

OUT15/16651

Dr Warren Mundy
Commissioner
Business Set-up, Transfer and Closure
Productivity Commission
CANBERRA ACT 2601

By email: business.inquiry@pc.gov.au

Dear Dr Mundy,

Submission on the Draft Report on Business Set-up, Transfer and Closure

Thank you for giving the Office of the NSW Small Business Commissioner (OSBC) the opportunity to comment on the Productivity Commission's (Commission) Draft Report on Business Set-up, Transfer and Closure (Draft Report).

The role of the OSBC is to support small businesses in NSW by:

- providing mediation and dispute resolution services;
- delivering quality small business support through a range of programs and resources; and
- speaking up for small business within government.

The OSBC has reviewed the Draft Report and makes the following comments relevant to small business on selected matters raised in the Draft Report. Since small businesses account for over 99 per cent of all entries and exits,¹ small business should be 'front of mind' when considering barriers to business entries and exits.

Setting up a business

The OSBC supports the view that although the generic requirements to setting up a business do not currently represent a serious barrier to set up, there is room for improvements to streamline and better coordinate the set-up process.²

In this regard, the OSBC alerts the Commission to the Federal Government's proposal, announced as part of its 2015-16 Budget, to make it easier to start a business by streamlining business registration processes.³ The proposal involves developing a single online business registration site by mid-2016, and will include ABN, company, business name, GST, PAYG and FBT registrations.

¹ Draft Report, 17.

² Draft Report, 72.

³ http://www.budget.gov.au/2015-16/content/glossy/sml_bus/html/sml_bus-10.htm

The OSBC also draws the Commission's attention to a relevant NSW Government initiative designed to make it easier for small businesses to set-up and begin trading. Service NSW, the NSW Government's one-stop service for government customers, has developed a webpage designed to be the central starting point for someone wanting specifically to set up a café or restaurant in NSW.⁴ The page succinctly summarises the various regulatory processes (including registrations and licence applications) that the business owner may need to go through, and provides direct links to the starting points for those processes.

The OSBC also agrees with the Commission that local governments can be a significant source of potential regulatory burden on new businesses.⁵ This is part of the reason why the OSBC has, in partnership with the NSW Business Chamber, developed the Small Business Friendly Councils Program to increase the number of NSW councils working proactively with small businesses. Under that Program, councils commit to adopting initiatives to improve their regulatory interaction with small businesses.⁶

The OSBC supports the Commission's recommendation (within Draft Recommendation 3.1) that all levels of government should implement the leading practices and recommendations from the Commission's report on *Regulator Engagement with Small Business* (2013). The OSBC regularly works with other NSW Government agencies to encourage the adoption of these leading practices.

As part of the OSBC's efforts to minimise the overall regulatory burden on small businesses in NSW, the OSBC is working with the Australian Business Register (ABR) to encourage NSW Government agencies to make greater use of business data held by the ABR. Doing so seeks to limit businesses being asked to repeatedly provide the same basic information to government agencies.

Business structures

The OSBC supports Draft Recommendation 4.1, namely that in principle there should be a consistent approach to the taxation of business entities regardless of their ownership structure and size. To this end, and as discussed in our submission to the Federal Government's *Re:Think Tax Discussion Paper*,⁷ the OSBC supports the creation of a simpler business structure specifically for the small business sector.

Small business access to finance

Access to finance and business transfers

The discussion in chapters 5 to 7 of the Draft Report primarily focuses on access to finance by nascent or new businesses. The potential impact of small businesses' limited access to finance on business transfers is given less attention.

The OSBC raises this point because it has come across circumstances in which small business owners nearing retirement have found it difficult to sell their successful

⁴ Available at: <http://www.service.nsw.gov.au/transaction/open-cafe-or-restaurant-nsw>.

⁵ Draft Report, 77.

⁶ For further information about this program, see <http://www.smallbusiness.nsw.gov.au/supporting-business/small-business-friendly-councils-program>, or email sbf.councils@smallbusiness.nsw.gov.au.

⁷ Available at: http://bettertax.gov.au/files/2015/06/NSW_Small_Business_Commissioner.pdf

businesses. These business owners have encountered difficulties finding suitable purchasers, one reason being that younger purchasers have been unable to obtain sufficient debt finance from banks to facilitate the purchase of the business. Although the businesses for sale are viable and have a good track record, sufficient finance has been denied to potential purchasers due to them lacking sufficient collateral (that is, for reasons other than those associated with the prospects/risks of the business).

This type of problem is particularly faced by businesses based in regional areas, since the pool of purchasers can often be even more limited, exacerbating the difficulties faced by the exiting business owner/s as they try and sell their business to new owners.

