Submission to the Productivity Commission

Inquiry: Reducing barriers to business dynamism in Australia

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This submission responds to the Commission's terms of reference and its call for submissions, addressing four of the Commission's priority areas (the administrative and regulatory costs of starting a business, second the innovation ecosystem, capital markets, and human capital and management capability) together with the terms of reference's repeated references to corporate and personal insolvency. It makes five targeted recommendations. As per the terms of reference, none of the recommendations rely on changes to tax, workplace relations or merger frameworks, and none focusses on capital gains tax. Each is framed around a specific, well-identified market failure, an additionality/marginality question, and a pre-committed evaluation and sunset, so that future governments have the potential to weigh each against a cost–benefit standard.

1. Executive summary

At least in part, Australia's productivity problem is a business-dynamism problem. Firm entry and exit rates have fallen since the mid-2000s; labour and capital now flow to more productive firms more slowly (with increased firm concentration); and new technologies and management practices diffuse too weakly across the business base. The evidence is increasingly clear that it is **young** firms (in contrast to **small** firms) that drive net growth, and that Australia's binding constraints sit at four points in the firm lifecycle: the fixed cost of entering and scaling; the availability of risk capital for intangible-rich firms with high spillover potential; the demand-side "valley of death" between a working prototype and a first paying customer; and the cost and stigma of exit (considered in the broader context of Australia's cultural environment).

The five recommendations below are further described in the remainder of this document, along with evidence and arguments in their support:

Recommendation	Market failure	Area
1. Re-establish and scale an SBIR-style challenge-procurement program ("BRII 2.0"), with buyer-side risk held centrally and a credible first-customer pathway	Information asymmetry, buyer career-risk asymmetry, and knowledge spillovers cause government to under-buy from innovators	Innovation ecosystem
2. A partial loan guarantee for intangible-rich young firms, plus recycled co-investment, built on guarantees and prudential settings (not tax)	Credit rationing under asymmetric information; over-reliance on residential-property collateral	Capital markets
3. Increase consistency between corporate and personal insolvency for small-business owners, widen and streamline small business restructuring, and adjust insolvent-trading exposure	Costly, stigmatised, asymmetric exit deters efficient risk-taking (reflecting social benefits and costs, rather than just private financial and reputational ones) and slows reallocation	Insolvency, business exit (terms of reference)
4. Complete occupational-licensing mutual recognition and introduce once-only ("tell-us-once") digital business registration	Fixed compliance costs that scale poorly for young firms; jurisdictional coordination failure	Business entry
5. Reorient firm support toward technology diffusion and young high-growth firms, targeted by growth potential rather than size	The under-provision of adoption because knowledge and management practice are only partly appropriable	Human capital; innovation spillovers

We feel most strongly about our first recommendation: the causal evidence that early-stage government contracts crowd in private capital is internationally strong and well-established, and Australia already has a vehicle which could fill this role. Access to capital (Recommendation 2) is material, but the binding friction is the collateral channel and the non-financeability of intangibles (a textbook theoretical credit-rationing problem best addressed through partial guarantees and co-investment rather than tax concessions or any more direct and costly interventions in a fiscally constrained environment). Recommendations 3 to 5 are low hanging fruit ideas, several of which are low-cost, fast wins that the Commission (and others) have in many cases touched on in previous work.

2. The problem: Australia's business dynamism has declined

Dynamism has fallen, and it is bad for Australian productivity. Business entry and exit rates in Australia declined from the mid-2000s and have not recovered, with much recent entry concentrated in non-employing sole traders rather than employing firms[1]. The OECD's 2026 survey finds Australia has slipped "to the middle of the pack" on product-market-regulation indicators, having been an OECD leader in the early 2000s, and identifies administrative and regulatory burdens and fragmented state-level licensing as drivers of that relative decline[2]. Treasury estimates that slower labour reallocation to more productive firms accounts for around one-quarter of the slowdown in productivity growth, and that the slowing was worse in industries where competitive pressures declined[3]. The Reserve Bank documents a parallel worsening of capital misallocation[4].

Young firms, not small firms, are a major source of innovation. Using ABS BLADE microdata, the e61 Institute finds that young firms contribute around six percentage points to annual headcount growth, while small **old** firms detract from it by about four-and-a-half percentage points; young firms (aged five years or less) account for roughly three-fifths of gross job creation and around half of value-added growth[5]. This suggests that support allocated by firm size is mistargeted, because it subsidises many stable, low-growth incumbents (e.g. rural florist, urban pharmacy); support should instead be oriented to firm **age and growth potential**.

