

**RESPONSE TO THE SENATE INQUIRY INTO SMALL BUSINESS
EMPLOYMENT FROM THE CENTRE FOR REGIONAL INNOVATION AND
ENTERPRISE**

The Centre for Regional Innovation and Enterprise (CRIE) is a facilitative agency comprising the University of Western Australia (UWA), the Great Southern Development Commission (GSDC) of WA, the Great Southern Area Consultative Committee (ACC), the Business Enterprise Centres (BEC) located at Albany, Tambellup and Jerramungup, Landcare Enterprise plus local farm and non-farm business representatives.

This is a joint submission that addresses the terms of reference outlined by the Senate Inquiry. It should be noted that separate submissions have been sent independently from the members of CRIE addressing matters of specific importance to them.

1st Term of reference:

The effect of government regulation on employment in small business, specifically including the areas of workplace relations, taxation, superannuation, occupational health and safety, local government, planning and tenancy laws.

Government regulation – at all levels – has both positive and negative impacts on small firms. However, the impact of such policies is likely to differ across firms and industries. Also of importance is the size or scale of the small firm's operations. For example, micro firms with less than 5 employees (usually nil employees other than the owner-manager) will experience different impacts from such regulation than medium-size firms with between 100 and 200 employees.

Most small firms start up with few employee resources other than the owner-manager(s) and the volunteer assistance of their families. For example, Within Western Australia in 2001 there were 132,000 privately owned, non-agricultural small businesses, under the control of an estimated 186,300 owner-managers. Of these 65.5 per cent were male and 34.5 per cent female. Further, an estimated 66 per cent of small firms in WA during 2001 were home-based.¹ The majority of the small firms in Australia are micro-enterprises.

Discussions with small business owner-managers suggest that government regulations are of major concern to some but of little concern to others. Most don't become concerned over such regulations until they attempt to undertake a particular task or strategy and find that they are restricted from doing so by government regulation. Compliance issues such as workers compensation and compulsory superannuation levies are viewed by most small business owners as necessary 'evils' that simply add substantial 'on-costs' to their payroll.

¹ Characteristics of WA Small Business, WA Labour Market Economics Office, April 2002.

For industries that involve a highly volatile annual business cycle, the preference is for casual employment. Under these circumstances small business owner-managers have demonstrated a shift toward sub-contracting in a similar manner to that already embraced by the corporate sector. Two case studies can be offered as evidence for this. The first is a roofing contractor who 'employs' up to 35 workers during projects but who experiences long periods of inactivity during the year. The second is a plumbing contractor located in a regional area of WA who employs up to 12 tradesmen. Both these firms have shifted all workers onto sub-contracting agreements even assisting them to register for their ABN and offering their own Accountant at the employer's cost to help them set up in self-employment. Recent regulatory moves to restrict such practices and overcome the problem of 'disguised wage labour' only serve to promote more creative strategies to avoid taking on workers under conventional means.

One of the most significant steps small business owner-managers take in the evolution of their enterprise is the decision to employ full or part-time staff. Small firms find this a particularly daunting task because it brings with it significant responsibility and compliance issues for which they are usually poorly prepared. Negotiating wage levels, dealing with human resource management issues, paying leave loadings (e.g. of up to 17.5%) and tracking payments for taxation, superannuation and workers compensation all add to what is an already high administrative workload.

Particular issues that have been noted by small business owners to whom we have spoken are the inability to pay workers standard rates for night or weekend work where the job requires it and the worker is happy to receive such payment. The payment of 17.5% leave loading for a job where no shift work exists. Having to pay more to an employee when they are away, than you would for a full week's work.

Another key area of concern for small firms is the industrial relations legislation where it is perceived by many to be almost impossible to terminate employment for an employee who does not comply with agreed standards. Many owner-managers are also fearful of employees making wrongful claims of unfair dismissal against them. Such claims – even if unfounded – usually incur court or solicitors fees and place substantial stress on the owner.

The recent public discussions relating to the introduction of employer funded maternity leave is a further example of how small firms may become caught in the negative aspects of an otherwise desirable social policy decision. While a large firm such as bank can afford to offer women generous paid maternity leave provisions within their employment contract, most small firms – particularly micro-enterprises – cannot. Small firms will struggle to pay both the wages of the missing worker and the cost of a replacement.

