

Ai GROUP SUBMISSION

Parliament of Australia Standing
Committee on Education and
Employment

Inquiry into inhibitors to
employment for small business
and disincentives to working for
individuals

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Ai Group Submission to Standing Committee Inquiry into inhibitors to employment for small business

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About Australian Industry Group

The Australian Industry Group (Ai Group) is a peak industry association in Australia which along with its affiliates represents the interests of more than 60,000 businesses in an expanding range of sectors including: manufacturing, engineering, construction, automotive, food, transport, information technology, telecommunications, call centres, labour hire, printing, defence, mining equipment and supplies, airlines, health and other industries. The businesses which we represent employ more than one million people. Ai Group members operate small, medium and large businesses across a range of industries. Ai Group is closely affiliated with many other employer groups and directly manages a number of those organisations.

Australian Industry Group contact for this submission

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1. Executive summary

The Australian Industry Group (Ai Group) is pleased to make a submission to the current inquiry into *“Inhibitors to employment for small business and disincentives to working for individuals”*.

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.

Australia’s small businesses (with 1-19 employees) accounted for 93% of Australia’s 826,393 employing businesses as of 30 June 2014. Small businesses continue to have higher entry and exit rates than larger businesses, reflecting the higher rates of business ‘churn’ at this end of the economy. Improving small business success and viability is vital to securing a better growth trajectory in output, employment, incomes and living standards from here.

We therefore urge this Committee to consider impediments to small business formation, continuity and transfer, in the context of this inquiry. Fostering the formation of new small businesses is vital to ensuring a vibrant future stream of innovation, investment, employment and self-employment opportunities. In our recent submission to the Productivity Commission Inquiry into Barriers to Business Entries in Australia (Feb 2015), Ai Group noted impediments to the successful setup, entry, transfer and exit of businesses in the following areas:

- declining international competitiveness for Australia with regard to the time and ease of starting a new business;
- poor international competitiveness for Australia with regard to the overall burden of government regulation and the flexibility of workplace relations, which may impede the setup of new businesses and/or the retention of existing businesses;
- a declining number of businesses operating in Australia in 2012-13, in absolute numbers and on a per capita basis;
- a need to encourage and improve Australian business innovation, leadership and capabilities;
- barriers to new business formation arising from workplace relations;
- barriers to new business formation arising from access to finance;
- barriers to the successful transfer of ownership of existing businesses.

With regard to employment opportunities in small businesses, Ai Group notes that even as our national output growth slows, skill shortages in key growth industries including mining services, engineering, education and health services are being exacerbated by structural changes across our economy, as well as the deepening demographic impacts of our ageing population and workforce. Around 10% of all Australian employees are now aged 60 or over and 18% are aged 55 or over. And the current population ‘bulge’ in these age brackets means there are fewer young people ready for these professional roles as the baby boomers retire.

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At the same time, at the younger end of the working population, rising education participation and changing industry skill demands have seen a declining share of employment going to young workers, with less than 6% of the workforce aged 15 to 19 years old and 10% aged 20 to 24 years old in 2015. Participation rates for these younger age groups are in long-term decline, with a sharper rate of decline evident over the past five years, as participation in formal tertiary education has risen.

In our submission to Productivity Commission's inquiry into Australia's Workplace Relations Framework we detailed 10 key problems identified by employers and proposed solutions. These included the following problems of particular concern to small businesses:

1. It is too difficult and costly to terminate poor performing employees; and
2. Awards are still far too complicated.

In addition to the those problems identified and discussed within Ai Group's submission to the Productivity Commission inquiry into Australia's Workplace Relations Framework, the highly prescriptive and inflexible nature of the modern award system is a particular problem for small business employers. Small business employers and their employees are generally reliant on the modern awards system, where the system provides coverage of their industry and/or occupation, and less likely to undertake enterprise bargaining. In short, the award system must be simpler and less prescriptive for small business employers.

Ai Group's full submission to the Productivity Commission inquiry into Australia's Workplace Relations Framework can be found at the following link: [Ai Group submission to the Productivity Commission inquiry into Australia's workplace relations framework](#)

Ai Group looks forward to ongoing participation in the Committee's inquiry.

2. The business environment in which 21st century workplaces operate

2.1 Recent trends in the Australian economy

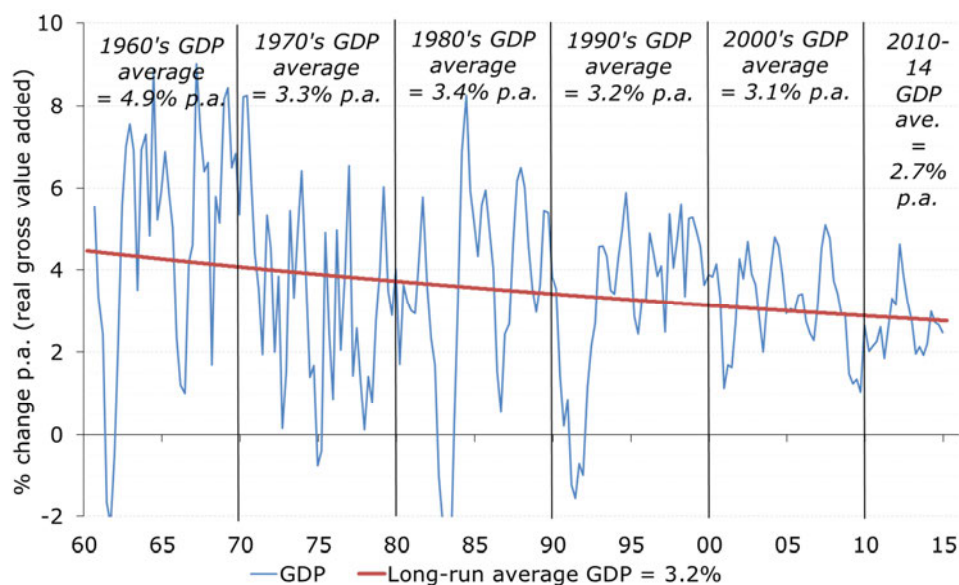
At a headline level, the Australian economy since 2010 can best be characterised as ‘slower and lower’, relative to the growth rates achieved in the decades prior to this one. This trend is evident across a range of key macroeconomic aggregate measures for Australia including growth in real GDP, business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

The ‘new normal’? slower growth in output, productivity and incomes

In real output (inflation-adjusted) terms, GDP grew by an annual average of just 2.7% over the past five years and 2.5% in 2014, well below the long-term average of 3.2% p.a. (chart 1). There are many factors contributing to this latest slow period, which has been evident despite the positive stimulus from mining investment boom which peaked from approximately 2008 to 2012. Indeed, the boost received from mining investment during this period partially masked the flat or declining trends occurring elsewhere in the economy due to factors including: a cyclical lull in local residential house construction; an extended period of the Australian dollar trading above parity with the US dollar (2010-13); effects of the GFC in advanced economies (e.g. low inflation and low rates of return); structural changes in key global supply chains, with production hubs moving East; demographic changes; and technological changes that are affecting many parts of the economy.

While it is to be hoped that this extended slow period is an aberration and Australia will return to something closer to ‘trend’ growth (3 ¼ % p.a.), the long-term nature of some of these trends and adjustment processes means it is entirely possible that GDP growth rates of 3% or under could settle in to become Australia’s ‘new normal’ rate of growth.

Chart 1: Australian GDP growth (real value added output)



Source: ABS, *National Accounts*, to Dec 2014

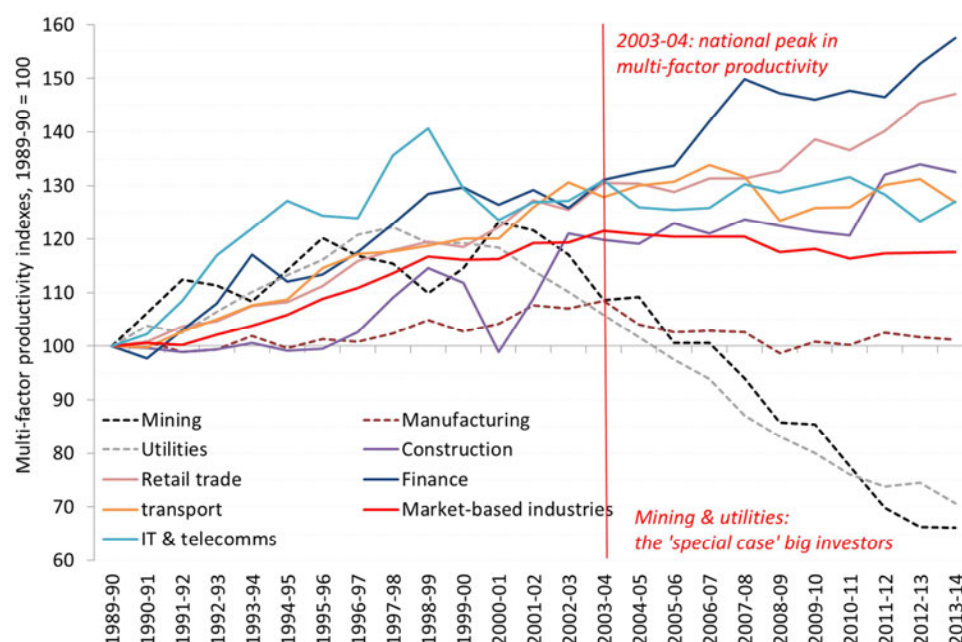
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As Treasury noted in its latest Intergenerational Report (March 2015), stronger productivity growth is required if we are to overcome these multiple headwinds to growth. Australian productivity growth rates have been trending lower, in a similar pattern to real GDP growth and other key indicators. At a national level, Australian multifactor productivity has flatlined at best since the turn of this century (see Chart 2). And compared to our global competitors, Australia has performed especially poorly, with national multifactor productivity *falling* by an average of 1.2% p.a. from 2007 to 2011 and by 1.3% in 2012 and 2013, compared with global estimates of an improvement of 0.6% p.a. from 2007 to 2011, 0.2% in 2012 and -0.1% in 2013¹.

