Submission to the Productivity Commission Inquiry into Reducing Barriers to Business Dynamism in Australia

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Executive summary

This submission supports the Productivity Commission's objective of reducing unnecessary barriers to business entry, expansion, transfer, restructuring and exit. However, it argues that Australia's business-dynamism agenda should be examined explicitly through a service-productivity lens.

Services account for approximately 80 per cent of Australian production and employ nearly 90 per cent of Australian workers. Improving business dynamism without understanding how productivity is created in services risks designing reforms around an outdated model of the economy in which the individual firm is treated as a largely self-contained production unit. (Productivity Commission)

Service productivity is generated not only through the efficient conversion of labour and capital into outputs. It emerges through interactions among customers, employees, managers, suppliers, technologies, regulators and partner organisations. Increasingly, value is created through interconnected service networks rather than within the boundaries of a single firm.

Business dynamism should therefore be understood as the capacity of firms and service systems to:

- enter and contest markets;
- introduce new services and business models;
- adopt, integrate and diffuse technologies;
- acquire capabilities and scale successfully;
- form and reconfigure productive networks;
- transfer knowledge, data and organisational assets;
- restructure without unnecessarily destroying viable capabilities; and
- exit in an orderly way that protects customers, workers, suppliers and essential service continuity.

The Commission should distinguish productive dynamism from business churn. High entry and exit rates do not necessarily improve productivity where service quality deteriorates, critical knowledge is lost, customers experience discontinuity, or the costs of coordination are transferred to workers, households or other organisations.

This submission recommends that the Australian Government:

1. adopt an explicitly service-based and systems-oriented definition of productive business dynamism;
2. introduce service-sensitive regulatory stewardship and cumulative regulatory-burden assessments;
3. establish a national service-productivity and management-capability program;
4. improve access to finance for intangible assets and service innovation;
5. use procurement, demonstration projects and regulatory testbeds to create pathways for innovative service firms to scale;
6. improve data portability, interoperability and digital infrastructure;
7. design restructuring and insolvency processes to preserve viable service capabilities and continuity; and
8. establish a national measurement framework linking business dynamism to service productivity.

1. The importance of a service-productivity perspective

The Commission defines business dynamism as processes of change among firms, including business establishment, expansion, contraction, transfer of ownership and closure. Its inquiry appropriately recognises that unnecessary barriers to these processes can constrain innovation, productivity, investment and employment. (PC Government)

The underlying policy logic is that productive businesses should be able to enter and grow, while capital and labour should move from less productive businesses to organisations capable of using them more productively. This process remains important. International evidence links business dynamism to job creation, innovation, knowledge diffusion and productivity-enhancing resource reallocation. It also indicates that regulatory burdens, access to finance, skills, market structures and the efficiency of insolvency systems influence dynamism. (OECD)

However, conventional accounts of business dynamism tend to focus on:

- the number and age of firms;
- entry and exit rates;
- employment creation and destruction;
- firm survival;
- the reallocation of labour and capital;
- market concentration; and
- the growth of high-performing firms.

These indicators are useful, but they provide an incomplete account of productivity in a service-dominated economy.

In services, customers frequently contribute time, information, effort, data and other resources to service production. Employees exercise judgement and emotional, cognitive and relational capabilities. Suppliers and partner organisations provide complementary resources. Digital technologies connect these actors and increasingly determine whether information can move efficiently across organisational boundaries.

Productivity is consequently shaped by the aggregate of decisions and interactions among stakeholders. The productive unit is often a service value network, rather than an individual firm.

My research into Productivity for Service and Network based firms, the need to extend productivity analysis beyond the boundary of the firm was clearly established. It identifies integrative and collaborative efficiency as particularly important dimensions of productivity in service and network-based organisations.

A reform that lowers the cost of creating an individual business may therefore have limited productivity effects if the business cannot:

- access complementary service providers;
- integrate with established data or payment systems;
- secure appropriate employees;
- demonstrate compliance to prospective customers;
- participate in government or corporate procurement;
- navigate overlapping regulatory regimes;
- obtain finance for intangible investment; or
- establish the legitimacy and trust necessary to enter a service market.

The inquiry should examine these wider conditions.