Research suggests that the main areas involving industrial disputes within small firms are over wages, leave and dismissals or disciplinary action by employers.² This is significantly different from the experience of large firms who tend to have a much wider

² Savery, L., and Mazzarol, T.W. (2001). "The Characteristics of Small Business Human Resources - A Comparison of Small and Large Firms." *Small Enterprise Research: The Journal of SEANZ* 9(2): 32-41.

range of issues to address, particularly health and safety and general working conditions. Most small firms lack the in-house human resources capabilities of large firms and work on the basis of trust and personal relations to ensure smooth employee relations. However, the more complex the

At the local government level the small business owner-manager is likely to experience their main problems in securing approval for changes to planning schemes when seeking to expand their operations or establish new businesses. Our experience of dealing both with local government authorities and small firms suggests that many local government councils lack empathy when dealing with small businesses. Council restrictions on home based business activities, or particular types of business activity in commercial precincts can have negative effects on encouraging the formation and growth of small firms.

While we are not advocating that local government remove any restrictions on business activities, we believe more can be done at the local government level to provide assistance to small firms in understanding planning and other regulatory decisions. Our discussions with both Council's and small business owners suggest that the key to improving the relationship is to facilitate greater dialogue between the two parties. Local authorities that have appointed dedicated business development or economic development officers are more likely to succeed in this area than those who don't.

Within regional and rural areas such as the Great Southern Region of WA where local government authorities lack the resources for dedicated business or economic development staff, consideration should be given to establishing regional officers jointly funded by multiple councils.

2nd Term of Reference:

The special needs and circumstances of small business, and the key factors that have an effect on the capacity of small business to employ more people.

As a general principal the problem facing small firms is that they don't set out with the intention to employ anyone. They only seek to employ when there is a need to secure external labour for achieving other objectives. The 1971 Bolton Committee of Inquiry into Small Firms in the United Kingdom identified clearly that management of a small business is substantially different from managing a large firm. That inquiry found five key areas that were a source of problem for small business owner-managers namely: 1) Financial – particularly raising and using finance, costing and control information; 2) Marketing – identifying and developing new markets and products; 3) Production – particularly scheduling and purchase controls; 4) Human Resources – particularly organization and delegation and personnel management; 5) Physical Resources – particularly management of technological change and the implementation and use of information systems.

Little has changed since the 1970s in terms of the practical dynamics of small business operation. Government policy has focused on the small business sector as a generator of employment since the Birch Report into small business job creation in the United States during the 1980s.³ Unfortunately the actual track record of small firms in generating employment has been modest. Although small firms certainly make a strong contribution to employment, the level of this contribution is much less than originally predicted.⁴ For example, the average annual growth in employment within Australian small firms over the period 1983-1997 was only about 3.2 per cent.⁵

At least three factors are important here. The first is the rate of employment turnover and business start up and mortality within the small firm sector. The second is the quality of the jobs created, and the third is the nature of the firm at start up. Within the small firms sector at any time there is a high 'churn over' with large numbers of new start ups being matched by equally large numbers of small business closures. Over the period from 1993 to 1996 this 'churn over' rate varied from 3 to 7 times.⁶ An examination of the employment contribution made by small manufacturing firms in the United States over the period 1973-1988 found that large firms had the greatest impact on job generation, and that jobs with larger firms were more durable.⁷

For most small firms, the only persons employed are the owners, and even where additional jobs are created, the type of work generated is frequently less durable than within larger firms. Many small business start-ups are 'lifestyle' firms, in which the owner is seeking to create a modest income and with limited growth aspirations.⁸ The nature of the small firm at time of start-up is therefore of importance. If the business has been created with strong resources, and its founders have a desire for significant growth, the impact such a business can have on job creation is likely to be high. Thus the issue is not the quantity of small business start-ups but their quality.

For governments seeking to encourage additional employment through the creation and growth of small firms the challenge is to encourage those owner-manager/entrepreneurs who have a desire and the capacity to grow sustainable employment generating firms. For example, faced with the need to create 100 new jobs in a regional area the choice may be between attracting one large firm with the capacity to generate by itself all the employment, four small firms with 25 employees or 20 micro-firms with 5 employees. Analysis of small business survival rates suggests that the best options are either the single large firm or the 20 micro-firms. This is due to higher mortality rates among the

³ Birch, D. (1987). Job Generation in America: How Our Small Companies Put the Most People to Work. New York, The Free Press.

⁴ Storey, D. (1994). Understanding the Small Business Sector. London, Routledge.

⁵ ABS (1999). Special Article: Employment Generation by the Small Business Sector, Year Book Australia, Australian Bureau of Statistics, Cat. No. 1301.01.