Some of this decline in national multifactor productivity since 2003-04 has been due to the unique influence of unusually large long-term investments in mining and utilities during this period that have not yet resulted in a fully commensurate increase in output volumes (e.g. due to time lags between investments and their output growth). But weak productivity growth is apparent in other industries also (see Chart 2). This suggests that Australia's productivity problem runs deeper than just this temporary capital expansion cycle in mining and utilities. It requires a response at both:

1. the national level, that is, macroeconomic policy that enhances our allocative flexibilities and efficiencies across industries and sectors; and
2. the workplace level, that is, microeconomic policy that enhances our productive flexibilities and efficiencies with regard to innovation, technologies and work practices within businesses.

Chart 2: Australian multifactor productivity, selected market-based industries



Source: ABS, *Estimates of multifactor productivity, 2013-14*, (Dec 2014).

¹ Productivity Commission estimates calculated from the Conference Board Total Economy Database, in PC 2014.

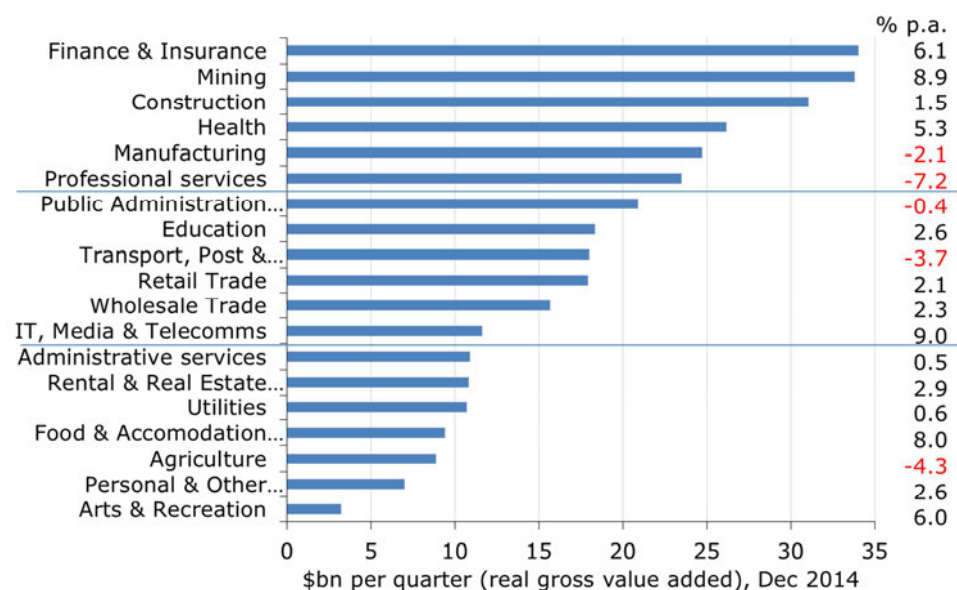
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Australia's mix of output: rebalancing is required

As Australia moves beyond the resources boom that has reshaped our economy over the past decade (with a large investment cycle now being followed by large increases in mining output volumes), it is becoming increasingly urgent that other, non-mining industries and sectors improve their growth in investment, employment, output and incomes. This issue lies at the heart of long-standing concerns about relatively low non-mining business investment held by the RBA, which have prompted it to cut Australia's cash rate to a record low of 2.0% in May 2015.

In addition to this (very welcome) monetary policy response, Ai Group has been calling for some time for our national microeconomic policy framework to more actively encourage and enable the rebalancing that is now required.² To illustrate this task, Australia's two largest industries, finance and insurance and mining, currently contribute around 9% of GDP each, in value-added output terms (see Chart 3). They are growing more rapidly than other industries and so their dominance – and our dependence on them – is increasing. Among other large industries, construction and health services are also growing well, largely for demographic reasons. Other larger industries are faring less well however, so the range of industries that are driving our growth is narrowing.

Chart 3: Australian industries, value added output and latest growth rate (Q4 2014)



Source: ABS, *National Accounts*, to Dec 2014

The implications of this narrow growth base for Australia's economic outlook were highlighted recently by the OECD. Indeed, in its latest assessment of the Australian economy, the OECD noted that *"with the end of the mining boom, Australia must look toward non-resource sectors for future growth"*. In order to achieve this, economic policy must seek *"rebalancing to sustain growth"* and that it must *"enable the economy to diversify towards more sectors of high-value added activity"*. The OECD recommends that in response, Australian economic policy should focus on:

² See for example, Ai Group (March 2014), *Growing and rebalancing the Australian Economy: Ai Group's 10 point plan for a strong and diversified economy*.

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“further improving the operating environment for the private sector, most importantly in infrastructure, taxation, labour skills and innovation. Improving educational and labour market opportunities for minority groups would not only reduce social exclusion but also boost growth potential.”³

Similarly, the Australian Treasury’s latest Intergenerational Report (March 2015) highlights the urgency of implementing policy that fosters business flexibility and sustainability. It aims for a

“policy agenda [that] will support productivity growth by helping to position Australian businesses to be flexible, competitive and robust in the face of dynamic global conditions.”

The Treasury lists this current Productivity Commission Review of workplace relations as a key step toward identifying workplace relations reforms that will support this long-term objective.

Productivity improvement at the firm level

Productivity improvement at the firm level is a well understood goal, but it can be difficult to achieve in practice or to measure accurately. Ai Group conducts an annual survey of Business Prospects which sheds light on recent success rates in achieving labour productivity improvements and the factors that may have contributed to changes (up or down) in firms’ labour productivity.

In this year’s CEO Business Prospects Survey, labour productivity improved for a net balance of 8% of all businesses in 2014. This result was below what had been initially expected for 2014, as of the end of 2013, when a net balance of around 20% of CEOs had anticipated an improvement in their own business’ labour productivity in 2014.

Across the four major industry groups included in this year’s survey, labour productivity improvement was achieved by a higher proportion of businesses in mining services in 2014 than in other industries, with a net balance of 29% of mining services CEOs indicating an improvement in 2014. CEOs in the services sectors were the next most successful group in achieving labour productivity improvements, with a net balance of 15% of respondents recording an improvement in 2014. On balance, only 6% of manufacturing CEOs reported labour productivity improvements in 2014, while 5% of construction CEOs did so.

Two fifths of businesses that reported an improvement in labour productivity in 2014 attributed their improvement to a change in business processes that helped increase their output using the same amount of labour (see Chart 4). Restructuring was listed by 16% of the CEOs who reported an improvement as the key reason for labour productivity improvement. 13% of CEOs (most of them in manufacturing) made additional capital investment during 2014, which helped increase their output per hour of work. Higher demand (11%) and increased staff skills and capabilities (9%) were also cited as the main factor behind better labour productivity in 2014 by CEOs across all industries.

³ OECD (Dec 2014), *2014 OECD economic survey of Australia: rebalancing to sustain growth*, and OECD (February 2015), *Economic Policy Reforms 2015: Going for Growth* (pp. 141-144).

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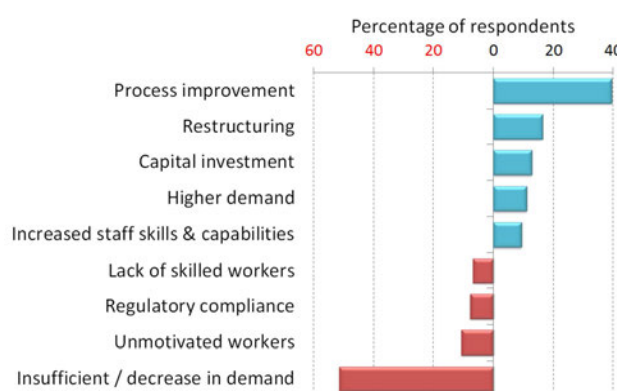
Among businesses that experienced a decline in labour productivity in 2014, around half (51%) identified a fall in demand as the key reason behind the deterioration. This indicates that their output fell by more than their labour inputs did in this period, such that their lower output increased their average labour content per unit of goods or services produced. This may simply be due to the time lags involved in adjusting inputs to match expected outputs, with labour typically taking longer to adjust (up or down) than output or material inputs, due to the time required to recruit new staff or, on the downside, to shed excess labour.

Rather intriguingly, 11% of CEOs nominated ‘unmotivated workers’ as a factor eroding their labour productivity in 2014. While there can be many factors contributing to an apparent lack of employee motivation, the very weak national labour market and subdued private sector wage growth over the past two years could be contributing to this outcome (for example, if employees would like to change jobs but cannot due to lack of opportunities elsewhere).

8% of CEOs listed regulatory compliance as the number one factor causing lower labour productivity in 2014. This partly reflected the ongoing challenges faced by Australian businesses with regards to industrial relations, but also touches on other areas of regulatory compliance costs. 7% of respondents attributed the deterioration in their labour productivity in 2014 to a lack of skilled workers.

For 2015, 39% of all CEOs expect their business’ labour productivity to improve, while 9% expect it to decline, leaving a net balance of 30% of businesses having a positive outlook for their own labour productivity in 2015. This optimism is particularly evident in the mining services industry, with a net balance of 42% expecting higher labour productivity in 2015. This is followed by the services sectors (31%), manufacturing (30%) and construction (23%) industries (Chart 4).

Chart 4: Reasons for changes in labour productivity in 2014



Australian business global competitiveness: improvement is required

The World Economic Forum’s (WEF) Global Competitiveness Index and other data sources indicate that Australia’s global competitiveness has slipped in recent years, falling to 22nd in 2014-15, from an all-time national best ranking of 15th place in 2009-10. These numbers are the statistical expression of the commonly heard comment from business leaders that “Australia has become a very expensive country in which to make things or to do business” (see Table 1).