A key mechanism of broader social benefit and economic gains is diffusion, not just invention. For a technology-importing economy (which Australia is and is likely to remain, according to almost every measure), the larger aggregate gains come from adopting and adapting existing technologies and better management practices across the mass of firms, not only from new-to-the-world invention. The OECD's frontier-versus-laggard work shows global frontier firms sustained strong productivity growth while laggards stagnated, pointing to a diffusion failure[6]; the Commission's five-year productivity review made the same point in its "innovation for the 98 per cent" analysis[7].

Information failures are making it hardest for those firms that potentially lead to productivity benefits through spillovers for the firms that drive dynamism to get access to growth and risk capital. Under asymmetric information, lenders ration credit rather than clear the market on price, because higher interest rates worsen the pool of borrowers[8]. Further, when so much capital is sourced from overseas, and lending firms have only so much staff and time to consider (or even discover) investment opportunities, the transaction/discovery costs alone limit some Australian firms' access to global capital markets (especially when the spillover benefits of such expansion aren't solely private benefits accruing to the founders themselves, but broader social spillover benefits accruing to other firms, consumers, and tax revenues). In Australia this operates through the collateral channel: around 95 per cent of small-business lending is secured, compared with about 70 per cent for large business, and just under half of small-business credit is secured against residential property[9]. As the RBA has observed, almost all SME lending is secured, and residential property has an outsized role in collateralising the loans of small businesses, so intangible-rich young firms (and founders without housing equity, typically younger and those from less-advantaged backgrounds) are locked out of straightforward debt finance[10]. Venture capital is thin by international standards, at roughly 0.15 per cent of GDP against about 0.4 per cent in the United States and Israel[11].

The 5 recommendations in the next section go to addressing some of these issues.

3. Recommendations

3.1 Recommendation 1 — Re-establish and scale an SBIR-style procurement program ("BRII 2.0")

Market failure: Government has the potential to be a first customer for innovative young firms, but systematically under-buys from them. Three frictions operate: buyers cannot verify unproven suppliers and so default to incumbents with track records (information asymmetry); a procurement officer bears the downside of a failed novel purchase but captures none of the upside, so the privately optimal choice is the safe incumbent even where the socially optimal choice is the innovator (buyer-side career-risk asymmetry); and the knowledge and certification generated by a first contract benefit the wider market (positive spillovers). Australia's panel-based procurement compounds the problem with access difficulties. The scale of the gap is visible in the Commonwealth's data: in 2024–25, small and medium enterprises won 52 per cent of contracts by number but only 21 per cent by value of procurements below $1 billion (below the 25 per cent value target in the Commonwealth Procurement Rules)[12].

Recommendation: Re-establish and materially scale the Business Research and Innovation Initiative (BRII) as a standing program, redesigned and modelled on the United States SBIR and United Kingdom SBRI models, with four features:

- a central innovation-procurement fund that pays for feasibility (Stage 1, up to roughly $100,000) and proof-of-concept (Stage 2, up to roughly $1 million) contracts, so the cost and risk sit centrally rather than on a line agency's budget (neutralising the career-risk asymmetry)
- a credible Stage 3 "first-customer" commercial pathway for successful prototypes, which independent United Kingdom review identified as the missing link in that country's scheme[13]
- firm-retained intellectual property and a light-touch, standardised application to lower fixed bid costs (government implicit equity is covered by taxation)
- outcome-specified, not solution-specified, challenges, so the state defines the problem and leaves room for innovation.

Australia could aim up to something like the US SBIR scale, but agencies should only fund projects that pass a value-for-money test. The program should not become a guaranteed spending pool, a quota, or a rule that a fixed share of procurement must got o small business no matter what.

Evidence: Using a regression-discontinuity design on ranked United States Department of Energy SBIR applicants, Howell finds that an early-stage award approximately doubles the probability that a firm subsequently receives venture capital (from about 10 to about 19 per cent), with large positive effects on patenting and revenue, and that these effects are stronger for more financially constrained firms; notably, larger later-stage grants show no measurable effect, which argues for concentrating public money at the earliest, most information-constrained stage[14]. Australia's own BRII has a favourable independent evaluation, which found it met its objectives, projected a positive benefit–cost ratio (about $1.64 returmed per dollar invested in its first round), and recommended scale-up[15]. The United States program disbursed roughly US$4.7 billion across SBIR and STTR in 2022[16].

