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Submission to Productivity Commission Issues Paper 'Business Set-up, Transfer and Closure'

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EXECUTIVE SUMMARY

Over the past decade the Internet has grown to become an invaluable part of the Australian economy. The digital economy generated $79 billion (or 5.1%) to GDP in 2013-14 in Australia alone.

The Internet is an open access platform that lowers the barriers for new business entrants and levels the playing field for small businesses competing with big businesses. This competition drives productivity and economic growth.

The Government should assist Australians to take advantage of the Internet's pro-competitive benefits. In order to do this Government will need to ensure that Australians have the necessary infrastructure, skills and culture in place to drive innovation and to create new businesses.

This will require the Government to:

- ensure that the new business entrants, and in particular technology startups, have access to finance;
- modernise the Copyright Act to include a fair use flexible exception so as to enable new businesses to make the most of data driven business models;
- embed science, technology, engineering and mathematics into school curriculum to ensure that students have the skills they require to be the innovators and business owners of the future; and

- support and foster an entrepreneurial business culture.

This will also require the Government to consider removing or rebalancing regulations which discourage new online business entrants and, where possible, avoid introducing new regulations which would have that effect.

The Internet is the engine room for economic growth and innovation

The Internet and associated digital technologies (the **Internet**) has fostered innovation, increased competition and driven productivity and economic growth. As recognised by the Government in the Intergenerational Report, "[c]ontinuing to encourage entrepreneurship and innovation, enhancing resource allocation, investing in and using infrastructure efficiently, facilitating trade with other countries and improving physical and human capital investment will all be critical to Australia's future productivity performance."[1]

The economic value of the transformation of the Australian economy from a non-digital to a digital economy cannot be overstated. In Australia, Deloitte Access Economics estimated that the direct contribution of the Internet to the economy was worth around $79 billion in 2013-14, equivalent to 5.1% of GDP.[2] The Deloitte research also indicates that the digital economy could be worth $139 billion by 2020 (7.3% of GDP).[3]

The Internet continues to power economic growth around the world. By 2016 there will be 3 billion Internet users globally and the Internet economy will reach $4.2 trillion in the G-20 economies.[4]

The Internet provides a unique opportunity to new businesses. This is because it facilitates unforeseen technological innovations, which create opportunities that were unimaginable only a short time ago.

Open access fuels competition

The Internet is an open access platform

The distinctive qualities of the Internet are ease of access and decentralised control. The open nature of the Internet is a consequence of the protocols and standards that underpin how its infrastructure works. The open nature of the Internet means that users, be they a new or established business, can generally create new applications, content or services that will be accessible by other users of the Internet without restriction or the need for approval.

In practice this means that the Internet is an enormous engine for innovation and new business growth. Google is a strong supporter of maintaining an open Internet.

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[1] 2015 Intergenerational Report Australia in 2055, (2015) 92.
[2] Deloitte Access Economics, *The Connected Continent II: How digital technology is transforming the Australian economy*, (2015) 11.
[3] Ibid 45.
[4] The Boston Consulting Group, *The Internet Economy in the G-20*, (2012) 3.

Leveling the playing field for new business entrants

As Nera Economic Consulting noted in its November 2014 report, the Internet and mobile computing have removed or reduced many of the impediments traditionally faced by new business entrants, including upfront fixed costs; the importance of economies of scale; establishing a brand and raising customer awareness; the need for physical space; the costs of providing information to customers, the costs of switching to alternative suppliers; difficulties with creating new distribution channels; and obtaining direct access to customers.[5]

Example

4Cabling is an Australian manufacturer, wholesaler and retailer of cabling and IT management accessories such as voice, data, fibre, electrical cabling and server rack equipment, which is based in Sydney.

4Cabling, entered the market exclusively as an online business. At the time, the data communications industry was dominated by a few big companies that would pass their products onto a distributor, who would then sell their products to an exclusive network of electrical and data wholesalers. The founder of 4Cabling, Nicole Kersh a 21 year old university student, believed that a vertically integrated company that was a wholesaler, distributor and retailer could undercut the market. However, Nicole had limited appetite for the financial risk associated with starting a new business.

Opening the business online, rather than a shop front, allowed her to incrementally enter the market with minimal risk and cost; 4Cabling avoided the necessity of carrying inventory and was instead able to fill orders as they were made, which smoothed the company's costs and revenues in the early stages of the business, reduced the need for carrying costs of financing and reduced the risk and costs of stocking and manufacturing items that did not sell.