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Table 1: WEF Global Competitiveness Indexes: Australia's ranking

Year	Overall competitiveness	Flexibility of wages	Burden of Gov. regulation	Technological readiness	Business Innovation
2007-08	19	87	68	17	22
2008-09	18	90	66	19	20
2009-10	15	75	85	20	20
2010-11	16	110	60	23	21
2011-12	20	116	75	22	22
2012-13	20	123	96	19	23
2013-14	21	135	128	12	22
2014-15	22	132	124	19	25

Source: WEF Global Competitiveness Reports

Arguably Australia's loss of global competitiveness in recent years has been partly due to other countries doing better and moving up the ranks, but in some areas Australia's performance has deteriorated in absolute terms (e.g. in the burden of Government regulation and in the cost of staff redundancies). In the global context, perception matters almost as much as reality, since expectations and impressions play a significant role in the decision-making of businesses and individuals regarding when and where to place their next investment in labour and capital.

This loss of competitiveness is not simply a temporary or relative cost story that can be put down to our high dollar, after several years of 'over parity' AUD trading against the US dollar. While the high Australian dollar has most definitely contributed to the tough trading conditions facing Australian business in recent years (our own case of 'Dutch disease'), it is not the only factor. The five key weaknesses that the WEF series identifies as impeding Australian businesses' global competitiveness in 2014-15 and as requiring a response are:

1. **25.4% of businesses nominated restrictive labour regulations.** A restrictive labour market has topped the list of key business impediments in Australia in each of the WEF's Global Competitiveness Reports since 2008-09, but a far higher proportion of business leaders said it is an impediment in 2014-15 than in previous years. This suggests that labour regulations have become a greater impediment to competitiveness in Australia in 2014-15, instead of improving.
2. **11.1% of businesses nominated tax rates,** reflecting the relatively high rate of corporate taxation in Australia (as opposed to the total tax burden, which is around the average of OECD countries).
3. **10.7% of businesses nominated inefficient Government bureaucracy,** highlighting the burden that government regulation and reporting requirements (including labour regulation) place on businesses, in terms of its time and cost to business.
4. **10.1% of businesses said an inadequate supply of physical infrastructure** (e.g. in transport and telecommunications) is impeding Australian business competitiveness.
5. **10.0% of businesses nominated tax regulations,** reflecting the complexity and reporting requirements associated with Australia's taxation system.

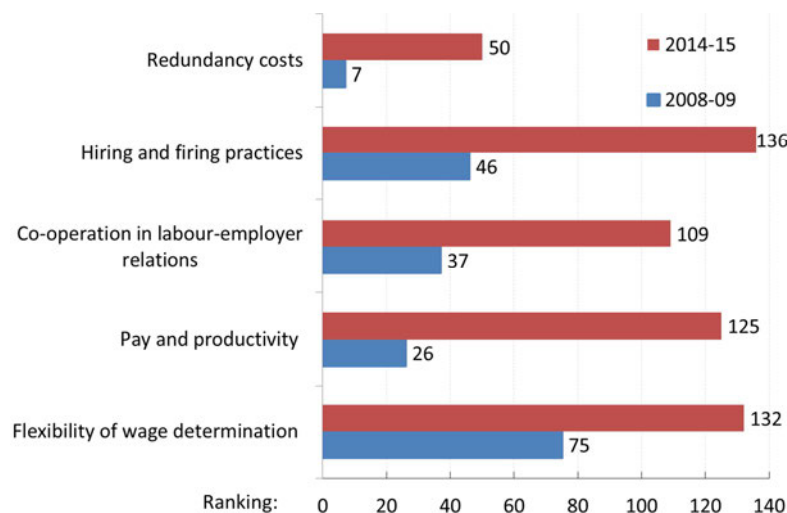
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Other problems for Australian business in 2014-15 that relate to the labour market include:

- Poor work ethic in national labour force (9.2% of businesses commenting on Australia);
- Insufficient capacity to innovate (5.3%); and
- Inadequately educated workforce (3.7%).

The WEF Global Competitiveness series suggests that on this set of labour market indicators, Australia's relative performance has deteriorated in recent years (see Chart 5). This relative deterioration is partly due to labour market reforms in other countries that have improved their ranking relative to Australia's, but also due to an outright decline in Australia's score on some key measures. These include the flexibility of wage determination (reflecting the continuation of Australia's centralised wage setting processes); hiring and firing practices (reflecting relatively more restrictive access to casual and contract workers); pay and productivity for workers (reflecting the failure to reduce unit labour costs and improve labour productivity); and cooperation in workplace labour relations.

Chart 5: Australia's global ranking on selected labour market indicators



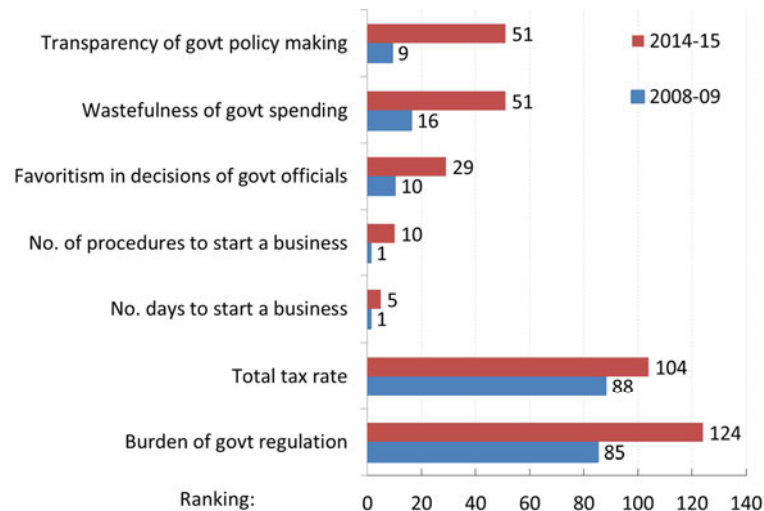
Source: WEF Global Competitiveness Reports

The WEF Global Competitiveness series includes a number of comparative measures that may help in identifying regulatory inhibitors to setting up a new business in Australia, relative to other countries. In 2014-15, Australia ranked (chart 6):

- 15th for number of days to start a business, down from equal 1st position in 2008-09;
- 10th for Number of procedures to start a business, down from equal 1st position in 2008-09;
- 124th for Burden of government regulation (out of 144 countries), down from 85th in 2008-09;
- 104th for the total tax rate for businesses, down from 88th in 2008-09.

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Chart 6: Australia's global ranking on selected regulatory indicators



In 2014-15, Switzerland was ranked again as the most competitive country in the world, closely followed by Singapore. Rankings at the top of the GCI have remained relatively stable in recent years. Highly advanced large economies including the US, the UK, Japan and Hong Kong continue to dominate the Top 10 list, as do the more specialised and 'boutique' northern European nations including Germany, Finland, the Netherlands and Sweden.

These top-ranking nations all tend to share competitive characteristics such as:

- very open and competitive trade facilities (including large and efficient ports),
- advanced manufacturing sectors,
- very high education standards and
- strong and stable financial, legal and political systems.

3 Recent trends in Australian business numbers

The ABS business register (a national database of all businesses in operation that is updated annually) indicates there were 2.1 million businesses operating in Australia as of 30 June 2014. Of these, 1.2 million businesses were registered entities but did not employ anyone (57% of all registered businesses). In June 2014, 826,393 businesses had any employees and only 55,302 businesses had 20 or more employees (see table 2). Small businesses with 1-19 employees accounted for 93% of all employing businesses, including 69% with only 1 to 4 employees.

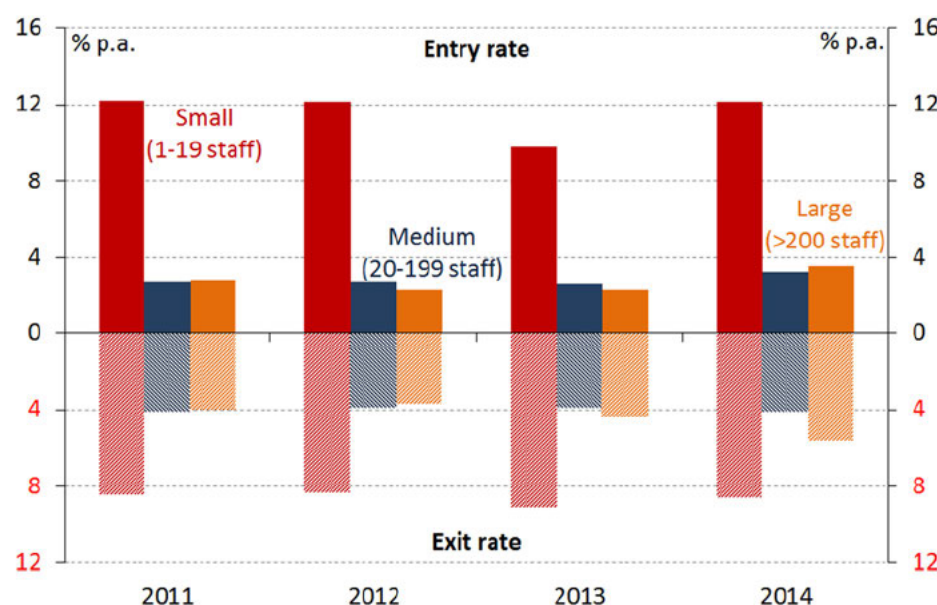
Table 2: Australian business registrations, by employment size

	Jun 2010	Jun 2011	Jun 2012	Jun 2013	Jun 2014
Non-employing	1,303,040	1,306,023	1,306,093	1,264,298	1,273,769
Employing					
1-4	580,177	581,741	582,719	563,412	571,176
5-19	189,023	191,812	198,340	197,412	199,915
20-199	48,958	49,302	50,522	50,946	51,688
200+	3,452	3,534	3,606	3,598	3,614
All employing	821,610	826,389	835,187	815,368	826,393
Total	2,124,650	2,132,412	2,141,280	2,079,666	2,100,162

Source: ABS Counts of Australian businesses, Jun 2010 to Jun 2014.

