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<u>Productivity Commission Inquiry into Reducing Barriers to Business Dynamism</u>

Submission by Brian Young

This submission is made in my personal capacity and reflects my professional experience as an Australian manufacturer, exporter and business owner. The views expressed are my own and do not necessarily represent those of AES Environmental or any other organisation.

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Executive Summary

I welcome the opportunity to provide a submission to the Productivity Commission's inquiry into reducing barriers to business dynamism.

I have spent more than four decades establishing and operating Australian engineering and manufacturing businesses, including AES Environmental, competing in domestic and international markets.

This submission is made from the perspective of an Australian manufacturer, exporter and employer with more than four decades of experience establishing, growing and operating businesses in highly regulated and internationally competitive markets.

I support the technical reforms proposed by the Australian Restructuring Insolvency & Turnaround Association (ARITA) regarding insolvency law and restructuring. However, I believe one important issue has received insufficient attention.

Australia's greatest barrier to business dynamism is not simply regulation. It is the culture that surrounds business failure.

Governments encourage innovation, entrepreneurship and investment, yet business owners who experience genuine commercial failure are frequently subjected to financial, regulatory and social consequences that discourage future entrepreneurial activity.

An effective economy depends upon people willing to take commercial risks. Public policy should therefore distinguish clearly between honest business failure and deliberate misconduct, encourage business recovery wherever possible, and create an environment where experienced entrepreneurs are able to contribute again.

1. Business Dynamism Depends on Risk

Every successful business begins with someone prepared to accept uncertainty. Without entrepreneurs willing to invest their own capital, employ staff and develop new products, there is no economic growth.

- A high number of those businesses will inevitably fail therefore failure and learning from failure needs to be recognised as an inherent characteristic of entrepreneurship rather than evidence of incompetence or misconduct.
- Once financial distress becomes apparent, multiple stakeholders, including financiers, insolvency practitioners and creditors, begin pursuing their respective interests. The current framework can create incentives that do not always maximise the long-term value of the business or produce the best outcome for employees, unsecured creditors or the wider economy. Extending the insolvency process is a subtle method for increasing the fee charges while banks rarely care, as they already have more security from the owner than necessary and will start making arrangements to recover the outstanding debt, irrespective of the owners disposition or business insolvency outcome.
- In my experience the current system offers nothing constructive for the community and business.
- In my experience, the ATO's approach can be overly enforcement focused and, in some cases, may reduce opportunities for viable business recovery.
- Meanwhile there is no one to support the psychological and emotional aspects for the entrepreneur, the owner, business employees, and families facing immediate uncertainty. No one to go for raising concerns over the increased charges and fees imposed by banks or the time the insolvency process takes to complete.
- Once the insolvency process commences the owner receives a sentence likened to criminal conduct and it’s the insolvency sector that sets the tone drives the narrative based on the best deal for themselves.
- Australia can actually benefit when entrepreneurs are prepared to “ *give it another go*” after experiencing commercial failure.
- Some aspects of Australia's regulatory, banking and insolvency framework may unintentionally favour business closure over rehabilitation.

2. Honest Business Failure Must Be Distinguished from Misconduct

The insolvency system must deal firmly with:

- fraud
- illegal phoenix activity
- deliberate tax avoidance
- dishonesty
- breaches of directors' duties.

However, these behaviours should not be confused with businesses that fail because of changing markets, interest rates, supply chain disruption, customer insolvencies, broader economic conditions. In addition to an owners poor business understanding, for failing to understand fundamental cash flow, and entering into sometimes with no alternative un commercial profitable activities.

Honest commercial failure is fundamentally different from misconduct and Policy settings should recognise that distinction.

3. Australia Carries a Stigma Around Business Failure and almost all willhang out to dry the Owner

In my experience, Australia continues to attach significant public stigma to business failure. Directors frequently lose not only their businesses but also their homes, personal savings and professional reputation. Very few will come back from the negative stigma, which will discourage what becomes potentially more capable people from establishing new businesses, and going on to succeed. Almost everyone learns from their living experience, starting and running a business is no different and many business owners develop their greatest commercial judgement through periods of significant adversity.

Countries with strong entrepreneurial cultures will generally accept that commercial failure is often part of eventual success, and Australia should move towards that type of model.

4. Regulation Should Encourage Recovery

The objective of insolvency law should not simply be orderly liquidation. It should encourage:

- early intervention;
- restructuring where viable;
- preservation of employment;
- preservation of supplier relationships;
- maximising creditor returns.
- Business mentoring re-engineering/ turnaround
- Preservation of the business will support social cohesion
    - Families;
    - employees;
    - communities;
    - future entrepreneurial confidence.