Expected effect and additionality: Higher survival, follow-on private investment and revenue for participating young firms; better public-service outcomes; and a demonstration effect that de-risks these firms for private capital (attacking the same financing friction as Recommendation 2 from the demand side). The additionality question is directly testable (see below).

Risks and safeguards: The main risks are "picking winners" and capture by professional grant-seekers (rent seekers). Mitigate with staged competitive selection, independent expert assessment, a hard sunset and renewal tied to evaluation, and published cost–benefit metrics. Decision thresholds could be used, if a scaled pilot fails to raise follow-on private investment for participants relative to ranked near-miss applicants (the Howell test), it should not be scaled further.

3.2 Recommendation 2 — Improve access to capital through a partial loan guarantee and recycled co-investment (no tax concession)

Market failure: The credit-rationing result of Stiglitz and Weiss applies directly: because higher interest rates worsen the borrower pool through adverse selection and adverse incentives, lenders ration credit rather than price it, leaving capable borrowers unfunded even when they would pay more[8]. In Australia this is harshest for young, intangible-intensive firms, because roughly 95 per cent of small-business lending is secured and about half is secured against residential property[9, 10]. The result is a financing "valley of death" between research and commercial revenue, in an equity market that remains thin[11].

Recommendation: Two complementary, non-tax instruments:

- **A partial (not full) loan guarantee** for cash-flow-based and intangible-backed lending to young firms, modelled on the United Kingdom's British Business Bank guarantee schemes, under which government guarantees a capped share (of the order of 70-80 per cent) of eligible loans while the lender retains material risk to preserve screening incentives, subject to an aggregate cap, risk-based pricing, an additionality test at design, and a legislated sunset-and-evaluation[17]
- **recycled co-investment** through an expanded Australian Business Growth Fund and/or a successor to the Innovation Investment Fund, using the latter's asymmetric-returns design — under which government supplied most of the capital but capped its share of the upside at around 10 per cent — to crowd in private capital rather than replace it[18,19].

Because the terms of reference exclude tax as a focus, this recommendation deliberately avoids tax-concessions and instead works through guarantees, co-investment and prudential settings. For example the concessional capital treatment APRA already applies to authorised deposit-taking institutions' investments in the Australian Business Growth Fund[20].

The design of the Your Future, Your Super performance test could also be a model, as it discourages superannuation funds from allocating to unlisted growth assets. Treasury's 2026 consultation on strengthening that test proposes an "emerging" asset class benchmarked to CPI plus a margin to accommodate venture capital and similar assets[21]. The Commission could usefully endorse addressing this barrier in principle, while leaving the benchmark methodology to Treasury's process.

Evidence: The collateral channel and credit rationing are well documented for Australia[9, 10]. The co-investment evidence should be presented honestly as mixed: Cumming found Innovation Investment Fund backed funds were markedly more likely to finance seed-stage firms[18], and the independent Murray–Cowling evaluation found supported firms were more likely to be early-stage and to secure follow-on finance and successful exits, but also more likely to fail, and concluded the funds earned modest returns which would not by themselves attract long-term private investment interest[19].

Commissioned research for the Australian Business Growth Fund identifies an equity-funding gap of around $40 billion for established small and medium firms[20]. This evidence supports a targeted, capped, rigorously evaluated intervention, not an open-ended subsidy, and not a claim that any single vehicle will "fix" venture capital.

Expected effect and marginality: Modestly higher debt availability for intangible-intensive young firms; more early-stage equity where private capital is genuinely absent; and reduced reliance on the founder's home as collateral (and therefore less dependence on privileged founders, and potentially older founders), which itself currently dampens risk-taking.

Risks and safeguards: Moral hazard and contingent-liability exposure on guarantees; crowding out of private lenders and investors; and deadweight from funding deals that would have proceeded anyway. Safeguards: partial guarantees with lender co-risk, hard caps, risk-based pricing, additionality tests, and independent evaluation with a pre-committed sunset.

3.3 Recommendation 3 — Entrepreneur-friendly insolvency: harmonise, streamline restructuring, and recalibrate insolvent-trading exposure

Market failure. Efficient exit is half of dynamism. Exiting firms are, on average, around 20 per cent less productive than their industry even five years before exit, so their orderly departure reallocates resources to better firms[22]. But Australia's settings deter risk-taking and slow that reallocation. Insolvent-trading liability attaches earlier than in comparable jurisdictions (the United States has no equivalent provision at all) which can push directors toward premature administration and raises the ex-ante cost of entrepreneurship. Small-business owners must routinely navigate corporate insolvency (under the Corporations Act, regulated by ASIC) and personal insolvency (under the Bankruptcy Act, regulated by AFSA) as two separate systems, because personal guarantees over the family home and supplier accounts tie the two together.