Entry and exit rates are significantly higher for small employing businesses than for larger employing businesses, due to the higher rates of 'churn' among small businesses. ABS business registration data indicates that over the past five years, around 90,000 small businesses with 1-19 employees commenced operations each year (12% of all small employing businesses), and around 65,000 ceased operations (8.5% of all small employing operations). These entry and exit rates have been relatively constant over the past five years (see chart 7).

Chart 7: Australian businesses with employees, annual entry and exit rates (%)



Source: ABS, Counts of Australian Businesses, June 2010 to June 2014

The ABS estimates that in total, small businesses employed 43% of total private sector employees (excluding the financial sector) in 2012-2013, down from 53% in 2006-07. This compared to 25% of

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all employees in medium firms and 32% in large firms in 2012-13. As for the economy more broadly, the majority of small businesses with employees are in services industries, as are the majority of small business employees (table 3). Services industries such as finance, healthcare, education, professional services, retail and hospitality currently account for around 70% of Australian output (in value-added terms) and 75% of employment. The construction industry also accounts for a significant share of small businesses and small business employment (around 13% of small business private sector employment). Construction typically accounts for around 10% of value added activity and employment in the Australian economy.

Table 3: Businesses with employees in Australia, by major industry group

	Number of businesses, (June 2014), '000		Small business employment, private sector (2012-13)*	
	1-19 employees	All employing businesses	Employees in businesses with 1-19 employees	
	'000	'000	'000	% of industry
Agriculture	51	53	412	83
Mining	3	4	24	13
Manufacturing	42	48	264	29
Construction	132	136	632	60
Distribution services#	146	159	884	36
Business services#	177	189	1,079	45
Household services#	172	187	1,207	41
All industries	771	826	4,542	43

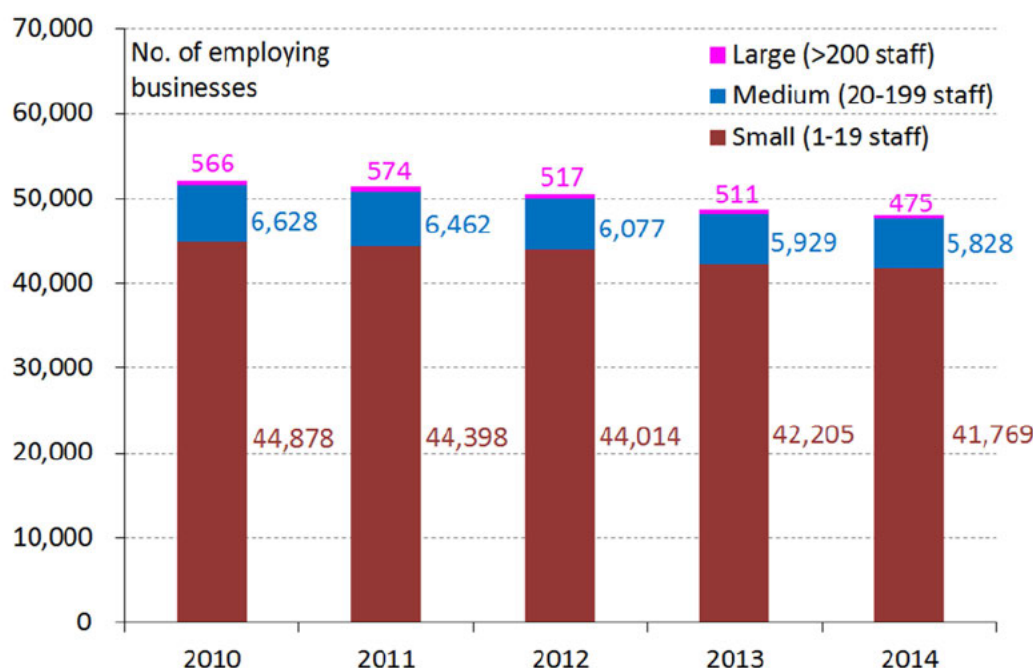
* Private sector, non-financial industries.

'Distribution services' includes to Wholesale Trade, Retail Trade and Transport, Postal and Warehousing;

'Business services' includes Information Media and Telecommunications, Rental, Hiring and Real Estate Services, Professional, Scientific and Technical Services and Administrative and Support Services;

'Household Services' includes Accommodation and Food Services, Education and Training, Health Care and Social Assistance, Arts and Recreation Services and Other Services. Source: ABS.

Chart 8: Australian manufacturing businesses by employment size



Source: ABS, Counts of Australian Businesses, June 2010 to June 2014.

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Manufacturing accounts for around 7% of Australian GDP and employment, but a smaller proportion of employing businesses (6%), small employing businesses (5.4%) and small business employment (5.8% of all private sector small business employees). The number of employing businesses in manufacturing has steadily declined for at least the past five years (chart 8).

ABS data suggest that non-employing businesses and employing small businesses (all those with zero to 19 employees) accounted for 33% of total private non-financial industry real output (i.e. value added) in 2013. This compared to 23% by medium businesses and 44% by large firms in 2012-13. Around 97% of small businesses were wholly Australian owned in 2013 (ABS).

Recent research done by the RBA (2015) found that on average, 35% of non-employing and small businesses are located in the regional areas, compared to 20% for large firms. About 30% of small businesses in NSW are regionally based, compared to around 20-25% in Victoria, South Australia and WA. Around 55% in small businesses in Queensland and 60% in Tasmania are in regional areas.⁴

Meanwhile, analysis by the Commonwealth Treasury (2014) indicated that 18,368 small exporters shipped goods to the value of \$1.3 billion in 2012-13. This represents 42.7% of all goods exporters and 0.5% of the total value of all goods exported.⁵

RBA (2015), which was based on latest liaison program research conducted by the central bank, noted that both current and expected business conditions for small businesses have remained significantly below their long-run average and before the global financial crises. There has been little sign of recovery, either. This compared to large firms whose overall conditions have almost returned in long-run average. As a result, small businesses' selling prices and profits have both come under significant pressure since the GFC. Small businesses have scaled back their hiring activities and capital spending, to a greater degree than larger businesses.

The RBA also noted that over the past two years, conditions for small businesses in the wholesale and retail sectors have improved somewhat due to higher household consumption, while those in construction also fared better due to growth in residential building activity. In contrast, small manufacturers have continued to struggle.

On top of the very challenging trading conditions over recent years, small businesses continue to face a number of long-standing headwinds as noted by RBA (2015). Small businesses are often less resilient than large firms in a downturn (economy-wide decline in demand). They cannot take advantage of economies of scale to lower their average cost compared to large businesses. Many small businesses do not have the skills or resources to stretch over multiple (and/or new) areas of their businesses. And small businesses face financing constraints such as cash flow, cost and access to borrowing, and payment delays by customers.

⁴ Nicholls S. and Orsmond D. (Reserve Bank of Australia), *DRAFT: The Economic Trends, Challenges and Behaviour of Small Businesses in Australia*, 2015. Link: <http://www.rba.gov.au/publications/confs/2015/pdf/orsmond-nicholls.pdf>

⁵ Small exporters are defined as with less than 20 payees and estimated annual turnover less than \$1 million and exports of less than \$1 million. Link: <http://www.treasury.gov.au/PublicationsAndMedia/Publications/2012/sml-bus-data>

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Inhibitors to innovation in Australian small businesses

The latest data on rates of business innovation indicate that just over a third of all Australian businesses (37%) introduced some sort of innovation in 2012-13, across areas such as goods and services production, operational processes, organisational processes and marketing methods. This was a lower proportion than a year earlier (41.3% in 2011-12) but a similar proportion to earlier years. There appears to be a slight positive trend towards a growing proportion of businesses undertaking innovation over the past decade, although the annual data are highly variable and, in some years, incomplete (chart 9). These data on innovation are not available by age of business or date of establishment, but across all Australian businesses in 2012-13:

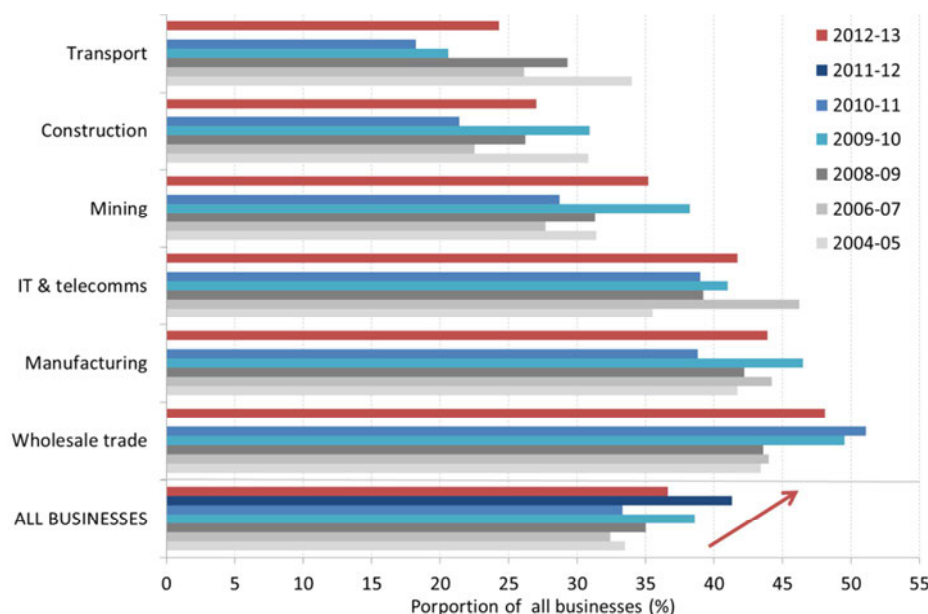
- Large businesses were more likely to innovate (67% of businesses with 200+ employees and 58% of businesses employing 20-199 people) than smaller ones (29% of businesses with less than 5 employees).
- Businesses in the wholesale trade, retail trade, and IT & telecoms industries were the most active innovators (close to 50% of businesses in these industries reported an innovation) with transport the least innovative (24%).
- Changes to organisational or managerial processes were the most common type of innovation (20.2% of businesses) followed by changes to goods or services (20%), marketing methods (19%) and operational processes (17%).
- Not all innovations required expenditure. Indeed, 39% of innovators said there was no expenditure associated with their innovation in 2012-13. Another 34% said they acquired new machinery or equipment and 28% spent something on training. 27% spent money on marketing activities to introduce new goods or services.
- Collaborative innovation activities were relatively rare in 2012-13, with just 14% of all businesses undertaking any form of collaborative arrangement (38% of businesses employing 200+ people). 6% of businesses undertook some type of joint marketing while 5% undertook the joint production of goods or services and 4.6% undertook joint R&D activity. For the innovation collaborators, their partners included clients and customers (44% of collaborators), suppliers (42%), consultants (28%) and other businesses in the same company group (22%). Of the 14% of businesses that undertook collaborative innovation, just under 10% partnered with a university and 5% partnered with a government research agency.
- 6% of all businesses abandoned (that is, ceased without completing) an innovation activity during 2012-13. Manufacturers were more likely than businesses in other sectors to have abandoned an innovation (almost 10%).
- The most common reason for undertaking innovation in 2012-13 was 'profit related reasons' (72% of innovators). Other frequent reasons (as well as profit) were 'to increase responsiveness to customers' (51% of innovators);
- 'increase market share' (43%); 'establish new markets' (35%); 'improve product quality' (38%); improve efficiency of supply (34%) and 'improve safety and working conditions' (22%).
- Ideas for innovation came from a wide range of sources including: from within the company or group of companies (59% of innovators); from company clients or customers (40%);