2. Productive dynamism is more than firm entry and exit

The relationship between business dynamism and productivity is not automatic.

The Productivity Commission has previously cautioned against making changes in individual indicators such as entry, exit or concentration, which is the the objective of policy. Policy should instead address the underlying mechanisms that allow competition, innovation and productive resource reallocation to occur. (Productivity Commission)

This distinction is particularly important in service industries.

Firm entry can introduce innovation, competition and new service models. However, excessive fragmentation can also increase coordination costs, duplicate administrative systems and make end-to-end service delivery more difficult. This is evident in industries in which customers must navigate multiple providers, eligibility systems, technologies and funding arrangements.

Similarly, business exit may release resources for more productive uses. But poorly managed exits in health, aged care, disability, education, regional transport or other essential services can:

- disrupt continuity of care or support;
- destroy trusted relationships;
- increase customer search and transition costs;
- disperse specialised workforces;
- eliminate locally embedded knowledge;
- transfer costs to families or governments; and
- leave regional or vulnerable communities without an alternative provider.

The objective should therefore be productive and inclusive dynamism: renewal and reallocation that improve the capacity of the overall service system to create value.

This requires policy to consider not only whether firms can enter and exit, but also whether they can connect, learn, adapt, scale, transfer capabilities and contribute to reliable end-to-end service delivery.

3. Major barriers to service-sector dynamism

3.1 Cumulative and fragmented regulation

The Commission has identified regulatory and administrative burdens as a principal focus of the inquiry. These burdens include business registration, industry licensing and the requirements encountered when businesses enter or expand into new markets. (Productivity Commission)

For service firms, the problem is frequently not a single regulation. It is the cumulative effect of multiple requirements administered by different agencies, jurisdictions and professional bodies.

A technology-enabled health service, for example, may need to address clinical governance, professional registration, privacy, cybersecurity, data storage, medical-device regulation, consumer law, procurement requirements, insurance and state-based service-delivery rules. Each requirement may have a legitimate purpose, but the combined regulatory journey may be difficult to identify or navigate.

Australia's federal structure can compound these problems. The OECD has identified overlapping regulations across Australian jurisdictions and burdensome occupational licensing as impediments to competition and business dynamism. It has also highlighted continuing digital-connectivity disparities affecting regional and remote areas. (OECD)

Regulatory reform should therefore assess the end-to-end business journey, rather than reviewing each obligation separately.

3.2 Insufficient management and absorptive capability

The Commission's call for submissions identifies human capital and management capability as one of its five priority areas. (PC Government)

This is critical. Reducing regulatory barriers will not, by itself, enable firms to innovate or scale. Businesses must have the capability to:

- identify and evaluate new technologies;
- redesign services and workflows;
- manage data and cybersecurity;
- develop employees;
- form partnerships;
- measure performance;
- understand customer journeys;
- manage risk;
- obtain and deploy capital; and
- translate innovation into repeatable operating models.

International evidence indicates that policies supporting skills, innovation and firms' capacity to absorb technological change can strengthen business dynamism. (OECD)

Management capability should not be viewed merely as an internal business matter. It is part of Australia's national productivity infrastructure.

3.3 Finance systems that undervalue intangible assets

Service innovation frequently depends on assets such as:

- software;
- organisational knowledge;
- workforce capability;
- service designs;
- data;
- customer relationships;
- intellectual property;
- algorithms;
- brands; and
- network partnerships.

These assets may be strategically valuable but difficult to use as collateral. Consequently, service firms can face difficulties financing innovation and scale even when they possess a viable business model.

Capital-market reform should therefore consider the distinctive financing needs of knowledge-intensive, digitally enabled and network-based service firms. Access to finance should encompass not only start-up capital, but also the patient growth capital required to move from a successful pilot to a sustainable and scalable service.

3.4 Barriers to becoming an accepted supplier

Many innovative firms can establish a business but cannot secure an initial market.

Government and large-organisational procurement processes may require:

- lengthy operating histories;
- substantial insurance coverage;
- audited financial records;
- demonstrated delivery at scale;
- complex tender documentation; and
- compliance certifications that are costly for small firms.