The success of the online store led to a bricks-and-mortar shop in Alexandria, Sydney. By 2014, 4Cabling had a turnover of $10 million a year and had a market share of around 15 percent and employed more than 20 people. Nicole subsequently sold the business to a private equity firm for a healthy profit in 2014.[6] Nicole is in the process of starting up a new online content business.

The Internet can create efficient supply chains and cost structures for key production activities. It can reduce the transaction costs of locating and purchasing supplies, and increase the efficiency of producing and delivering goods and services through, for example, enabling lower inventories or better cooperation among designers of new products.[7]

[5] Nera Economic Consulting, *Levelling the Playing Field: The Role of the Internet and Mobile Computing in Improving the Efficiency and Competitiveness of Australian Small Business*, (2014) ii.
[6] Fitzsimmons, C, '*'Trust your instincts': 4Cabling founder Nicole Kersh on how to sell your business*', BRW (online), 18 September 2014, <http://www.brw.com.au/p/business/mid-market/trust_your_instincts_cabling_founder_Jnef8uVSRTNb9h7BAoWjtK>
[7] Varian H, Litan R, Elder A, Shutter J, *The Net Impact Study* (2002) 15.

These are all essential for businesses, and particularly small businesses, entering the market for the first time.

Another business overhead substantially reduced by the Internet are IT costs. For example, the large scale take-up of cloud computing has substantially lowered the IT costs for new business entrants. Modelling by Google, the Center for Digital Business at MIT Sloan School of Management, and Analysis Group, which examined the cost of cloud versus on premise computing, found that while the total cost savings associated with cloud migration increase with firm size, the largest percentage savings are realized by small firms. In particular, it found that the average cost reduction for small firms - with 1 to 15 computer users - is approximately 71%.[8]

The Internet can also change the structure and scale of enterprises. It is a powerful export tool that enables not only established businesses, but also new businesses, to go global regardless of their size and geographic footprint. In particular this gives small businesses the ability to enter the market and access international customers and labour markets.

Example

Shoes of Prey, headquartered in Sydney's Surry Hills, is a rapidly-growing small business with a regional supply chain, that exports more than 60% of its sales. This initially online-only women's shoe retailer allows customers to design bespoke shoes via a web application, with the shoes then manufactured on-demand in China and shipped anywhere in the world.

Since Shoes of Prey was founded in 2009, it has grown from a workforce of 3 people to 100 worldwide, with 15 Sydney-based employees. Its customers have designed over 4.5 million shoes on its website and in 2012 Shoes of Prey's revenue grew by 300%. Shoes of Prey has now also established an offline presence, opening a boutique in Sydney in 2013 in David Jones' flagship Elizabeth Street store and subsequently in Westfield Bondi Junction, Sydney. In late 2014, Shoes of Prey partnered with the upmarket U.S. department store chain Nordstrom to open concession outlets in several of Nordstrom's U.S. stores. It has since opened two concession outlets and has plans to open a further four by early May 2015.[9]

Shoes of Prey has been growing 50% year-on-year and gross profits have risen 250% in the last 12 months.[10]

[8] Google, MIT Sloan School of Management, and Analysis Group, *Policy by the Numbers*, (2012) < http://policybythenumbers.blogspot.com.au/2012/10/modeling-costs-of-cloud-vs-on-premise.html>.
[9] See Shoes of Prey website <https://www.shoesofprey.com/stores>.
[10] Mitchell, S, 'Shoes of Prey steps out of the web and onto the street', Sydney Morning Herald (online), 5 November 2014, <http://www.smh.com.au/business/retail/shoes-of-prey-steps-out-of-the-web-and-onto-the-street-20141104-11gpsc.html#ixzz3TrtoIsq4>.

STEPS TO BE TAKEN TO REMOVE REGULATORY IMPEDIMENTS

The Productivity Commission has observed that ABS data indicates a longer term decline in business entries.[11] This is a concern given the importance of a thriving and growing private sector to overall economic growth and prosperity.