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competitors (30%); research sources such as journals and publications (30%); suppliers (26%); professional conferences (23%); consultants (19%); or industry associations (17%).

- 90% of businesses that introduced an innovation reported a benefit from doing so in 2012-13 (although this included 29% who said it was too early to identify the exact nature and size of the benefit). 43% improved their customer service, 40% improved their revenue and 28% 'gained a competitive edge'. 19% reduced their costs.
- Barriers to undertaking or increasing innovation in 2012-13 included lack of funds (20% of all businesses), lack of skilled personnel (17% of all businesses), uncertain demand of new goods and services (15%), government regulations and compliance (13%) and adherence to standards (4.5%).

Chart 9: Businesses 'introducing an innovation', selected industries



3 Recent trends in the Australian labour market

Employment, unemployment, under-employment and participation

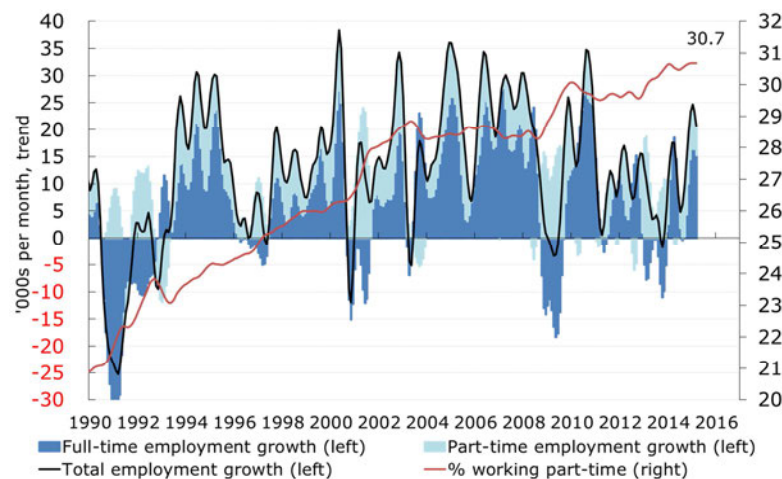
The following trends in the Australian labour market set out the broad parameters in which to consider how best to improve small business employment and labour force participation:

- **Total employment growth** has been weak since 2011, with annual growth rates of well under 2% since June 2011 (trend). This equates to monthly net jobs growth numbers of 15,000 to 18,000 at best, compared with net jobs growth that regularly exceeded 30,000 per month in the decade up to 2011. Most recently, total employment growth improved to around 1.6% p.a. (around 20,000 per month, trend) in the first months of 2015. Jobs growth remains weaker than labour force growth (currently 23,000-25,000 per month, or 1.9% p.a., trend) or adult population growth (currently 33,000 per month, or 1.7% p.a. to 1.8% p.a.) and hence it is too weak to push the unemployment rate significantly lower.
- The prevalence of **part-time employment** (defined by the ABS as less than 35 hours per week) rose to a record high of 30.7% of the workforce in late 2014 (trend) and remains at that level (see chart 10). Of the 392,000 jobs added to the economy over the three years to March 2015, 234,000 (60%) have been part-time employment. This increase in part-time work relates to changes in Australia's industry mix, with stronger labour demand from industries that have higher needs for shift work, part-time work and flexible arrangements. On the supply side, increased workforce participation among women with childcare responsibilities and older people means that more workers prefer to work part-time rather than full-time or not at all. Indeed, the latest data on under-employment suggest that at least 70% of those working part-time in February 2015 were not able to work more hours.
- **Unemployment** numbers and the unemployment rate appear to be 'stuck' at around 760,000 people or 6.2% of the labour force actively seeking work (March, trend). The unemployment rate has been over 6% since June 2014 and over 5% since June 2011.
- A further 8.7% of the workforce were **under-employed** in February 2015 (that is, in work but willing and able to work more hours in the labour force surveys, trend). This is the highest such rate in the history of this data series, dating back to 1978. This rise in under-employment is directly related to the rise in part-time work as a proportion of the labour force. Within the part-time workforce, the proportion of workers who are under-employed had been relatively stable, at around 26% since 2009, but it rose to 29% in February 2015.
- The **participation rate** is drifting lower as the population ages. It has, however, fallen by a greater margin for men over the past three years than it has for women, suggesting greater numbers of 'discouraged workers' among men. This disparity probably reflects the decline in labour demand in the industrial sectors that traditionally employ more men, including machinery manufacturing, utilities and construction. This has begun to turn around in 2015, as employment in the very large (male-dominated) construction sector recovers.

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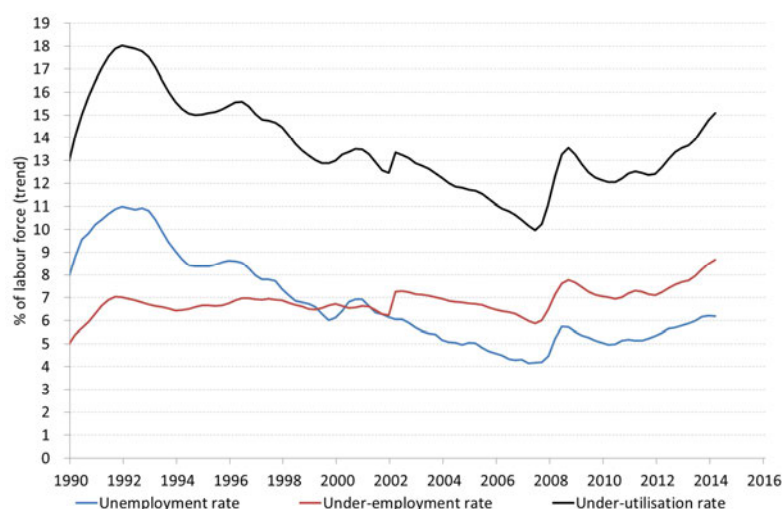
- At the **younger** end of our working population, rising education participation and changing industry skill demands have seen a declining share of employment going to young workers, with less than 6% of the workforce aged 15 to 19 years old and around 10% aged 20 to 24 years old in 2014. For those that are in work, the majority of younger workers are in services sectors such as retail and hospitality and work part-time only (72% of 15-19 year old workers and 37% of 20 to 24 year old workers), to fit in with their studies
- Participation rates for the younger age groups is in a gentle, long-term decline, with a sharper rate of decline evident over the past five years as participation in formal tertiary education has risen. For 20-24 year olds, labour force participation fell from a recent peak of 82.2% in 2008 to 78.1% in late 2014. For 15 to 19 year olds, labour force participation fell from a recent peak of 59.5% in 2008 to 53.3% in the middle of 2014 (see chart 8). It is now at comparable levels to the 60-64 year old age group. Participation for 15 to 19 year olds appeared to stabilize later in 2014 and may have recovered slightly in early 2015.

Chart 10: Employment growth per month, full-time and part-time status (trend)



Source: ABS, Labour Force Australia, estimates as of March 2015

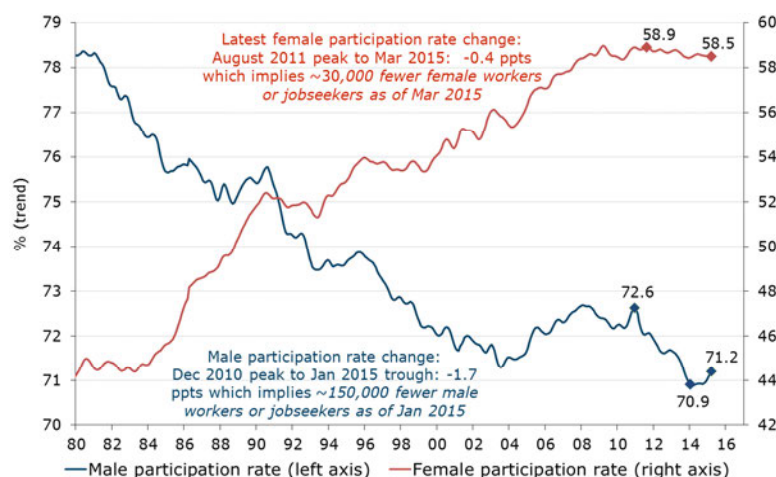
Chart 11: Unemployment, under-employment and labour utilisation rates (trend)



