues such as the attitude of a business owner to growing the business, the burden of paperwork associated with employing more staff, the impost of penalty rates, and a range of workplace relations issues that can dissuade a small business from employing; and
- Chapter 4 looks at the evidence that certain categories of jobseekers face impediments to finding and maintaining employment with a small business. It considers issues including a job seeker's lack of skills and work experience, limited recognition of their skills, and their personal circumstances which can include disability and ill-health.