Recommendation:

- Harmonise corporate and personal insolvency where a small-business owner must navigate both, through a single, coordinated process, consistent with the direction of the Parliamentary Joint Committee's 2023 inquiry[23] and the UNCITRAL Legislative Guide on Insolvency Law for Micro- and Small Enterprises, which recommends simpler, faster, more affordable procedures for such firms[24].
- Widen and streamline the Small Business Restructuring pathway (Part 5.3B of the Corporations Act, available since 1 January 2021): raise the eligibility threshold above its current $1 million in liabilities, simplify practitioner processes and documentation, and subsidise access to advice for eligible firms. Demand is demonstrated: ASIC recorded 3,388 restructuring appointments between July 2022 and December 2024, up from just 82 in the scheme's first eighteen months, and now around a fifth of director-initiated appointments, with the large majority of plans put to creditors approved[25]. This latent demand has grown alongside a sharp rise in insolvencies, with 14 722 companies entering external administration for the first time in 2024–25, up 33 per cent[26].
- Recalibrate the insolvent-trading prohibition and the safe harbour (in force since September 2017 and independently reviewed in 2021) to give directors clearer, cheaper protection for genuine attempts[27].
- Preserve and sharpen anti-phoenixing integrity. Founder-friendly failure rules only work, economically and politically, if integrity is credible; relief should be targeted at honest failure,

employee-entitlement and tax-lodgement preconditions retained, and any liberalisation paired with the phoenixing-integrity measures the Commission is already reviewing under its terms of reference.

Expected effect and additionality: Faster and cheaper exit and restructuring; more viable firms preserved; lower ex-ante deterrence to founding; and quicker redeployment of labour and capital from firms that cannot continue.

Risks and safeguards: The principal risk is weakening creditor protection or enabling misconduct. Safeguards: retain the integrity preconditions, distinguish viable restructures from misconduct cases through better triage, and note the Australian Taxation Office's role as the dominant creditor and effective gatekeeper, designing eligibility and timing accordingly.

3.4 Recommendation 4 — Cut the fixed cost of entry and scale: complete occupational-licensing mutual recognition and introduce once-only registration

Market failure: Regulatory compliance has large fixed costs that scale poorly for young and small firms, and jurisdictional fragmentation is a coordination failure that raises the cost of entering and expanding. RBA research finds that stricter occupational entry regulation is associated with lower business entry and exit and a slower flow of workers to more productive firms[28]. Automatic Mutual Recognition, which lets a licence-holder in one state work in another, commenced in 2021 but carves out many occupations which blunts its gains[29], especially when many regulated professions (such as those in engineering, and medicine) are associated with the startup ecosystem.

Recommendation:

- Require states and territories to justify or sunset their Automatic Mutual Recognition exemptions against a transparent net-benefit test, moving toward single national licences for priority trades
- Introduce once-only ("tell-us-once") digital business registration, so a firm supplies core information to government once and it flows to all relevant agencies, building directly on the administrative burdens the Commission has flagged around obtaining an ABN and setting up PAYG withholding
- Standardise and digitise recurring complience and reporting obligations for young firms.

Evidence: Economic modelling prepared for the Department of the Prime Minister and Cabinet estimated that Automatic Mutual Recognition could generate additional economic activity of around $2.4 billion over the decade to 2030, with more than 168 000 workers benefiting[30]. The Commission's own 2025 competition analysis estimated that improved labour mobility across licensed occupations could be worth up to around $846 million a year, with electrical and related trades alone worth $51–62 million, and that aligning licensing standards could be worth substantially more again[31]. The broader case is reinforced by the Commission's 2025 finding that cumulative regulatory burden is now large enough to warrant a target of reducing net regulatory costs by $10 billion by 2030[32].

Expected effect and additionality: Lower entry and expansion costs, better geographic allocation of labour, and faster scaling of young firms across state lines.

Risks and safeguards. Some licensing rests on genuine health, safety or consumer-protection rationales. The safeguard is a structured, evidence-based exemption test rather than blanket removal, retaining outcome-based standards where risk is material.

3.5 Recommendation 5 — Adjust firm support toward diffusion and young high-growth firms

Market failure: Australia is predominantly a technology adopter and net importer, yet much firm support is skewed toward size rather than age or growth, and adoption of proven technologies and management practices is under-provided because the associated knowledge is only partly appropriable (a diffusion externality distinct from the spillover case for invention subsidies).