Source: ABS, Labour Force Australia, estimates as of Feb Qtr 2015

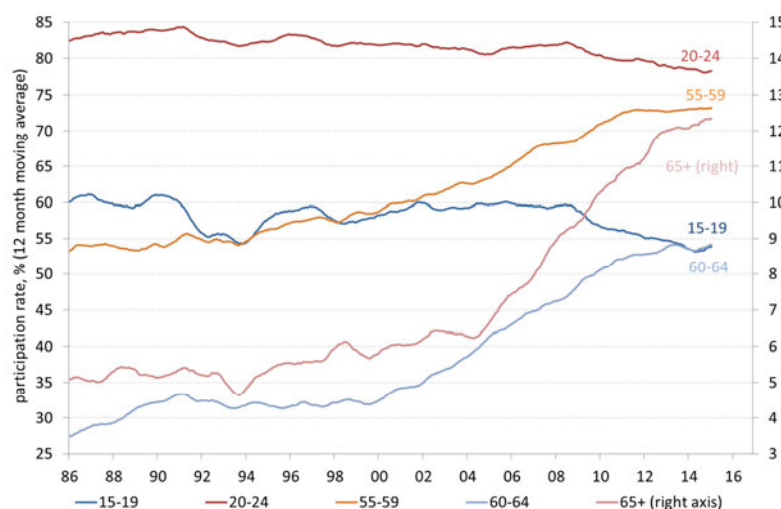
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Chart 12: Labour market participation rates, by sex (trend)



Source: ABS, Labour Force Australia, estimates as of March 2015

Chart 13: Labour market participation rates, by selected age group (trend)



Source: ABS, Labour Force Australia, Detailed quarterly estimates, as of March 2015

Employment trends by industry

Employment has been growing more strongly in services sectors than in the industrial sectors for some time. **Healthcare and social services** is Australia's single largest employing sector, with just under 1.4 million employees as of February 2015, equal to 12% of the workforce, or 1 in 12 workers nationwide (chart 13). Health sector employment grew by an average of 3.8% p.a. over the decade to 2014, adding an average of 43,200 workers each year. This industry has the highest proportion of female workers in Australia, at 78% of the workforce in 2014 (chart 14). It also has one of the highest rates of part-time work, with around 45% of healthcare workers working part-time (ranging from 35% in hospitals to 57% in residential care services). Actual hours of work per employee in healthcare averaged 29.4 hours per week as of February 2015, versus the all-industry average of 33.9 hours. Over the five years to February 2015, 26% (201,000 jobs) of the 770,000 net additions to the workforce were in health (ABS labour force, trend data).

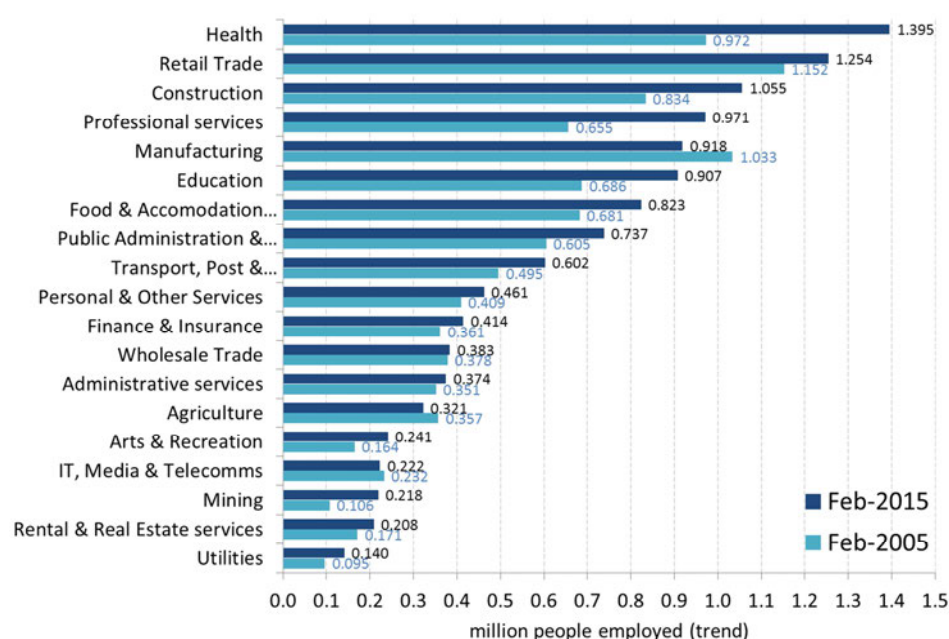
In second place came **professional services**, which added 127,000 jobs (16.5% of total jobs growth) in the five years to February 2015. Professional services employees work 36.3 hours per

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week on average and earn above-average salaries. Other relatively large industries that employ large numbers of part-time workers - **retail trade** and **hospitality** – have also grown relatively strongly in recent years. These two industries increased their employment numbers by 82,800 and 86,400 respectively over the five years to February 2015, accounting for 10.8% and 11.2% of total net employment growth over that period.

The dominance of these four sectors in recent employment growth (collectively accounting for 65% of net employment growth over the five years to February 2015) means that their labour demand characteristics go a long way to explaining recent trends in headline employment, including the rising share of part-time and female workers. These trends all look set to continue. In turn, this pattern of demand can be expected to further elevate the importance of flexible work and especially flexible work hours arrangements in enabling stronger employment growth.

Chart 14: Industry employment, 2005 and 2015 (trend)



Source: ABS, Labour Force Australia, detailed quarterly, estimates as of Feb Qtr 2014

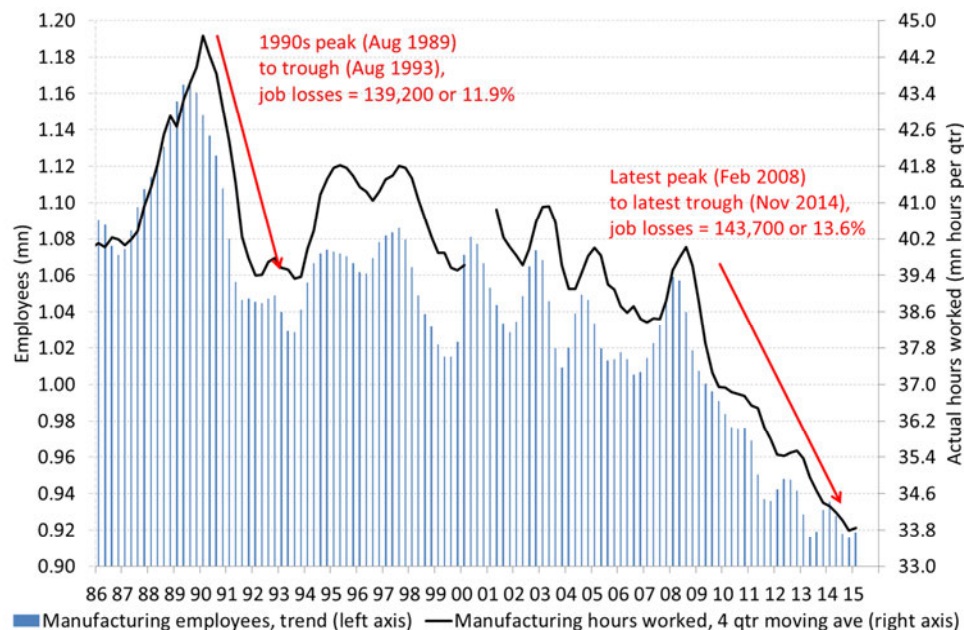
Conversely, **manufacturing** has shed 143,700 positions since 2008, equivalent to 13.6% of its 2008 workforce. Around three quarters of manufacturing workers were male in 2014, and 19% were aged over 55 years (versus 17% for all industries). This workforce profile, together with this history of large-scale labour shedding, may help to explain why so many more men (up to 150,000) than women (up to 30,000) have apparently ‘dropped out’ of the labour force over the past five years. A more flexible range of re-skilling and re-employment options is now required, to enable this potentially large group of (mainly older and mainly male) ‘discouraged jobseekers’ to move back into the workforce. Paradoxically, the large scale and very visible nature of this shrinkage can make it more difficult for remaining businesses to retain and attract the skilled labour they need, such that skill shortages persist even through these workforce cuts.

Skills shortages and labour hire difficulties remain even more visible across the major growth sectors of the economy and especially in the construction sector. Recent Ai Group construction outlook surveys indicate that during the six months to September 2014, close to half (45.7%) of

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construction businesses in Ai Group's half-yearly Construction Outlook survey reported major or moderate difficulty in recruiting skilled labour. Sourcing sub-contractors was also a major or moderate difficulty for over a third of construction businesses (34.3%). Across the broader economy, 12% of CEOs in Ai Group's annual Business Prospects report for 2015 identified skill shortages as a major impediment to their business growth. This proportion has been broadly stable for the past three years, at 10-12% of CEOs.