These requirements protect purchasers but can also reinforce incumbent advantage. Innovative firms encounter a circular problem: they cannot demonstrate delivery at scale without a major customer, but they cannot obtain a major customer without demonstrating delivery at scale.

Procurement reform is therefore directly relevant to business dynamism.

3.5 Limited interoperability and data portability

A new service provider's ability to compete increasingly depends on access to data and its capacity to connect with established technology systems.

A lack of interoperability can function as a non-price barrier to entry. It can lock customers and organisations into incumbent providers, increase switching costs and prevent new firms from contributing specialised components to a wider service system.

Common standards, secure data portability, application programming interfaces and trusted digital identity arrangements can reduce these barriers while maintaining appropriate privacy and security safeguards.

4. Recommendations

Recommendation 1: Adopt a service-based definition of productive business dynamism

The Commission should define productive business dynamism as:

The capacity of firms and interconnected service systems to form, innovate, expand, reconfigure, transfer capabilities and reconfigure or exit in ways that improve productivity, competition, service quality and community wellbeing.

This definition would retain the importance of entry, growth, reconfiguration or exit while recognising that service productivity is relational and networked.

The Commission should assess whether reforms improve:

- firm-level productive efficiency;
- coordination across organisations;
- knowledge and technology diffusion;
- customer outcomes;
- workforce capability;
- service continuity; and
- the overall capacity of the service system.

Recommendation 2: Introduce service-sensitive regulatory stewardship

Regulatory stewardship should require policymakers and regulators to manage regulation as an interconnected system, balancing the achievement of regulatory objectives with innovation, competition and growth. The Productivity Commission has already advocated a stronger stewardship approach in which regulatory agencies actively consider these trade-offs. (Productivity Commission)

For service industries, regulatory stewardship should include:

1. mapping the complete regulatory journey for representative businesses;
2. identifying duplication across agencies and jurisdictions;
3. assessing cumulative compliance costs;
4. testing whether requirements disproportionately affect new and small firms;
5. introducing once-only provision of common business information;
6. establishing clear regulatory pathways for innovative or hybrid services;
7. recognising trusted standards and equivalent approvals where appropriate; and
8. measuring the time and administrative effort needed to obtain approval.

Priority mapping exercises should be undertaken in sectors with high community value and complex regulation, including digital health, aged care, disability services, housing, professional services, tourism and regional transport.

Recommendation 3: Establish a National Service Productivity Capability Program

The Australian Government should establish a capability-building program for small and medium service enterprises.

The program should integrate:

- service design;

- customer journey mapping;
- service blueprinting;
- process improvement;
- digital and data capability;
- technology adoption;
- business-model innovation;
- systems thinking;
- workforce development;
- network and partnership management; and
- productivity measurement.

Delivery could occur through universities, industry associations, business-excellence organisations and regional economic-development bodies.

Existing organisational excellence assets, including the Australian Business Excellence Framework, could provide a structured basis for diagnosing organisational capability and supporting continuous improvement.

Government support should prioritise capability transfer rather than isolated consultancy. Participating firms should develop internal capability to continue improving after the funded intervention concludes.

Recommendation 4: Improve finance for intangible and service-system investment

The Commission should recommend further investigation of financing barriers affecting service firms whose principal assets are intangible.

Potential measures include:

- improved guidance for financial institutions on assessing intangible assets;
- co-investment or loan-guarantee mechanisms for service innovation;
- patient growth-capital instruments;
- support for commercialisation and service-model validation;
- recognition of training, software, service design and data infrastructure as productive investments; and
- financing for collaborative projects involving multiple small service providers.

Support should be designed to avoid permanently subsidising uncompetitive firms. Its purpose should be to address information, coordination and collateral failures that inhibit otherwise viable service innovations.

Recommendation 5: Use procurement and testbeds to create pathways to scale

Governments should treat procurement as both a purchasing mechanism and a market-shaping instrument.

Recommended reforms include:

- proportionate tender requirements;
- simplified procurement pathways for smaller contracts;
- challenge-based procurement;
- pre-commercial procurement;
- paid demonstration projects;
- staged contracts that increase with demonstrated performance;
- consortium bidding arrangements for small providers; and
- publication of interoperable procurement and performance data.