Recommendation:

- Establish a technology-adoption and management-extension program for laggard firms. A modern equivalent of agricultural extension, delivering proven digital and management practices through accredited advisers, peer cohorts and small matched vouchers, targeted by growth potential rather than firm size, and delivered with a stronger evaluation standard than most business-advisory programs (including staged or randomised rollout linked to BLADE data and analysis)
- Reorient direct innovation grants toward young, high-growth firms, where the evidence indicates the largest return per public dollar
- On the in-scope regulatory side, further streamline Corporations Act relief for employee share schemes, so that cash-poor young firms can compete for talent, building on the 2022 reforms that lifted the unlisted-company offer cap to $30,000 a year[33, 34, 35].

Evidence: The frontier-versus-laggard literature and the management-practices literature together establish that diffusion of existing best practice, not only invention, drives aggregate productivity[6, 35]; the Commission's innovation for the 98 per cent analysis reached the same conclusion for the Australian firm base[7]; and the e61 evidence on young firms indicates where growth-oriented support is best directed[5].

Expected effect and additionality. Faster catch-up by laggard firms, better allocation of talent to young firms, and higher additionality per public dollar than untargeted, size-based support.

Risks and safeguards. Extension programs can become low-value if poorly delivered; guard against this with rigorous evaluation, private-sector delivery partners, and firm co-payment to screen for genuine demand. The Commission should note that the government's non-compete reforms (workplace relations) and any new research-and-development tax measures sit in domains the terms of reference exclude, and should be coordinated with, rather than duplicated by, the measures recommended here.

4. Implementation, evaluation and sequencing

Low-hanging fruit first. The insolvency and occupational-licensing reforms (Recommendations 3 and 4) are the lowest-cost and fastest to implement, and align with various past PC and Government work; they could be advanced as "do first." The procurement program and finance instruments (Recommendations 1 and 2) require budget and careful institutional design and should be staged through pilots with hard evaluation gates, precisely to avoid crowding out private capital or politically directed allocation.

Evaluate by default, using data Australia already has. Every measure in this package could be linked to BLADE-compatible identifiers (and often tax data), with an evaluation plan agreed before rollout. BLADE — the ABS Business Longitudinal Analysis Data Environment — links tax, trade, intellectual-property and survey data across the near-universe of Australian businesses and is well suited to identifying causal effects on survival, employment, innovation and productivity (we are fully aware the PC is aware of this, but just including the detail for completeness/other readers). Making "evaluate by default" a design rule would be a material institutional improvement over the stop-start, under-evaluated business-support programs common in advanced economies.

Define the thresholds clearly that will impact policy continuation/progression. For Recommendation 1, if a pilot does not raise follow-on private investment for participants relative to ranked near-miss applicants, it should not be scaled. For Recommendation 2, if a loan-guarantee pilot shows low additionality (a high share of loans that would have been made anyway, just with cheaper capital and therefore more private benefit at the expense of taxpayers) or default rates inconsistent with the fiscal cap, it could be wound back. For Recommendation 4, if removing a mutual-recognition exemption produces measurable/demonstrable safety harms, the targeted carve-out should be retained. Building these tests in at the design stage is the surest way to keep the package within the Commission's cost–benefit discipline.

Scope and capital gains tax. This submission has been deliberately confined to the regulatory, insolvency, procurement, prudential and expenditure levers within the terms of reference. It does not propose changes to tax, workplace relations or merger frameworks as its focus, and it does not use any capital gains tax mechanism (other than implicitly in any reference to tax-payer benefits of increased activity in the startup sector). The access-to-capital recommendation is built on guarantees, co-investment and prudential settings precisely because these target the credit-rationing and collateral frictions directly, without the distributional and revenue questions that tax concessions raise. However, this paper should not be taken to be an endorsement of any aspect (or recent, or past) changes to the capital gains tax system from a business dynamism (and startup, innovation) point of view.

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33. Treasury Laws Amendment (Cost of Living Support and Other Measures) Act 2022 (Cth) schedule 4, amending the Corporations Act 2001 (Cth) to insert the employee share scheme offer regime, including the unlisted-company cap; see Federal Register Legislation (https://www.legislation.gov.au/Details/C2022A00014)

34. Corporate Collective Investment Vehicle Framework and Oter Measures Act 2022 (Cth) schedule 10, removing cessation of employment as a deferred taxing point for employee share schemes; see Federal Register of Legislation (https://www.legislation.gov.au/C2022A00008/asmade/text)

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