In an increasingly data-driven digital world, it is essential that policymakers both minimise regulatory impediments to not only digital based businesses models, but also to traditional businesses that are increasingly using digital technologies, and put in place policies that will ensure Australians are equipped with the right technical skills and business experience to make the most of today's opportunities. Equally, if regulations are required, it is important that these are balanced, proportionate and based on robust evidence.

Access to finance

Having sufficient capital to start a business is always a major issue for new business entrants. Any regulatory changes that enable new, and particularly small, business entrants to access capital, manage cash flows and share risk are vital to encouraging the creation of new businesses.[12]

For this reason, Google welcomes the recommendation of the Financial System Inquiry that the Government graduate fundraising regulation to facilitate crowdfunding for both debt and equity and, over time, other forms of financing.[13] Google strongly encourages the Government to act on this recommendation and to remove the current regulatory impediments to this source of funding.

One of the major expenses for any new business entrant is staffing costs, including wages. One form of finance, especially for technology company startups, is employee share schemes (**ESS**). These schemes effectively enable fledgling businesses to compete for talented staff by reducing up-front staffing costs. They also incentivise staff by giving them a direct financial stake in their employers and offer the potential for financial rewards commensurate with the level of risk associated with such businesses. Unfortunately, current taxation laws as they presently apply to ESS for startups require tax to be generally payable by employees at the point in time at which rights can be exercised, as opposed to the point in time at which the rights are actually exercised. There are various well documented practical problems with this timing issue. Google welcomes the Government's announcement on 14 October 2014 that it intends to change the taxation treatment of ESS.[14]

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[11] Productivity Commission, *Business Set-up, Transfer and Closure*, Issues Paper (2014) 5.
[12] StartupAUS notes in the Crossroads report that a lack of early stage capital for startups in Australia is one of the most obvious market failures of the Australian startup ecosystem (see *Crossroads: An action plan to develop a vibrant tech startup ecosystem in Australia*, (2014) 46.)
[13] *Financial System Inquiry Final Report*, (2014),177-180.
[14] Bruce Billson, Minister for Small Business, 'Encouraging employee share ownership and entrepreneurship' (Media Release, 14 October 2014).

Reforming the taxation treatment for ESS will remove one of the most significant regulatory impediments to online business entrants.

Copyright and fair use in the digital age

Another essential ingredient to encouraging new business entrants in a data-driven world is a flexible copyright regime. Australia's current copyright regime is out of date and in urgent need of re-invigoration. In particular, the current Copyright Act provides only limited closed categories of defences to acts of copyright infringement.

The ALRC's *Copyright and the Digital Economy* report recommends the implementation of a 'fair use' flexible exception. Google supports such a 'fair use' exception and encourages the Productivity Commission to endorse this recommendation as an opportunity to remove a regulatory impediment to new online business entrants needing to make use of data-driven business models.[15] As noted by Lateral Economics in its report Excepting the Future,[16] "[t]he copyright regime is one of the framework conditions for investment and innovation." "The US has become a hotbed for the development of the internet, including online services."[17] The report also notes "how important the US's flexible copyright exception, fair use, has been in enabling many of the most pioneering and remunerative innovations" and gives examples such as the Apple i-pod, Facebook and Google search.

Without a U.S. fair use style exception in the Copyright Act, there is far less scope for new Australian businesses capitalising on the next wave of innovation, unlocking new investments and economic growth.

Research conducted in 2012 by Lateral Economics, *Exceptional Industries* and *Excepting the Future*, values the 'copyright exceptions sector' at $182 billion dollars per annum, or 14% of Australia's GDP.[18] The 'copyright exceptions sector' includes sectors that rely on using copyright material, such as education and research institutions, libraries, cultural institutions and digital, Internet and web hosting providers.

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[15] Regarding the relevance of copyright to competition in markets for copyright material, Google notes the ACCC's submission to the ALRC review, which states that:

> *The ACCC broadly supports the introduction of a fair use exception, as proposed by the ALRC, and considers that such an exception is likely to promote an appropriate balance between socially beneficial incentives to create and incentives to disseminate and use copyright material.*
>
> *... introducing more flexible copyright laws should be able to accommodate and foster technological advances and innovations that might otherwise be curtailed by prescriptive and/or narrow exceptions.*

ACCC submission to the ALRC Copyright and the Digital Economy Discussion Paper, (2013), 2 and 7.

[16] Lateral Economics, *Excepting the Future Internet intermediary activities and the case for flexible copyright exceptions and extended safe harbour provisions,* (2012) 40.