⁶ ABS (1998). Small Business in Australia, 1997. Canberra, Australian Bureau of Statistics, Cat. No. 1321.0, Commonwealth of Australia, AGPS.

⁷ Davis, S. J., Haltiwanger, J., and Schuh, S. (1994). "Small Business and Job Creation: Dissecting the Myth and Reassessing the Facts." Business Economics(July): 13-21.

⁸ McMahon, R. (1998). "Stage Models of SME Growth Reconsidered." Small Enterprise Research: The Journal of SEAAANZ 6(2): 20-35.

slightly larger firms. However, the large firm option is inherently more risky as any failure will remove all employment from the region.⁹

Government policy should recognize that few small firms will actively seek to employ large numbers of workers and most will be focused on life-style rather than growth. Attention should be given to encouraging those enterprises that have the potential for growth and therefore employment. In the United States these firms have been recognized by the term *Entrepreneurial Growth Companies* (EGC).¹⁰ These EGC firms are growth oriented and embrace innovation with a desire to quickly expand beyond their regional boundaries to become established in national or international markets. It is important to note that such firms are not necessarily high technology and generally do not require significant injections of venture capital from foundation.¹¹

What distinguishes the EGC firms from the also ran is their desire to find innovative points of differentiation within their product or processes to offer superior quality or value to the market. Productivity enhancement through innovation coupled with entrepreneurial drive by the owner-managers is the key to successful small firm growth and subsequent employment generation. While such firms may represent only a relatively small proportion of all small businesses they are likely to have a disproportionate impact on the creation of employment opportunities within Australia. Within regional economies they will provide leadership and wealth creation with the capacity to retain their head office and many of the value added jobs at home.

Further, as many small firms grow to medium size (e.g. between 20 and 200 employees) they become highly vulnerable. One of the weaknesses of Australia's otherwise robust economy is the lack of a vibrant medium size enterprise sector. In Germany the *Mittelstand* companies – many of which are family owned – have provided a strong force of highly innovative, globally focused medium size firms that are recognized as a major source of economic growth.¹² Italy too has experience strong economic and employment growth from its medium-size enterprise sector.¹³ Such firms collaborate together to achieve enhanced levels of productivity and competitiveness with benefits to their regional economies.¹⁴

Within Australia the medium-size enterprise sector is poorly understood and frequently disadvantaged by policies that are directed at either the smaller or larger firms. Privately owned, mid-sized firms within regional areas are usually viewed as 'large' employers and their loss can have significant impacts on local economies. Such firms are vulnerable to

⁹ Duncan, J. W., and Handler, D.P. (1994). "The Misunderstood Role of Small Business." *Business Economics* July: 7-12.

¹⁰ NCOE (2001). *Five Myths About Entrepreneurs: Understanding How Small Businesses Start and Grow*. Washington, D.C., The National Commission on Entrepreneurship.

¹¹ Bhide, A. (2000). *The Origin and Evolution of New Businesses*. Cambridge, Oxford University Press.

¹² Simon, H. (1992). "Lessons from Germany's Midsize Giants." *Harvard Business Review* March-April: 115-123.

¹³ Rosenfeld, S. (1997). "Bringing Business Clusters into the Mainstream of Economic Development." *European Planning Studies* 5(1): 3-21.

¹⁴ Humphrey, J., and Schmitz, H. (1995). *Principles for Promoting Clusters and Networks of SMEs*. Vienna, Austria, UNIDO Small, Medium Enterprises Programme.

competition from large multi-domestic or multi-national corporations, which can target them with lower prices, higher quality or more aggressive marketing.

Many mid-sized enterprises within regional areas do not invest adequately in R&D, training or capital expenditure.¹⁵ Such firms cannot afford to be complacent about innovation, investment and growth yet they frequently don't think and act globally or benchmark themselves against international best practice.

Australian government policy needs to recognize that employment growth within the small business sector is contingent on business growth and that business growth is contingent on the character, attitude and expertise of the owner-manager or entrepreneur. Attention needs to be given to creating the conditions that will encourage the emergence of entrepreneurial managers with the ambition to create and grow EGC firms able to offer quality, sustainable employment.

3rd Term of Reference:

The extent to which the complexity and duplication of regulation by Commonwealth, state and territory governments inhibits growth or performance in the small business sector.

Research by the *Australian Industry Group* has found that many regionally based firms consider the level of government support they receive to be inadequate.¹⁶ This criticism was leveled more at state and federal government than local. However, there remains a need for greater coordination between all three tiers of government.