Regulatory testbeds and sandboxes should allow firms to trial innovative services under controlled conditions. These arrangements should include clear entry criteria, consumer safeguards, evaluation requirements and a pathway from successful trial to broader market adoption.

Recommendation 6: Strengthen interoperability and data portability

The Australian Government should accelerate the development and adoption of interoperable standards in service industries.

Priority areas include:

- secure data portability;
- common data definitions;
- open and documented interfaces;
- digital identity;
- consent management;
- cybersecurity assurance; and
- mechanisms that allow customers to transfer their information between providers.

Interoperability should be treated as competition and productivity infrastructure. It reduces switching costs, facilitates specialist entry and allows new service configurations to emerge without requiring each firm to recreate the entire delivery system.

Recommendation 7: Preserve service capability during restructuring and exit

Insolvency and restructuring processes should recognise that the value of a service firm often resides in relational and intangible capital.

This includes:

- employee knowledge;
- customer relationships;
- supplier networks;
- service records;
- licences and accreditations;
- data;
- organisational routines; and
- trust within a community.

Where a service provider is viable but experiencing financial distress, restructuring mechanisms should support early intervention and the preservation of these capabilities.

Where exit is unavoidable, arrangements should facilitate:

- orderly customer transition;
- secure transfer of records and data;
- continuity of essential services;
- employee redeployment;
- transfer of viable contracts and intellectual property; and
- retention of locally important capabilities.

These measures should not protect persistently inefficient businesses. They should prevent unnecessary destruction of productive service capacity during business restructuring or exit.

Recommendation 8: Establish a service-productivity and business-dynamism measurement framework

The Commission should recommend the creation of a national measurement framework linking business dynamism to service productivity.

Traditional indicators should continue to include:

- firm entry and exit;
- firm age;
- survival;
- high-growth firms;
- employment reallocation;
- productivity dispersion;

- business transfer; and
- investment.

These should be supplemented by service-sensitive indicators such as:

- time required to establish and obtain approval for a service;
- time from pilot to commercial scale;
- customer effort and administrative burden;
- workforce capability and employee turnover;
- technology adoption and diffusion;
- data interoperability;
- service quality and continuity;
- coordination and rework across organisations;
- procurement access;
- intangible investment;
- regional service availability;
- network resilience; and
- integrative and collaborative efficiency.

Longitudinal linked data should be used where possible to examine which combinations of regulatory settings, management capabilities, financing arrangements and network characteristics enable service firms to scale productively.

5. Implementation principles

Reform should be guided by five principles.

5.1 Focus on system outcomes

Regulations should be evaluated against their combined effects on productivity, innovation, competition, service quality and community wellbeing.

5.2 Apply proportionality

The compliance pathway should reflect the level of risk, organisational size and maturity of the activity. Lower-risk pilots should not necessarily face the same initial requirements as established, large-scale services.

5.3 Protect public value

Business dynamism should not be pursued by shifting risks and costs to customers, employees, suppliers or communities. Consumer protection, safety, privacy and integrity remain essential.

5.4 Support learning and adaptation

Reforms should be introduced with clear evaluation mechanisms. Regulators and firms should be able to learn from implementation and revise arrangements where unnecessary barriers or unintended consequences emerge.

5.5 Recognise regional differences

A regulatory or financing requirement that is manageable in a major city may prevent market entry in a regional or remote community. Place-based pilots and regional impact assessments should be incorporated into reform design.

Conclusion

Australia's productivity challenge is increasingly a service-productivity challenge.

Business dynamism is essential to productivity, but its contribution cannot be assessed solely through business formation, growth and exit statistics. In a service economy, productivity depends on how effectively customers, employees, suppliers, technologies, regulators and partner organisations combine their resources to create value.

The policy objective should therefore be to build an economy in which innovative businesses can enter, capable businesses can scale, knowledge can diffuse, technologies can be integrated, productive networks can be formed and unsuccessful ventures can exit without unnecessarily destroying valuable service capabilities.

Reducing administrative and regulatory barriers is an important part of this task. It must be accompanied by investment in management capability, intangible assets, interoperability, procurement pathways and service-system coordination.

A service-productivity lens would strengthen the Commission's inquiry by connecting business dynamism to the actual structures through which most Australians work, consume services and experience economic and social value.

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