[17] Ibid.

[18] Lateral Economics, *Exceptional Industries: The economic contribution to Australia of industries relying on limitations and exceptions to copyright,* (2012) 6.

Australia's current copyright regime fosters risk and uncertainty. As indicated in Google's submission to the ALRC discussion paper, Copyright in the Digital Economy (ALRC DP 79), the existing "[o]utdated copyright exceptions mean that consumers cannot time and format shift lawfully acquired content in a seamless way (for example, it is lawful to copy a CD to use on a tablet, but not a DVD). Cloud providers cannot exercise copyright exceptions on behalf of users. And more than 15 years after search engines were invented, it is still not possible to operate a search engine in Australia without a significant and unacceptable level of business risk … due to the lack of legal protection for standard search engine activities such as crawling, indexing and caching."[19]

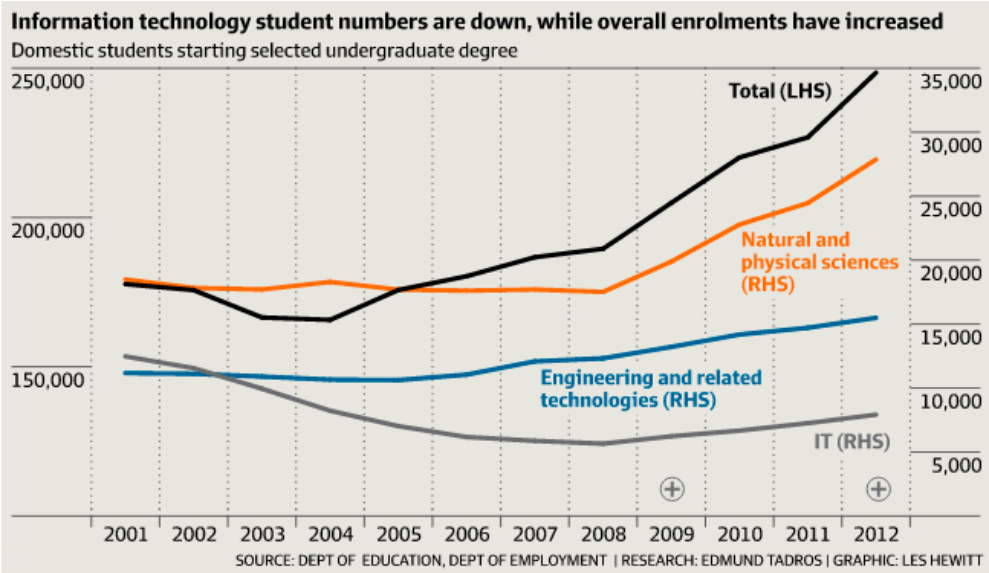
More flexible, technology-neutral copyright laws would also make a substantial contribution to Australia's economic growth. For example, Lateral Economics estimated that the additional value added or welfare gain to the Australian economy would be $593 million over ten years.[20]

Information Communications Technology skills shortage

In order for future, and current, Australian businesses to capitalise on the economic opportunities that the Internet offers, it is essential that they are equipped with the skills that are required in the digital world. Those skills include science, technology, engineering and maths (**STEM**). This is because STEM skills are the building blocks for computer science degrees and computer science degrees are in turn an important ingredient in the creation of successful technology startups. This is borne out by PwC's finding that 29% of people who founded technology startups had a computer science degree.[21]

Alarmingly, less than two percent of university students in Australia will graduate with computer science degrees.[22] Of even greater concern is the fact that there has been a significant decline in enrolments in university computer science degrees in the last decade, particularly among women.[23] The Australian Financial Review reported that there was a 36% decline in students starting computer science at Australian universities since 2001 and a 41% decline in students graduating from those degrees and this is at a time when there was a significant increase in graduates in most other professional fields.[24]

[19] Google Australia, *Google submission to ALRC discussion paper Copyright in the Digital Economy (ALRC DP 79)*, 1 <http://www.alrc.gov.au/sites/default/files/subs/600._org_google.pdf>.
[20] Lateral Economics, above n 16, 43.
[21] PwC, *The Startup Economy: How to support tech startups and accelerate Australian innovation*, (2013) 18.
[22] Ibid.
[23] Hutchinson, J and Tadros, 'Shortage of IT graduates a critical threat', *Financial Review* (online), 4 February 2014 <http://www.afr.com/p/technology/shortage_of_it_graduates_critical_tOuFEdBporFCdLIonKFJFJ>.
[24] Ibid.