Chart 15: Manufacturing employment and total hours worked (trend)



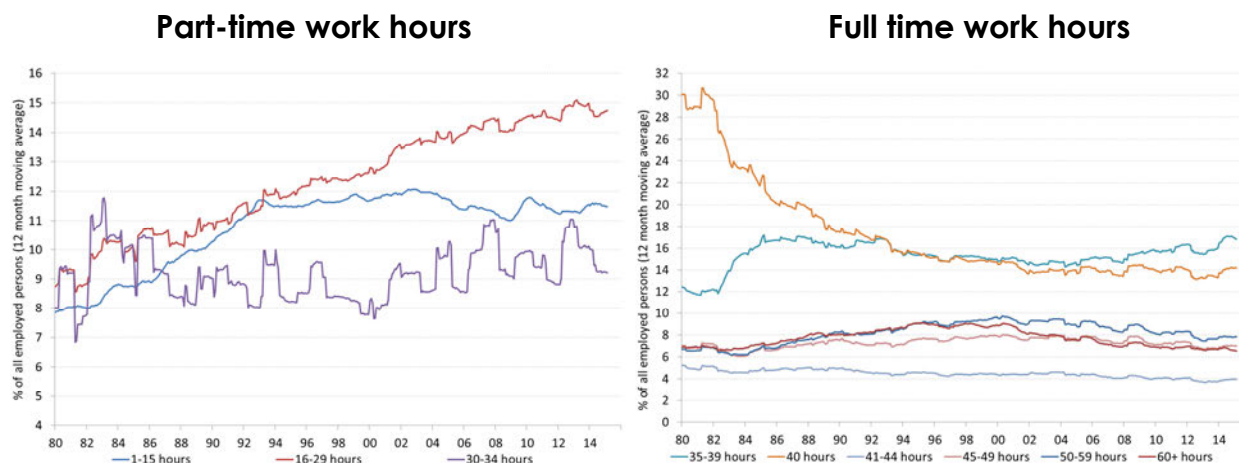
Recent trends in weekly work hours

Reflecting the employment trends discussed above, the weekly work hours bracket that has shown the strongest growth over the past decade (and more) has been the 16 to 29 hours per week bracket, which approximately equates to three work days per week. Around 15% of the workforce worked these hours by 2012, dropping slightly to 14.7% in 2014 and 2015 (Chart 16). More detailed analysis indicates that around 22% of all female workers worked 16 to 29 hours per week in 2014, as did 9% of men (Chart 17).

At the other end of the working week, a smaller proportion of the workforce now work extremely long work hours, with 7.8% of the workforce doing 50-59 hours per week and 6.6% doing 60+ hours per week in 2015, down from peaks of 9.7% and 9% respectively in the year 2000 (Chart 16). As in the past, men are far more likely to work long weekly hours than women in 2014 (Chart 17).

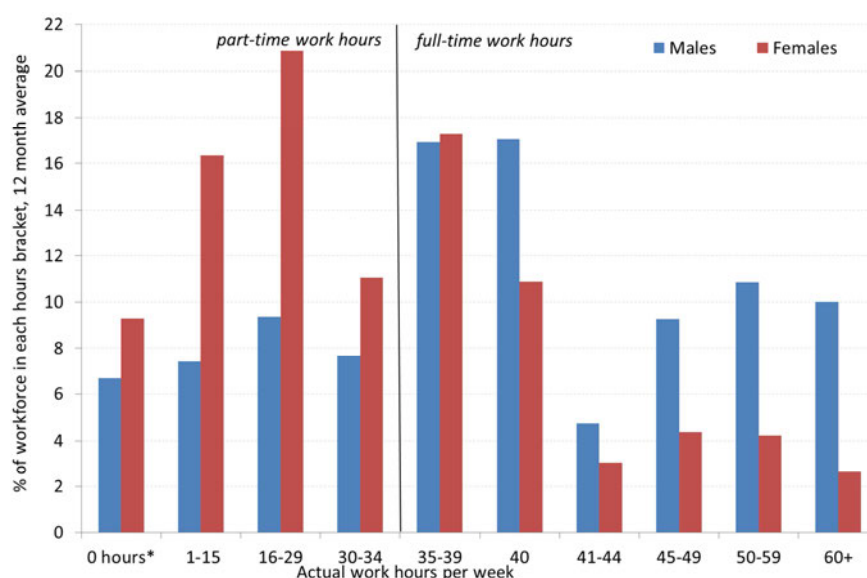
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Chart 16: Average actual work hours, proportion of total workforce



Source: ABS, Labour Force Australia, as of Feb 2015.

Chart 17: Average actual work hours, by sex (2014)



* '0 hours' indicates workers who are employed but did not work in the reference week due to leave or illness.
Source: ABS, Labour Force Australia, Quarterly detail, as of Oct Qtr 2014.

Forms of employment: employees, casuals, contractors and operators

The latest relevant ABS data on 'forms of employment' (Nov 2013) show that within the total paid workforce (see table 4):

- The proportion who are permanent employees (employees with paid leave entitlements, regardless of the number of hours they work) has been drifting up slowly over many years. 63.3% of the paid workforce were permanent employees in November 2013, up from 59.6% in 2004 and 60.8% in 1998.
- The proportion who are working on a casual basis (employees with no entitlement to paid leave, regardless of the number of hours they work) has been reasonably stable since 1998 at 19% to 20% of all workers. Indeed, it may have fallen a touch, with an average of 19.3% of workers in casual employment from 2008-2013, versus an average of 20.3% for the

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period from 1998 to 2007 (albeit with incomplete annual data in these earlier years). The proportion of employees with no leave entitlements peaked at 20.9% in 2007, roughly coinciding with the commencement of GFC-related disruptions in the Australian economy. Casual work then fell to 19.0% in 2012.

- The proportion who are self-employed independent contractors gently declined from 9.1% in 2008 to 8.5% by November 2013. This probably reflects lower employment in construction between these years, as the residential construction cycle moved into a lower phase of activity. It may also relate to adjustments since the GFC.
- The proportion who are business owners (defined in the data since 2008 as 'business operators' who operate a business and may or may not employ others) declined from 10% in 2008 to 8.8% in November 2013. The reasons for this decline are not entirely clear, but may relate to the ongoing effects of the GFC from around 2008. It may also relate to the recent rise in prominence in the Australian economy of industries such as mining and finance, which are not as amenable to widespread small business ownership (see discussion below).

Table 4: Forms of employment in Australia, 1998 to 2013

% of all employed, status in main job	Employees		Non-employee workers			
	With paid leave	Without paid leave	Owner-managers of unincorporated businesses		Owner-managers of incorporated businesses	
			<i>With employees</i>	<i>Without employees</i>	<i>With employees</i>	<i>Without employees</i>
Aug 1998	60.8	20.1	3.5	9.3	4.0	2.2
Nov 2001	60.6	19.9	3.7	8.7	4.6	2.4
Nov 2004	59.6	20.6	3.1	9.6	4.5	2.6
Nov 2006	60.8	20.4	3.0	9.1	4.3	2.3
Nov 2007	60.9	20.9	2.9	8.9	4.1	2.4
			Independent contractors		Business operators	
Nov 2008	61.8	19.1	9.1		10.0	
Nov 2009	61.4	19.8	9.6		9.1	
Nov 2010	61.6	19.3	9.8		9.2	
Nov 2011	62.2	19.3	9.0		9.2	
Nov 2012	63.4	19.0	8.5		9.0	
Nov 2013	63.3	19.4	8.5		8.8	

Source: ABS, Forms of Employment, to Nov 2013

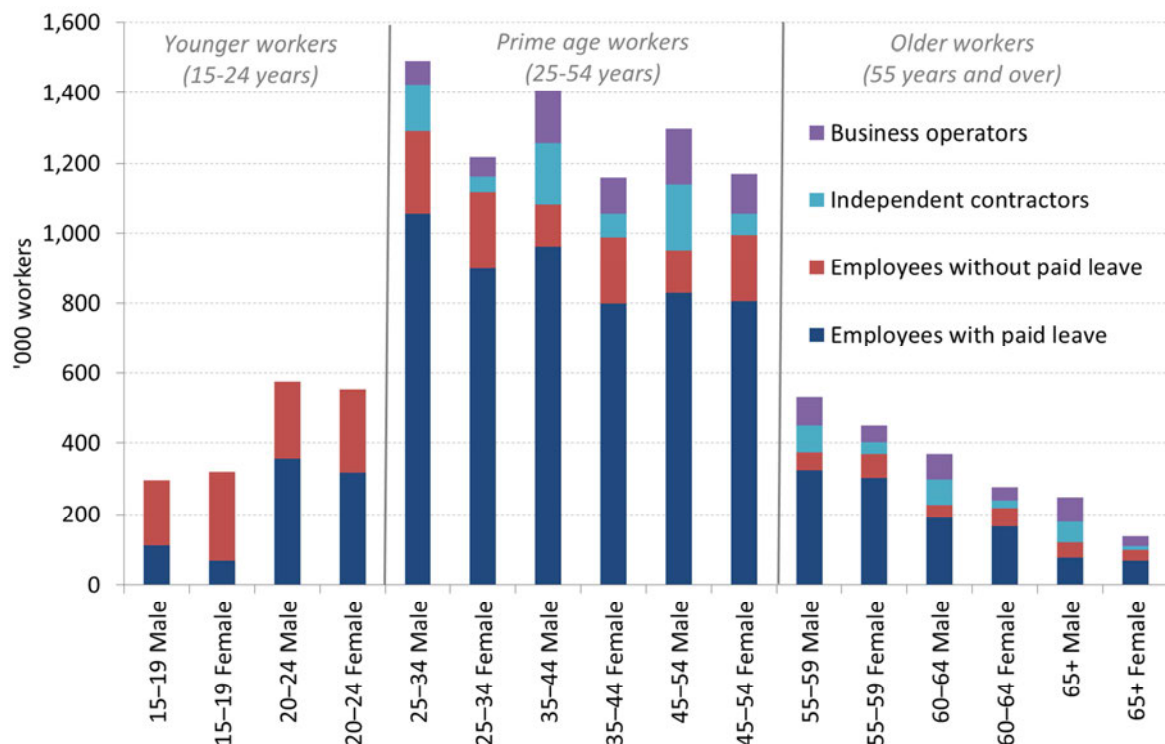
There are significant differences in the distribution of employment arrangements across gender and age brackets. As a broad generalisation, ABS data confirm that in 2013, casual workers (that is, employees with no paid leave entitlements) were more likely to be female and aged 15 to 24 years old, while independent contractors and business operators were more likely to be male and in the older age brackets (see chart 18). This distribution is unlikely to have changed since 2013.

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Age appears to be more significant than gender in this distribution, although within each age bracket, a higher proportion of women than men are casuals (employees without paid leave) and a higher proportion of men than women are independent contractors or business operators.

These differences in the demographic distribution of forms of employment reflect the normal progression of individual career paths over a typical life cycle, as well as the gender and age distribution of workers across the economy. For example, more women work in health and retail, which typically employ more part-time and casual workers, while more men work in construction and IT, which typically employ more full-time independent contractors.