Where businesses can realistically recover, regulatory settings should support that outcome.

5. Director Penalty Notices

Director Penalty Notices remain an important compliance mechanism, however, they should principally support genuine debt recovery rather than becoming an administrative process that discourages restructuring opportunities and remains as a forever burden. The ATO should have for example a 90-day limit to either enforce a DPN or it gets removed. The police are given a timeline for detaining people while the ATO can hold people to a debt until they die and then issue an un contested claim on the former directors, estate.

Earlier engagement between the ATO and distressed businesses may produce better outcomes for government, employees and creditors than allowing viable businesses to collapse unnecessarily. The ATO should focus on a constructive outcome a win/win rather than we'll close you up approach. The ATO should place less emphasis on the time an ATO agent spends with a client, and place more emphasis on constructive recovery. Taking a charge against the business assets for example costs nothing but offers some tangible security, rather than the pyramid debt that's based on additional fees and interest . That position retains no hope whatsoever of ever being realised within the current insolvency structure. There remains no practical point for the ATO to apply excessive interest rates on an existing distressed business debt. It's as if the ATO gets a significant resource benefit from the government with increased legislative action and resources if it can show a larger out of control debt to Treasury. There are aspects of Australia's financial and insolvency framework that can unintentionally create incentives for favouring liquidation over business rehabilitation. With every loss someone or something else will benefit.

Essentially from my experience any realised short term benefits generated through a business failure need to become balanced against the actual long term and terminal physical loss.

The objective should be recovery where recovery remains realistic. a mandatory pre-insolvency mediation process could include;

- business turnaround mentoring before formal insolvency;
- a review of DPN administration;
- greater support for restructuring rather than liquidation;
- simplified access to restructuring for Small and Medium sized Australian owned businesses.
- Any cost applied to a business restructure that delivers a benefit has to flow back first to Australian tax payer and community interests

6. Small Business Creates National Productivity

Small businesses remain Australia's largest source of innovation, employment and future growth. Reducing unnecessary bureaucracy affecting small business will improve productivity more quickly than many larger structural reforms.

Government policy should encourage more Australians to establish businesses rather than creating additional barriers to entry and recovery.

7. Learning from Failure

Many internationally recognised entrepreneurs experienced significant commercial failures before later success. Examples include Henry Ford, Walt Disney, Milton Hershey and Richard Branson. In addition, large corporations such as United Airlines and Johns Manville, and Donald Trump's casino and hotel companies, have successfully used Chapter 11 restructuring to continue operating. The businesses survive and continue contributing constructively.

The examples should not be viewed as celebrating failure, indeed they demonstrate that commercial setbacks do not necessarily determine a person's long-term economic contribution. It demonstrates a distressed business can with careful consideration once restored can not only contribute, but prosper and grow.

Every successful restructuring preserves more than a business, it preserves skills, supplier relationships, employment, tax revenue and community confidence.

8. Recommendations

I respectfully recommend that the Commission consider the following principles alongside technical insolvency reform:

1. Distinguish clearly between honest business failure and misconduct.
2. Encourage earlier restructuring rather than delayed insolvency.
3. Review Director Penalty Notice processes to ensure they encourage early engagement, restructuring and recovery where viable, while preserving appropriate enforcement against misconduct.
4. Reduce unnecessary administrative and regulatory burdens affecting small businesses.
5. Promote public understanding that responsible commercial risk-taking inevitably includes some business failures.
6. Ensure future reforms encourage entrepreneurship rather than unintentionally discouraging it.

Conclusion

Business dynamism depends upon people willing to innovate, employ others and invest their own resources despite uncertainty. No insolvency system, however well designed, can create a dynamic economy if capable entrepreneurs become unwilling to accept commercial risk because failure carries excessive financial, regulatory and social consequences.

Australia should continue strengthening its insolvency framework, but equally important is creating a culture that recognises resilience, recovery and responsible entrepreneurship as essential contributors to national productivity.

Australia has become very good at regulating business failure, but not nearly as good at facilitating business recovery.

I submit this document not to seek sympathy for business owners, but to highlight that building a successful business requires experience, and experience is often gained through adversity as much as through success. There is a need to learn multiple disciplines and invariably small and medium business owners, lack the professional resources and capabilities that can ward of early issues. In many instances decisions good/bad are made on the spot, and with more compliance digitisation demands placed by government. The chances of failure increase, Why should Australia not consider those having experienced the various aspects of the business needs model along with the demands be encouraged. To learn from prior mistakes and apply the successful points that leads to business and community prosperity.

Retaining and encouraging business owners by retaining experienced entrepreneurs in the economy is itself a productivity strategy.

Kindest Regards

Brian Young