

Business  
Council of  
Australia



submission

# Submission to the Productivity Commission Review of Barriers to Business Entries and Exits in the Australian Economy

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*Working to achieve  
economic, social  
and environmental  
goals that will benefit  
Australians now and  
into the future*

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The Business Council of Australia (BCA) is a forum for the chief executives of Australia's largest companies to promote economic and social progress in the national interest.

## About this submission

This is the Business Council of Australia's submission to the Productivity Commission Review of Barriers to Business Entries and Exits in Australia.

The Productivity Commission is seeking information on the nature and extent of barriers to business set-up and closure, and how overall economic efficiency could be improved by removing or reducing these barriers.

This submission identifies and examines barriers to business entry and exit that lower productivity growth, and recommends policy changes to lower these barriers.

## Introduction

Australia needs a vibrant, dynamic business environment that drives economic growth and job creation. To achieve this, policies need to encourage business innovation and productivity growth by allowing resources to flow efficiently from lower to higher value uses. Policies should not unduly prevent or slow the creation of new businesses or the restructuring of existing businesses aiming to succeed in competitive markets.

The regular entry and exit of firms in competitive markets is a sign of a successful and dynamic modern economy. The more easily business models can emerge or adapt to new consumer demands and new technology, the more quickly consumer welfare is enhanced and new jobs can be created.

Innovation and investment in new and existing businesses will occur in economies with:

- strong competition between local and global businesses
- access to infrastructure, knowledge and skilled workers
- well-structured tax and legal systems.

Australia's business environment needs to provide the appropriate reward for risk and encourage responsible risk-taking.

## Key recommendations

### Creating a more competitive business environment

- Remove regulatory restrictions on market-based competition, giving priority to outstanding National Competition Policy (NCP) changes assessed as offering substantial economic and employment benefits. This includes removing cabotage restrictions on coastal shipping, completing energy and water market reform, and introducing a cost-reflective system of road pricing.
- Move to a more globally competitive tax system by simplifying our tax system to reduce business compliance and administration costs; redesigning our taxes to lower

disincentives to invest and work; and taxing employee share schemes when share options are exercised, instead of when share options are provided.

- ▶ Regularly review all industry subsidies to ensure they are well-targeted, temporary in nature and demonstrably grow the long term productive capacity of the economy.

### **Reducing regulatory barriers to business entry and exit**

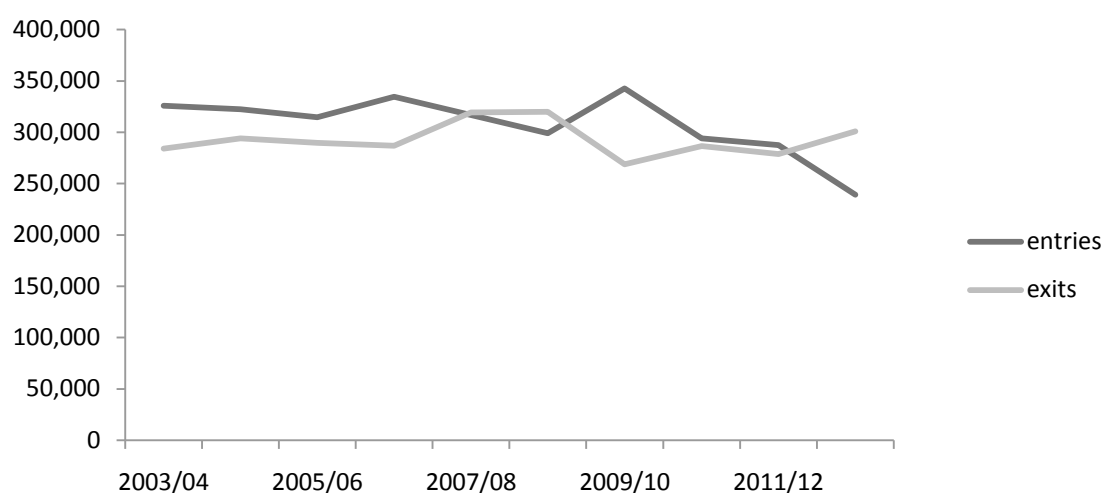
- ▶ All government's should prioritise the reduction and removal of unnecessary and costly red tape and the efficient administration of regulation by regulators.
- ▶ Simpler corporate rules and clearer guidance from regulators to help businesses 'do the right thing', by rationalising directors' liability provisions across state and federal legislation and reducing the reporting requirements for smaller companies.
- ▶ Improving decision making around the authorisation of business mergers and acquisitions.
- ▶ Remove technology-specific regulation that is adverse to business innovation.
- ▶ Deregulate retail trading hours, remove the red tape associated with industry participation plans and improve land use planning approval and zoning decisions.