Situations such as these illustrate that business transfers can also be adversely impacted by a prospective business owner's inability to access finance, a problem which is likely to rise as the ageing of business owners over the next decade coincides with the number of owners seeking to retire and exit their businesses. For this reason, the OSBC recommends further consideration be given to the impact of access to finance on business transfers.

Comprehensive credit reporting

The OSBC supports the view that the degree to which voluntary comprehensive credit reporting has been embraced by the lending market, and whether there is a case for participation to be mandated, should be reviewed once comprehensive credit reporting has been in use for a few years. The OSBC also supports the view that at that time further consideration be given to the potential costs and benefits of extending credit reporting to small to medium enterprises. The OSBC accordingly supports Draft Recommendation 7.1.

Credit guarantee schemes

Relevant to the Draft Report's discussion on whether there is a role for a credit guarantee scheme in Australia, the OSBC draws the Commission's attention to a credit guarantee scheme established in early 2015 by the South Australian Government.⁸

The *Unlocking Capital for Jobs Program* aims to assist small to medium sized enterprises to secure commercially viable loans where they would otherwise not have the balance sheet strength to satisfy a bank's lending criteria. The program is part of the South Australian Government's response to the decision by General Motors Holden to close its manufacturing facility in Elizabeth, South Australia. The government guarantee is 20 per cent of the funds loaned, and there is a minimum loan amount of \$500,000.

Given the Commission's conclusion that the evidence is inconclusive about the long term effects of credit guarantee schemes, in the future this program may be an opportunity to evaluate the operation of a credit guarantee scheme in the Australian context.

⁸ See <http://www.statedevelopment.sa.gov.au/industry/manufacturing/manufacturing-programs-and-initiatives/unlocking-capital-for-jobs>.

New business models, the digital economy and regulation

The Commission notes that governments and regulators face ongoing challenges of applying existing regulatory frameworks to new business models with differentiated products and services in a rapidly changing environment.⁹

As part of its efforts to meet these challenges, the NSW Government announced in July 2015 the establishment of an independent taskforce to examine the future sustainability of taxis, hire cars and other emerging point to point transport providers in NSW, including ridesharing apps.¹⁰ The taskforce will report back to the NSW Government by the end of October 2015 with recommendations, and consider the possible impact of any changes to regulation on existing investors. The OSBC draws this development to the Commission's attention in the context of the discussion in chapter 8 of the Draft Report.

Other government and industry restrictions – retail leasing and franchising arrangements

Commercial leasing arrangements

As noted in the Draft Report, the OSBC is conducting a review of the *Retail Leases Act 1994* (NSW). One of the issues identified by retail tenants as impacting on set-up costs is access to data concerning the value of leases in the market.

As was identified in the Commission's 2008 Inquiry Report on the *Market for Retail Tenancy Leases in Australia*, there is very little reliable data about the cost of leases in shopping centres readily available to prospective tenants. This can allow landlords to maximize the rents they charge, particularly for less experienced retailers. In addition to the absence of data about the cost of leases, there is also very little information in the market about the turnover retail leases can generate. The OSBC is aware that it is standard operating practice for shopping centre landlords to collect turnover data from their tenants on a monthly basis.

The absence of both types of information can make it difficult for new retailers to assess the value of a lease being offered relative to alternatives that may exist in the market. The absence of this data also makes it difficult for new retailers to decide if the shop on offer is the best fit for their new business. This data deficit can mean that new retailers find it difficult to negotiate the best possible deal, which impacts on their establishment costs.

For example, the OSBC has become aware of a situation in which a retail tenant in a shopping centre signed a lease with a rent that was twice that of other comparable retailers in the centre. The retailer relied on the agent telling them it was a good deal and similar to others in the centre. They also relied on their 'instinct' about the turnover they could generate based on the impression they had of the foot traffic through the centre. It was only after the lease was signed and the retailer began speaking to neighbouring businesses that they became aware of their mistake. In this case, the landlord was willing to renegotiate the contract, but this may not always be the case.

⁹ Draft Report, 180.

¹⁰ See <http://www.transport.nsw.gov.au/media-releases/solution-changing-industry-taskforce-examine-point-point-transport>.

While in this example the retailer may have been inexperienced in such negotiations, this is true of many new entrants into the market. However, the absence of easily accessible data makes it difficult for new retailers to carry out due diligence and encourages them to take risks by relying on their instincts and the information offered to them by landlords or agents.

Franchising arrangements

The OSBC recognises the role played by the Franchising Code of Conduct (Code) in governing the relationship between franchisors and franchisees, and given the new Code's recent introduction, the OSBC concurs that it would be prudent to monitor the new arrangements and examine any outstanding concerns in the review of the Code due in five years.

Further, the OSBC has avoided addressing matters covered by the Code in its review of the *Retail Leases Act 1994* (NSW). However, as part of that review, the OSBC has considered the impact of franchisor failure and the rights of franchisees to continue trading if they are capable of so doing. This is because this matter is not dealt with explicitly by the Code and it is within the scope of leasing agreements.