Chart 18: Forms of employment: age and gender distribution (2013)



Source: ABS, Forms of Employment, to Nov 2013

Across the major industry groups, there are concentrations of employees, casual workers, contractors and self-employed business operators (see Table 3) that clearly reflect the typical operational requirements of each industry.

- Permanent employment (with paid leave entitlements) accounts for very high proportions of employment in mining (88%), utilities (84%), finance and insurance (84%) and public administration (89%). These industries tend to be extremely capital-intensive and concentrated into a small number of very large corporations. Both of these characteristics are likely to limit the opportunities for people to establish themselves as self-employed contractors or business operators. These industries also tend to have relatively low proportions of part-time employees, which might reduce their need to offer the casual work arrangements common to some other industries.

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- Casual employment (without paid leave entitlements) is the dominant form of employment in accommodation and food services, with 58% of workers (440,000 people) in the hospitality industry in this form of employment. For women in this industry, 61% are in casual employment (265,000 women). Of these female casuals, 85% (227,000 women) work part-time. This single group – part-time women in hospitality work – account for 18% of all female casual workers and 10% of all casual workers in the Australian workforce. Other industries that have relatively high proportions (and numeric concentrations) of casual workers include retail trade (36%), arts and recreational services (33%) and administrative services (22%).
- Independent contractors are concentrated in construction (30% of construction workers), administrative services (22%) and professional services (17%). Numerically, the single largest groups of independent contractors are male construction workers (293,000 men and 30% of all independent contractors in 2013) and male professional service workers (100,000 men and 10% of all independent contractors). Among women, the largest concentrations of independent contractors are in professional services (49,000 women) and health services (38,000 women). Industries with very low rates of independent contracting include mining, wholesale trade, retail, hospitality, finance, education and healthcare (Table 2).
- Business operators are most common in agriculture, where they make up 46% of a relatively small national workforce. This reflects the typical ownership structure of small to medium sized farms across Australia. Outside of the agricultural sector, business operators make up a relatively higher proportion of the workforce in real estate services, professional services, administrative services, wholesale trade and ‘personal and other services’ (which includes for example, hairdressers, car mechanics and other consumer service businesses). Numerically, the largest groups of business operators can be found in professional services (110,000 people) and retail trade (107,000 people). These industries typically have relatively low barriers to entry and low capital requirements.

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Table 5: Forms of employment, major industries (2013 & 2014)

Industry (ANZSIC groups)	All employees (May 2014)			Forms of employment (Nov 2013)			
	People	Part-time	Female	Paid leave	No paid leave	Independent contractors	Business operators
	'000	%	%	%	%	%	%
Agriculture	321.4	27.4	28.4	24.3	21.7	7.6	46.3
Mining	264.6	3.5	15.5	87.8	9.3	2.5	0.4
Manufacturing	921.5	14.1	26.7	72.3	14.6	4.4	8.7
Utilities	144.2	9.0	21.3	84.2	11.8	2.7	1.3
Construction	1,029.2	15.5	11.4	48.1	12.7	29.7	9.5
Wholesale trade	385.6	17.1	32.4	73.8	10.5	3.1	12.6
Retail trade	1,228.9	49.1	55.9	53.5	35.9	2.0	8.6
Accomm. & food services	765.2	58.9	54.2	31.6	57.7	1.1	9.6
Transport & post	590.0	19.6	21.9	62.9	18.8	12.9	5.4
IT & telecomms	195.6	21.8	40.5	75.0	12.5	9.2	3.4
Financial & insurance	404.0	17.5	50.3	84.4	5.1	4.8	5.8
Real estate services	229.5	24.3	48.1	62.0	13.9	7.9	16.3
Professional services	937.6	20.6	43.2	61.9	8.7	17.0	12.5
Administrative services	397.1	41.4	52.1	45.4	22.1	21.8	10.6
Public admin. & safety	730.2	17.1	46.5	88.8	9.1	1.4	0.8
Education	902.5	38.1	70.6	75.5	17.2	4.2	3.2
Healthcare & social services	1,392.9	43.9	78.2	73.8	16.9	4.4	4.9
Arts & recreation services	183.5	48.2	46.6	45.9	32.7	14.0	7.4
Personal and other services	506.6	29.7	42.9	58.3	12.1	11.7	17.9
All industries	11,529.9	30.4	45.7	63.3	19.4	8.5	8.8

Source: ABS, Forms of Employment, to Nov 2013

4. Australian workplace relations framework needs to be nimble and flexible for small business

Ai Group recently submitted to the Productivity Commission's inquiry into Australia's Workplace Relations Framework that Australia's workplace relations framework is imposing barriers to productivity improvement, competitiveness and investment, and it is not providing the adaptability that employers and employees need. The workplace relations issues raised in Ai Group's submission to the Productivity Commission's inquiry are relevant to small businesses as well as medium and large businesses.

In our submission to Productivity Commission's inquiry into Australia's Workplace Relations Framework we detailed 10 key problems identified by employers and proposed solutions. These included the following problems of particular concern to small businesses:

It is too difficult and costly to terminate poor performing employees:

- A higher filing fee should be implemented for unfair dismissal applications;
- Jurisdictional issues should be dealt with separately in unfair dismissal cases;
- The FW Act should contain a civil penalty for lawyers and paid agents who encourage speculative unfair dismissal or general protections applications;
- Lawyers and paid agents should be required to disclose contingency fee arrangements;
- Determinative conferences should not be conducted by the FWC without the written consent of all parties;
- General protections applications should be lodged and dealt with in the Federal Circuit Court or Federal Court;
- A list of exemptions should apply under the general protections;
- A reverse onus of proof should not apply under the general protections;
- A compensation cap should be implemented for the general protections.

Awards are still far too complicated:

- Awards need to be much simpler and less prescriptive to provide a genuine 'minimum safety net';
- The FWC should retain its powers to set penalty rates within awards but changes should be made to the relevant criteria in s.134 of the *Fair Work Act 2009* (FW Act);
- 4 Yearly Reviews should be abolished;

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- Sections 157 and 160 of the FW Act provide the necessary flexibility to enable awards to be kept up-to-date.

Ai Group's full submission to the Productivity Commission inquiry into Australia's Workplace Relations Framework can be found at the following link: [Ai Group submission to the Productivity Commission inquiry into Australia's workplace relations framework](#)

The award system must be simpler and less prescriptive for small business employers

In addition to the those problems identified and discussed within Ai Group's submission to the Productivity Commission inquiry into Australia's Workplace Relations Framework, the highly prescriptive and inflexible nature of the modern award system is a particular problem for small business employers.

Small business employers and their employees are generally reliant on the modern awards system, where the system provides coverage of their industry and/or occupation, and less likely to undertake enterprise bargaining.

Modern awards are intended to provide, together with the NES, a fair and relevant '*minimum safety net*' of terms and conditions of employment.

In our submission to the Productivity Commission's inquiry into the workplace relations framework, Ai Group indicated that the modern award system is far too complex and prescriptive for employers and it does not reflect a genuine safety net.

This problem is especially the case for small business employers who have very little resources to navigate, interpret and implement modern awards terms. Usually in a small business the business owner is responsible for and undertakes all business functions, including human resources and payroll.

The level of detail in awards in areas such as types of employment, hours of work, breaks, leave, countless allowances, and numerous other areas especially cause problems for small business employers and their employees.

Despite all the effort of Award Modernisation in 2008 and 2009, and the 2012 Modern Award Review and the current 4 Yearly Review, we still have not achieved anything like a modern and simple award system. What we have is 122 industry and occupational awards of approximately 66 pages each. The modern awards are set to be longer rather than shorter after the current 4 Yearly Review as additional detailed schedules are being added to them by the FWC.

The purpose of award modernisation was to modernise and simplify Australia's award system.⁶ Awards, while they are significantly less in number than in the past, remain complex and lengthy. They are not simple or easy to understand despite these attributes featuring within the modern

⁶ See Explanatory Memorandum to the Workplace Relations Amendment (Transition to Forward with Fairness) Bill 2008

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awards objective.⁷ Many ambiguities and uncertainties continue to exist within awards, including in regard to coverage.

Small businesses have also had to experience the instability and uncertainty of the award system since the commencement of modern awards in 2010. This is the result of the constant review of modern awards, firstly with the 2012 Modern Award Review and now with the currently 4 Yearly Review, which is expected to run into the second half of 2016. It is without doubt that small business employers would find it difficult to understand their obligations arising under the modern award system while the system is subject to significant and ongoing change.

Australia is the only country in the world that has an award system and given the current complexity it is not surprising that not even one other country has adopted a similar system. New Zealand abandoned its award system many years ago.

The system's complexity and prescriptiveness is apparent by the more than 1000 minimum wage rates for different jobs. This is in addition to the National Minimum Wage in the National Minimum Wage Order. Numerous awards deal with topics comprehensively dealt with in the NES such as annual leave and personal/carer's leave.

Furthermore, the layered nature of our workplace relations system means that small businesses employers must be familiar with not only the modern awards that cover (and apply) to their workplace but also the NES and any common law obligations which arise out of any common law contracts of employment, letters of offer, or implied employment contractual terms.

This level of regulation is merely in relation to the direct employment relationship and does not include additional workplace regulation, such as anti-discrimination, workers compensation, work health safety, workplace surveillance and privacy laws to simply name a few. It is clear that small business employers are being hampered by workplace regulation and it would be unsurprising if this level of regulation deters some small business owners from employing employees.

Ai Group is not arguing for the abolition of the modern award system but a major simplification of it.

The simpler the content is in awards and the more that awards resemble a genuine minimum safety net, the easier it will be to reduce the number of awards from the existing number of 122.

It is important that awards are flexible so that businesses can be productive and competitive, and so that employers are able to reach agreement with individual employees on arrangements which suit their unique needs and preferences.

This is necessary to alleviate the regulatory burden experienced by small businesses across Australia.

⁷ See FW Act, s 134(1)(g).

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