### **Better access to information**

- ▶ Improve access to government information on regulation, tax and government services by greater use of online technology and raised awareness of ombudsman and small business advisory services.

### **Recent trends**

Over the past 10 years, the annual number of business entries has been generally offset by the number of business exits (Figure 1). Most businesses that enter or exit the economy employ less than 20 people. There has been a fall in the annual number of business entries since the global financial crisis, although allowance should be made for the change in the method of counting businesses in 2010.

**Figure 1: Number of business entries and exits, 2003/04 – 2012/13**

**Note:** Care should be taken in interpreting 2010 business entries due to the introduction of a new method of counting businesses

**Source:** ABS 2014a, cat. no. 8165.0

More recent company registration statistics published by the Australian Securities and Investment Commission indicate an increase of 10.2 per cent in the number of new companies registered in Australia in 2014 compared with 2013 (ASIC 2015).

### **The importance to the economy of business entry and exit**

Efficient business entry and exit is fundamental to generating ongoing productivity increases and higher incomes. Business turnover facilitates the shift of resources in an economy from lower value to higher value uses. This occurs as the labour, capital and land released by declining businesses is re-employed by new or growing businesses and put to more productive use, including by merging or transferring some or all of their operations to another business.

Such turnover leads to higher wages for workers, higher returns for investors and a stronger tax base for governments.

Recent studies of manufacturing and business services industries in Australia and Europe find that relatively high rates of business exit and entry are associated with stronger productivity performance (See Exhibit 1, below).

### Exhibit 1: Importance of business exit to productivity growth

A recent study of business productivity in Australian manufacturing and business services found that over the nine years to 2010–11, the exiting of businesses raised overall productivity by 12% in manufacturing and 23% in business services. Indeed, exiting businesses have relatively low productivity relative to established businesses many years before they close.

A study of European business services found that higher rates of business entry and exit are associated with higher productivity. It also found that higher regulation intensity is linked to lower productivity performance.

Source: Nguyen and Hassell 2014; Kox H, van Leeuwin G and van de Weil H 2010.

### Ease of business entry

Australia ranks quite highly for starting a business and getting credit, but then ranks less well on other 'ease of doing business' measures.

The World Bank *Doing Business* report includes measures of the time and cost of complying with selected regulations in 189 countries. These comparisons are based on actual and estimated costs rather than business perceptions of these costs. The report enables useful quantitative global comparisons, although it acknowledges that a limited range of policies affecting the business environment are considered. Other policies encouraging entrepreneurship and creativity are also desirable.

Australia is currently ranked 10th out of 189 countries when assessed against the World Bank's 'ease of doing business' indicators. Australia's relative rankings in five of these regulatory areas are summarised in Table 1.

**Table 1: Doing business 2015 – selected rankings (out of 189 countries)**

	Ease of doing business	Starting a business	Construction permits	Getting credit	Paying taxes	Resolving insolvency
Singapore	1	6	2	17	5	19
New Zealand	2	1	13	1	22	28
Hong Kong	3	8	1	12	2	25
USA	7	46	41	2	25	4
UK	8	45	17	17	4	13
Australia	10	7	19	4	39	14

Source: World Bank Group 2014.

Our relative global performance in the regulatory area of paying taxes is poorer than other regulatory areas with a ranking of 39th in the world. Our distance from world best practice in paying taxes increased (worsened) between the 2014 and 2015 reports.

In relation to the costs and time needed to set up a specific type of small- to medium-sized business in each country's major capital city, Australia currently performs close to international best practice (Table 2).

**Table 2: ‘Starting a business indicators’\*, selected measures of regulatory requirements**

Indicators	Australian results	Best practice results	OECD average results
Procedures (number)	3+	1 (Canada and New Zealand)	4.8
Time (days)	2.5	0.5 (New Zealand)	9.2
Cost (% of income per capita) <sup>^</sup>	0.7	0 (Slovenia)	3.4

\* Assumptions underlying the indicators include that the business performs general industrial or commercial activities, operates in the economy's largest business city, is 100% domestically owned, employs between 10 and 50 locals, does not perform foreign trade and is a limited liability company.