Small firms generally have little direct input into the policy making of State and Federal Government, however, at a local government level they can achieve greater impact, but as noted above, not all local government agencies are business friendly. Ideally the three tiers of government would work in harmony to ensure that small firms find it easier to interpret and deal with legislation, regulation and compliance, unfortunately this is not the case.

The reality of how the three tiers of government frequently work at a regional level is unnecessary duplication of services, political point scoring and resulting frustration and confusion among small business operators. This is evidenced in such areas as industrial labour awards, telecommunications, transport and trade practices. For example, small business development, planning and support services within regional WA are provided by a variety of local, state and federal government agencies including: the BEC network, WA Department of Agriculture, federal Small Business Assistance Officers, ATSIIC Aboriginal corporations, WA Department of Industry and Technology, Regional Development Commissions and contracted private sector accounting firms.

¹⁵ AIG (2001). *Industry in the Regions 2001*. Sydney, Australian Industry Group and Commonwealth Bank.

¹⁶ *Ibid.*

Although each agency is dedicated and competent the impression made on many small business owner-managers is that of a confusing array of bureaucratic entities each with various missions and responsibilities that are largely unknown. What the owner-manager understands is their immediate business task environment. If they are to grow their business and thereby generate employment, the owner-manager will require assistance from a business support network should provide guidance and resources to address the five key areas originally identified by the Bolton Committee of 1971 specifically: financial, marketing, production, human resources and physical resources. Further, they will require such assistance 'just-in-time' and usually will not want to devote significant time or resources to obtaining information or filling out paperwork.

Government agencies at both the federal, state and local levels should seek to enhance their level of coordination to provide assistance to small business owners in a timely manner and without increasing the complexity or compliance burden. Many small business owners with whom we have contact do not take advantage of the assistance available from government agencies because the process of application is considered too time consuming and complicated. We are aware of several accountants and business consultants who have built their business around assisting small firms access government funding schemes.

4th Term of Reference:

Measures that would enhance the capacity of small business to employ more people.

As noted above, attention needs to be given to the development of industry policies that encourage the creation and growth of sustainable small firms with the opportunity for stable employment and future growth potential. A deregulated or 'lassie fare' approach to economic growth is not likely to succeed in achieving this. However, government intervention in the process via attempts to 'pick winners' is also unlikely to succeed.

What is required is a **dual track approach** that focuses simultaneously on two ends of a continuum. At one end is the individual owner-manager or entrepreneur, at the other is the industry within which this individual is seeking to operate their business.

When seeking to develop policies to support the small business sector attention should be given to the personal values and orientation of the individual entrepreneur **not** their firm. From the perspective of employment generation the important question is whether this entrepreneur is prepared to expand their firm and can they manage growth?¹⁷ While these are issues over which governments can have little direct impact it should be recognized that the owner-manager or entrepreneur is a more important point of focus than the firm itself.

¹⁷ Kotey, B., and Meredith, G.G. (1997). "Relationships among owner/manager personal values, business strategies, and enterprise performance." *Journal of Small Business Management* 35(2): 37-64.

In seeking to understand the importance of this issue government policy should acknowledge that entrepreneurs come in several varieties and each type is likely to require different policy responses. The first consideration in this taxonomy is whether the entrepreneur is driven by opportunity or necessity? The first are those who launch a business venture in order to take advantage of perceived opportunity for growth or self-fulfillment. Such individuals are typically among those that develop sustainable, growth-focused businesses with the potential to employ. The second are those that enter self-employment due to a lack of alternatives. Such individuals are frequently undercapitalized and lacking in strong market or product development capability. Less employment generation is likely from the latter type of small business owner.

Also of importance is how experienced the entrepreneur is in terms of business. Too often government assistance programs are targeted at nascent or novice entrepreneurs with an aim to encourage more small business start-ups. However, as discussed earlier in this submission, the high 'churn over' rate among small firms means that such new venture creation may have limited sustainable impact on employment growth.

In addition to assisting start-ups and early stage firms, government policy should be directed toward experienced small business owners (habitual entrepreneurs), particularly portfolio entrepreneurs – defined as those who own and manage multiple business ventures. Research evidence suggests that such entrepreneurs are likely to be the most significant employers within a region.¹⁸

Support for the portfolio entrepreneur in a regional economy may indeed prove of greater benefit to the generation of employment. However, the allocation of scarce financial or business support resources to those who are already successful is likely to pose significant political difficulties for policy makers. Nevertheless a well-balanced approach to small business assistance by government agencies would target policies designed to generate a large pool of new and experienced entrepreneurs within regions.¹⁹

Attention should be given to policies that encourage and reward successful, experienced small business owner-managers to network with other like-minded entrepreneurs both within their region and nationally. Government agencies should encourage collaborative networking among successful entrepreneurs in order to foster innovation and competitive benchmarking.