Source: Australian Financial Review

It is essential that this trend is reversed if Australia is to make the most of the opportunities provided by the Internet.

National Digital Curriculum in schools key to early inspiration

In order to ensure that Australians are equipped with the technical skills required to enroll in computer science degrees, it is essential that STEM skills are taught at an early age as part of school curriculums. For students to take up studies in computer science it is important that they are exposed to computational thinking in the early years of their schooling. This has been recognised in the U.K., which recently updated its state schools curriculum so that students as young as five are familiarised with fractions and computer algorithms.[25]

Australia's National Curriculum for Digital Technologies has undergone an extensive drafting process and awaits final endorsement from The Education Council later this year.[26] It introduces computational thinking, logic and problem-solving capability into school curriculums, with simple visual programming taught in primary school and a general purpose programming language taught in high school.

This curriculum, if successfully implemented in schools across the nation and taught by passionate teachers, will be an important first step in preparing young Australians to become the creators, innovators and new business owners of the future.

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[25] Sean Coughlan, 'Curriculum changes 'to catch up with world's best'', BBC (online) 8 July 2013 <http://www.bbc.com/news/education-23222068>.

[26] The Digital Technologies Curriculum is expected to be put to the Education Council for official endorsement in December this year (See Simon Shawood, 'Australia's digital technologies curriculum parked again', The Register (online), 6 March 2015 <http://www.theregister.co.uk/2015/03/06/australias_digital_technologies_curriculum_parked_again/)>.

Supporting and encouraging entrepreneurs

In the Internet age, a strong homegrown technology sector is vital to creating Australian businesses, jobs and wealth. The economic opportunities are boundless. The technology startup sector has the capacity to grow into an important part of Australia's economy, providing a significant number of new businesses and jobs for the future. However, it will take dedicated efforts on the part of governments and the private sector to unlock that potential. One major area of weakness in the current policy framework is that there is no national system to support technology startup or business incubators.

This could in part be addressed by the Government as part of its Entrepreneurs' Infrastructure Programme. That programme could be used to increase the rate of Australian technology innovation by focusing on supporting local technology startup networks.[27]

International research indicates that money invested in supporting local technology startups is well spent. For example, a study by the U.S. Department of Commerce Economic Development Administration of 'business incubators' (including non-tech businesses) found that for every $10,000 of government funding invested in business incubators, between 46-69 local jobs were created, roughly 20 times more than created by infrastructure spending.[28] There are also estimates that for every $1 dollar of public money invested in U.S. 'business incubators', it returns $30 in local tax revenue in the U.S..[29]

Another area of weakness is that Australians are not generally taught entrepreneurial business skills. Like technical skills, the Government needs to give greater attention to ensuring that students are taught the skills they will need if they are going to establish successful businesses, such as financial literacy.

There are already small-scale examples of such programs operating in Australian schools: Startup Weekend (schools) Startup Apprentice and Club Kidpreneur. Club Kidpreneur Foundation is a not for profit body that runs entrepreneurship exposure programs in 250 primary schools [throughout Australia], reaching over 2,400 children. In the U.S. these types of programs are well established. One example is the Junior Achievement Award run by the Kaufmann Foundation, with 4.4 million students participating each year. There is ample opportunity for the Government to pursue initiatives, including with the private sector, in this area.

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[27] There is already infrastructure and startup communities in Australia that would be well placed to make the most of this support. For example, two Australian cities were recently nominated in the Startup Genome report as among the world's top 20 startup ecosystems, with Sydney ranked 12th and Melbourne 18th (Startup Genome, 'Startup Ecosystem Report', (2012) <http://cdn2.blog.digital.telefonica.com.s3.amazonaws.com/wp-content/uploads/2012/11/Startup-Ecosystem-Report-2012.pdf >.

[28] U.S. Department of Commerce, Economic Development Administration, *Construction Grants Program Impact Assessment Report*, (2008) pp ii-iii.

[29] National Business Incubation Association, Impact of Business Incubation in the US, (2009) 18 <http://www.infodev.org/infodev-files/resource/InfodevDocuments_896.pdf >.