+ The 3 Australian regulatory procedures are 1) ASIC registration Form 201; 2) ABN registration with the ATO; 3) signing up for workers compensation insurance with an insurance agency.

<sup>^</sup> Regulatory cost as a % of income per capita appears to be used to enable international comparisons of regulatory costs of establishing a business.

**Source: World Bank Group 2014.**

These results suggest that Australia could further lower business establishment costs by adopting international best practice, for example, if more of the required processes were able to be completed online as occurs in New Zealand.

## Creating a more competitive business environment

There are a number of steps Australia should take to create a more innovative business environment and grow new jobs, based on recent analysis and the experiences of Business Council member companies.

### Reinvigorating microeconomic reform

Competition is critical to drive businesses to design and deliver products and services that better meet the ever changing needs of consumers. A competitive business environment creates the conditions that encourage innovation and employment growth. Such an environment allows businesses to start-up, restructure and close easily, allowing resources to move to higher value uses.

Increasing the level of competition between businesses would be achieved by implementing the outstanding National Competition Policy (NCP) or ‘Hilmer’ policies of the 1990s and 2000s, as recommended in the Competition Policy Review (2014) draft report. Outstanding NCP reforms that should be implemented as a matter of priority by state and Commonwealth governments include:

- Removing cabotage restrictions in the *Coastal Trading (Revitalising Australian Shipping) Act* to move to an open, competitive market for coastal shipping services, with all other Australian laws being observed.
- Finalising energy reform and recommitting to reform in the water sector.
- Starting a process to introduce cost-reflective road pricing, with pricing subject to independent oversight and revenues linked to road construction, maintenance and safety.

These changes are recommended because of the increased productivity, income and employment growth that resulted from the earlier NCP reforms.

The Competition Policy Review draft recommendation that all Australian governments increase the effectiveness of their competitive neutrality policies would create more opportunities for business in markets where governments currently provide services. This would also enable governments to focus their resources on services that best meet the public interest.

Many of these policy changes have already been assessed favourably under the earlier NCP framework and the Council of Australian Governments (COAG).

The increase in Australia's 'distance from the frontier', as assessed in the latest World Bank *Doing Business* report, supports priority being given to policy changes that further promote a well-functioning and competitive private sector.

To drive continuous improvement in our business environment, the Business Council supports establishing institutional arrangements and incentives to drive ongoing implementation of competition policy. Actions set out in *Improving Australia's regulatory system* (BCA 2013) include the following priorities:

- the mandatory preparation of Regulation Impact Statements
- a performance and accountability code for all major regulators
- requiring any regulation which imposes a significantly increased red tape burden to have an equivalent offsetting red tape reduction within the same portfolio
- productivity payments from the Commonwealth to the states for good regulation performance.

*Priority should be given to removing restrictions on competition in markets that have already been assessed under NCP and COAG as offering substantial productivity, income and employment benefits.*

### **A more globally competitive tax system**

Taxes are essential to fund essential public services. However taxes should be structured in a way that does not discourage income and employment growth and undermine the very source of taxation itself.

Analysis of the recent World Bank indicators and supporting data suggests that Australia would be closer to a best practice business environment if it had:

- simpler tax laws to ease compliance costs
- lower corporate tax rates.

Consistent with these findings, the Business Council supports:

- Simplifying our tax system to reduce business compliance costs and tax administration costs. Ten of our taxes raise around 90% of tax revenue, and 115 raise the rest.



- Redesigning our taxes to lower disincentives to invest and work, and be more competitive with our major trading partners (BCA 2014a).
- Amending the tax treatment of employee share schemes so that the point of taxation is when the share, or rights, are exercised (BCA 2014b).

We need to lower tax on profit and employment income, and rely more on other broadly based taxes. The upcoming white paper on tax reform is an opportunity to establish a well-structured and more globally competitive tax system.

Changing the timing of taxing employee share options will improve the ability of start-up businesses to attract and retain talented staff. Currently, employees are taxed when share options are provided, instead of when converted into shares by the employee (exercised).

*A more globally competitive tax system will encourage greater domestic and foreign investment in Australia, increasing income and employment.*

### **Structural adjustment assistance**

Structural change in the economy is fundamental to the success of a modern dynamic economy. By its nature however, structural change brings with it considerable upheaval, particularly for people who lose their jobs and need to find new employment.

The Business Council estimates that the federal government spent \$5.1 billion on 97 industry assistance measures in 2011–12 (BCA 2014c). There is a risk that with the best of intentions, some of these measures unduly delay business exits, and act as a barrier to the entry of new businesses and creation of new jobs.