Employment within EGC firms should be encouraged via innovative remuneration schemes such as profit sharing and share options. Government regulation should be tailored to assist such firms to implement these schemes or at least not work against their implementation.

At the other end of the continuum, government policy should concentrate on establishing focused industry programs to encourage the growth of existing industries and to the enhancement of innovation and international competitiveness.

¹⁸ Westhead, P., and Wright, Mike (1999). "Contributions of novice, portfolio and serial founders located in rural and urban areas." *Regional Studies* 33(2): 157-173.

¹⁹ Useem, J. (1997). "Churn, Baby, Churn." *The State of Small Business*: 25-32.

Assistance should be provided to all industries not just 'favorites' with the understanding that while there may be uncompetitive firms, there should be no such thing as an uncompetitive industry. Enhancing industry competitiveness requires attention to be given to the structure of industry supply chain relationships as well as interactions among firms within the industry and across industries.

Employment generation within industries is likely to be enhanced if impediments to productivity and competitiveness are removed. Structural unemployment is typically the most difficult issue facing employment policy within industries. However, the decline of jobs in one industry or sub-industry sector may be offset by opportunities created in other industries or industry sub-sectors. Predicting these trends is not always easy, but too often there is significant lag between the provision of industry training programs and the growth of employment demand in emerging or expanding industries.

Greater attention should be given to mapping industry value chains and industry clustering behaviour. Small firms are generally lacking in resources and need to collaborate or network in order to secure access to capital, labour, expertise, materials or markets that they cannot afford to acquire or develop alone. As the complexity of business activities increases (perhaps through the application of new technologies, or the development of new products or markets) the ability of a firm to network is likely to assist its capacity to manage such increased complexity. By networking and clustering, small firms within industries or across industries can create sufficient demand to sustain categories of skilled employment that might otherwise be unsustainable.²⁰

Finally, attention should be given to indigenous enterprise to enhance the self-employment capacity of Aboriginal and Torres Strait Islander communities and reduce dependency on government income support. ASTIC currently supports a variety of employment and enterprise initiatives via CDEP programs. Although there are examples of successful enterprise and employment creation emerging from these programs there is concern over the proportion of budgets that are consumed in administration. Accusations have been leveled of excessive bureaucracy within ASTIC sponsored employment and enterprise programs leading to reduced opportunities at the community level.

Our own research within the Aboriginal community suggests that there is strong desire and ability to achieve employment and even self-employment. However, Aboriginal people generally have less family and personal experience of self-employment. Aboriginal people are more likely to experience significant barriers from a lack of business skills and confidence and securing finance and family support than non-Aboriginal people. Their ability to secure effective business support and information in the form of mentoring and training is likely to be critical to success.

²⁰ Baptista, R. (1998). Clusters, Innovation, and Growth: A Survey of the Literature. *The Dynamics of Industrial Clustering: International Comparisons in Computing and Biotechnology*. P. Swann, Prevezer, M., and Stout, D. Oxford, Oxford University Press: 13-51.

Recommendations:

- That government policy recognizes the special nature of small firms in lacking the resources, time and expertise to deal with compliance burdens.
- That government policy recognizes the financial impact – both in direct and indirect costs – of labour compliance.
- That government policy develop specific strategies targeted at segments within the small firms sector namely:
 - Micro-enterprises (with <5 employees) including home-based businesses
 - Small firms (with 5-20 employees)
 - Medium size firms (with 20-200 employees).
- That assistance and incentives be provided to local government authorities to develop enterprise creation and growth strategies targeting small firms with particular focus on the employment of business or economic development officers.
- Government policy should focus on the owner-manager or entrepreneur not the business and attention should be given to successful, experienced entrepreneurs who operate EGC firms not just nascent and novice entrepreneurs with start up firms.
- Government policy should focus on the creation of regional networks and alliances of firms and industries that foster innovation and productivity enhancement with specific attention to be given to mapping industry value chains and clusters.
- That government policy encourage enterprise and innovation behaviour within the education and training system to generate skilled and responsive employees who can assist the development of EGC firms.

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