The OSBC notes that subtenants have existing rights under the *Conveyancing Act 1919* (NSW) which may allow subtenants, including some franchisees, to seek a court order allowing them to become the lessee where a landlord has re-entered the property after the head lessee has forfeited the lease. The OSBC has concluded that this limited right should be incorporated into the *Retail Leases Act 1994* (NSW), as this would allow the NSW Civil and Administrative Tribunal to hear the matter. That Tribunal is deemed to be the appropriate jurisdiction for hearing these type of lease-related matters, because it is a more timely and cost effective forum than alternatives.

Government assistance for businesses – the OSBC's Small Biz Connect Program

In the context of the Commission's discussion of the provision of government assistance to businesses, and in particular to small businesses, the OSBC offers the following comments on the OSBC's Small Biz Connect Program (Program).

The Program funds a network of mobile business advisors to provide general business advice to local small businesses. The Program provides practical face-to-face support to new and existing business owners as well as skills development workshops. Key issues are business planning, marketing and starting a business. The Program is delivered across NSW by contracted not-for-profit regional service providers appointed through a merit-based procurement process.

The rationale for the Program is to address a market failure, being the failure by small businesses to obtain information and advice crucial to making informed business decisions. There exists an information asymmetry in which governments have vast amounts of information they can provide, but small business owners are time-poor managers dealing with an information overload and with no clear understanding of what they need to know, what information is available, or who might possess it.¹¹

¹¹ Schaper, M.T. (2014) "Is Anybody Listening? Improving Government Information And Communication To Small Business" in Kotey, B., Mazzarol, T., Clark, D., Foley, D. & McKeown, T. (eds.) *Meeting The Globalisation Challenge: Smart and Innovative SMEs In A Globally Competitive Environment*, Melbourne: Tilde, 134-151.

This failure can lead to poor resource allocation, including avoidable financial losses and unemployment. These problems are particularly acute for small businesses, since obtaining information on government processes and business practices represents a disproportionate drain on the resources of small businesses relative to larger businesses.

This information failure is the result of a complex operating environment characterised by significant regulatory requirements and new entrants that have limited knowledge and access to information.

Small business operators, and in particular sole traders and micro-enterprises (those employing less than 5 employees), face significant human and financial resource constraints and do not see value in business advisory services provided on a commercial fee-for-service basis. Consequently, small businesses are most affected by the identified market failure. The Program primarily assists non-employing businesses (91 per cent of Program clients) and micro-enterprises (8 per cent of Program clients), who would not otherwise access business advisory services provided on a commercial fee-for-service basis.

As a result, in the OSBC's view the Program is consistent with the first dot point within Draft Recommendation 11.1 to the effect that governments should give priority attention to "providing information and assistance on commercial matters, and through mentoring, skills and training, only where a market failure in private provision is clearly demonstrated".

In the absence of the Program, it is expected that the small business failure rates in NSW would be higher than currently experienced. The Program incorporates clear objectives and performance indicators.

Voluntary business exits

Small business capital gains tax concessions

The OSBC supports the suggestion in Draft Recommendation 12.2 that the current small business capital gains tax concessions be rationalised and simplified,¹² to reduce the compliance costs faced by small businesses.

Succession planning

The OSBC's experience supports the Commission's view that succession planning is not widely undertaken.¹³ The OSBC generally finds that small business owners do not consider or adequately address succession planning. In 2014/15, only 1.3 per cent of Small Biz Connect Program clients raised succession planning as their "primary issue", and it was an "other business issue" for only 1.1 per cent of clients.

The OSBC has developed a succession planning "health check" as part of its Small Biz Connect Program to support small businesses to identify gaps and opportunities in their succession planning.

¹² See further discussion in the OSBC's submission to Federal Government's *Re:Think Tax Discussion Paper*, available at: http://bettertax.gov.au/files/2015/06/NSW_Small_Business_Commissioner.pdf.

¹³ Draft Report, 46.

Corporate insolvency – phoenix activity and proposed ‘Director Identity Number’

Phoenix activity, most notably in the construction sector, can have a significant impact on small business, in particular when they are not paid and are unsecured creditors. This is because small businesses are more reliant on, and susceptible to, fluctuations in revenue cash flow.

The OSBC therefore supports Draft Recommendation 15.8 that directors be required to obtain and provide a ‘Director Identity Number’ at the time of company registration, to enable better tracking of directors of failed companies by relevant authorities.

Should you wish to further discuss any of these comments please contact Georgos Papanastasiou, Senior Advisor, Advocacy

Yours sincerely

Robyn Hobbs OAM
Small Business Commissioner

9 July 2015