Where there is a case for government assistance to help move people and other resources more quickly to higher value uses, the Business Council argues that such assistance should focus on:

- relying on existing tax and transfer mechanisms to deal with immediate issues
- providing information to displaced workers about available job opportunities
- in some specific circumstances, assisting with retraining or relocating workers to help them find new jobs
- time-limiting any assistance measures.

All industry assistance measures should be regularly reviewed to reduce the risk that they act as barriers to innovation and the creation of new businesses, and slow the restructure or closure of unviable businesses. Assistance should be short-term and designed to reduce the adjustment costs of moving people to where the new jobs are.

*The case for industry subsidies will need to be continually reassessed, to ensure that they are well targeted, temporary in nature and grow the long-term productive capacity of the economy.*

## **Reducing regulatory barriers to business entry and exit**

All government's should prioritise the reduction and removal of unnecessary and costly red tape and the efficient administration of regulation by regulators.

Regulation has an important role to play in upholding critical rights and providing legitimate safeguards, but to be effective regulation must be properly thought through and applied sensibly. Unnecessary regulatory costs can create barriers to starting and restructuring a business or divert business focus and activity away from designing better products, services and business processes.

### **Tax administration**

As discussed above, the World Bank report suggests that simplifying tax compliance and administration would speed up and reduce the cost of business transactions. Effective implementation of the government's new regulator performance framework for the Australia Tax Office should further improve tax compliance and administration. This requires federal regulators to publish key performance indicators next year (Commonwealth of Australia 2014).

### **Corporate rules**

Recent changes in corporate governance and law have been criticised for creating a culture that increasingly focuses businesses on risk mitigation and control, weakening incentives for innovation and entrepreneurship. This emphasis on 'conformance, not business performance' (Hilmer 2010) has contributed to businesses spending an estimated \$134 billion a year on complying with their own regulations. This is in addition to an estimated \$67 billion a year spent by business on complying with public sector regulations (Deloitte 2014).

A more proportionate and risk-based approach to corporate governance and reporting requirements involves establishing a baseline measure of the compliance burden of corporate governance regulation. This would be used to progressively streamline corporate governance regulation so it more efficiently manages investor risks.

Simpler drafting of corporate laws and clearer guidance from regulators would help business 'do the right thing' and lower prices to the extent that higher compliance costs are passed onto consumers. This includes rationalising directors' liability provisions across state and federal legislation and reducing the reporting requirements for smaller companies.

### **Insolvency law**

Efficient business exit or closure enables people, capital and other resources to move quickly from lower to higher value uses.

Well-designed and administered insolvency laws enable the efficient wind up of companies and equitable distribution of company assets and proceeds to creditors (including employees) and shareholders. A well-designed system is able to distinguish

financially distressed companies that are viable from inefficient businesses that should be liquidated (World Bank 2014).

Australia is ranked 14th internationally on the World Bank's 2015 measures of ease of resolving insolvency. Indicators include the time and cost taken to recover debt and the proportion of assets recovered by creditors. The main difference between Australia and the better performers (including Japan and the US) is the recovery rate and the strength of each country's insolvency laws as assessed by insolvency practitioners.

A 2004 Parliamentary Joint Committee was not persuaded that Australia should adopt aspects of US bankruptcy law. US law was assessed as being slower and more expensive than our voluntary administration procedures.

The Business Council considers there is merit in the Productivity Commission exploring options for improving the efficiency of Australian insolvency law and its administration.

### **Mergers and acquisitions**

The Business Council has in its submission to the Competition Policy Review suggested the following areas for improving the accuracy and cost-effectiveness of decisions on mergers and acquisitions:

- Amend the Competition and Consumer Act (CCA) definitions of “market” and/or “competition” to give legislative guidance to the principle that competition analysis should begin with an assessment of market dynamics – such as the extent of rivalry and barriers to entry – rather than concentration and static market definition.
- Streamline the Australian Competition and Consumer Commission’s (ACCC) formal and informal merger assessment processes.
- Regular ex-post reviews of ACCC decisions could be used to improve future decision making by examining *process issues* (such as whether the ACCC's internal steps were conducted in a timely and efficient manner) and *substantive issues* (including whether the assumptions used in the decision making have been borne out).

More efficient administration of competition law would enable businesses to restructure more quickly and be better able to meet changing global customer demands. This includes implementing the recommendations of the Competition Policy Review draft report that the ACCC:

- incorporate a wider range of viewpoints in its decision-making processes (recommendation 47)
- develop a media code of conduct to strengthen stakeholder perceptions of impartiality (recommendation 48).

### **Availability of finance**

Access to finance is an important enabler of new business creation. Lack of access to additional funds is the most commonly cited barrier to innovation for business (ABS 2014b).

The World Bank assesses the ease of businesses obtaining credit by measuring the following indicators of business accessibility to finance:

- The extent to which the rights of borrowers and lenders are protected by law.
- Accessibility and availability of creditworthiness information from credit reporting services. This enables credit providers to check past and current credit behaviour and assess the balance of investment risks and rewards.

Australia performs well internationally on these indicators and is ranked fourth internationally out of 189 countries. This suggests access to credit is not a substantial barrier to starting up a business in Australia, subject to the balance of investment risks and rewards.

However, the recent Financial System Inquiry's final report recommends several changes, to further increase access to finance in Australia, including:

- Supporting industry efforts to expand credit data sharing under the new voluntary comprehensive credit reporting regime.
- Developing regulatory settings that facilitate internet-based financing. A well-designed crowd funding system would encourage innovation by increasing funding options for all businesses, including small business.

More efficient financial markets would increase the diversity of available funding sources, such as for venture capital investment. The Business Council considers this would occur with:

- The white paper on tax reform assessing the tax distortions identified in the Financial System Inquiry's final report. This includes removing tax rules that that unduly favour one form of investment over another (such as the tax treatment of bank deposits), and simplifying the tax rules and administration of Venture Capital Limited Partnerships.
- The publication by financial regulators of regular performance reports, now required by the new regulator performance framework. This should encourage regulators to publicly identify ways of improving their cost-effectiveness and how administration and business compliance costs can be further reduced.
- Maintaining requirements to undertake Regulation Impact Statements before new financial regulation is introduced. International standards should be adopted only where the benefits of the standards outweigh the costs. Systemic problems with existing legislation and its administration should be identified and assessed before regulatory changes are made.

## **Technology neutrality**

Applying the principle of technology neutrality to regulation, wherever possible, will help increase the take-up of digital technology, creating more opportunities to increase business efficiency and competitiveness.

The Business Council identifies several barriers to using digital technology, including:

- restrictions on using electronic information disclosures
- requiring written consent instead of allowing electronic identification and verification
- multiple government initiatives on digital security instead of a consolidated, single approach.

The Financial System Inquiry's final report includes several recommendations to enable greater take-up of digital technology.

## **Employment**

Enterprise bargaining agreements are able to include barriers to competition that are not justified by the need to provide a safety net for vulnerable workers. These include restrictions in enterprise agreements on the:

- use of contractors by employers
- the buying or selling of goods and services from third parties.

The Competition Policy Review draft report (2014) observes that such restrictions in enterprise agreements appear to conflict with section 45 of the Competition and Consumer Act 2010 (CCA). This section prohibits trading restrictions in contracts.

The Business Council considers that such restrictions in employment agreements can prevent productivity growth and job creation. To reduce this apparent conflict, the Business Council supports amending section 45 so that the CCA expressly applies to awards and enterprise agreements.

## **Other regulatory barriers**

Other pro-competitive recommendations of the Competition Policy Review (2014) draft report that should be prioritised for implementation include deregulating retail trading hours and improving land use planning approval and zoning decisions. Improvements in these regulations can create opportunities for business expansion or new business activity. These regulations are generally the responsibility of state and local governments.

The Business Council also argues for removing red tape associated with industry participation plans for private projects that unnecessarily adds to business costs. The *Australian Jobs Act 2013* should be repealed as a priority.

## **Better access to information**

Governments could assist business by increasing the accessibility of information about regulatory, tax and other government services, including electronically.

Small business commissioners are funded by governments to provide some of this information, as well as providing dispute resolution advice and information on setting up and operating a business. A 2014 Productivity Commission report found a large number of existing government funded bodies set up to assist small business, including small business commissioners and ombudsmen. The report makes several recommendations

that aim to improve the cost-effectiveness of publicly funded information available to assist small business. Recommendations include raising awareness of ombudsman and small business advisory services, and rationalising the number of bodies providing them.

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BUSINESS COUNCIL OF AUSTRALIA

42/120 Collins Street Melbourne 3000 T 03 8664 2664 F 03 8664 2666 [www.bca.com.au](http://www.bca.com.au)

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