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23 March 2022

Productivity Commission

via: productivity.inquiry@pc.gov.au

Dear Commissioners

Productivity Inquiry

Thank you for the opportunity to provide a submission to the Productivity Commission's second five yearly inquiry into Australia's productivity performance.

The Australian Institute of Company Directors' (**AICD**) mission is to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. The AICD's membership of more than 48,000 reflects the diversity of Australia's director community, comprised of directors and leaders of not-for-profits (**NFPs**), large and small businesses and the government sector.

The AICD welcomes a comprehensive assessment by the Productivity Commission of potential economic reform areas to enhance Australia's productivity performance. Our positions in this submission have been informed by engagement with AICD members over a number of years, including the results from the AICD's twice yearly Director Sentiment Index (**DSI**). Provided at **Appendix A** is a summary of DSI results from the period 2012 – 2021. The AICD would be pleased to provide the Productivity Commission with further detail on the DSI and is able to facilitate direct engagement with AICD members, if of interest.

Executive Summary

This submission focuses on policy areas that concern the governance of Australian organisations and the role of directors, including the obligations and regulatory expectations directors face.

While the AICD supports microeconomic reform in other key areas, such as taxation, innovation, education and infrastructure, we have limited our input at this point to issues that are directly relevant to the role of directors of organisations of all sizes across the Australian economy.

The Government has made progress in recent years in enacting reform in areas that are relevant to the role of directors and governance of Australian businesses. This includes insolvency law reform and enabling virtual Annual General Meetings (**AGMs**) and electronic communications. These reforms should, over time, result in cost and time savings for organisations, directors and shareholders.

Our view is that there is room for further governance focused policy changes to spur productivity through encouraging directors to lead organisations in a way that promotes innovation and appropriate risk taking. Our key points are as follows:

1. The AICD's DSI results reveal that Australian directors consider that a reduction in short-termism, in both government policy making and business decision making, is key to driving productivity gains. Australia's recovery from the COVID-19 pandemic represents a unique opportunity to move away from short termism through empowering Commonwealth and State/Territory governments to

embrace targeted long-term microeconomic reforms that will boost productivity through promoting innovation and business investment.

2. The AICD's recommendations are focused on areas that we consider have the potential to support a culture of dynamism and entrepreneurism at organisations of all sizes. We encourage the Productivity Commission to consider the following:

   a) the potential for targeted corporate governance reform focused on stimulating measured risk taking and investment, reflecting on the success of the insolvency Safe Harbour under 588GA of the Corporations Act (**the Safe Harbour)**;

   b) measures to promote effective government and maintain progress in reducing the regulatory complexity and burden faced by boards and businesses of all sizes, including the need for a national reform agenda to ensure coordinated policy making in emerging areas; and

   c) measures to harness the untapped productivity potential of small and medium sized enterprises (**SMEs**) and NFPs, including support schemes focused on management and digital skills and how to drive improvements in the visibility and governance of the NFP sector.

1. General comments

3. As reflected in the Productivity Commission's own research and the 2021 Intergenerational Report, Australia's productivity performance has slowed considerably since the mid-2000s and is now well below its historical average.[1] While this trend is broadly consistent with other developed nations it does indicate the significant challenge that Australia will face in materially growing living standards in the future, given the importance of productivity to income growth.

4. The AICD's key insight from extensive feedback from members, including via the DSI, is that there is frequently a risk averse culture at a board level in Australia that impedes innovation and a dynamic approach to investment. This culture has been predominantly driven by regulatory frameworks and obligations that incentivise directors to focus on meeting compliance requirements and expectations, including to reduce the threat of personal liability, at the expense of strategy.

5. The AICD agrees with the Productivity Commission that decisions affecting productivity are ultimately made by businesses and individuals, including directors as stewards of Australian organisations. However, our view, and the view of our members as expressed through the DSI, is that existing policy settings relevant to governance are hindering the ability of businesses to respond dynamically to a changing economic environment, including the adoption of world-leading technologies.

6. We also note that, unfortunately, limited progress has been made in implementing the recommendations from the first of the Productivity Commission's five-year productivity inquiries in 2017 (**Shifting the Dial**) and that there remains significant opportunity for policy reform to drive productivity gains in these areas.

7. The AICD recognises that recent Government microeconomic reforms have made important and welcome inroads in creating greater flexibility for directors and organisations. These reforms include changes to continuous disclosure laws, virtual AGMs, electronic documentation and the introduction of the insolvency Safe Harbour. As detailed below, the experience with the insolvency Safe Harbour

[1] The Treasury, 2021 Intergenerational Report, Chapter 4: Productivity, June 202.

provides an insightful case study of how better targeted obligations on directors can promote a more flexible and dynamic business approach.

2. Risk aversion at the board level

8. The AICD is strongly of the view that Australia needs to actively create an environment where directors that act with integrity and commitment are free to pursue and harness new opportunities, undertake business investment and create jobs without being overly focussed on personal liability. At the same time, settings should ensure that individuals who do the wrong thing are held accountable. This will occur when the legal framework reflects sound underlying policy principles, and is both capable of being complied with, and appropriately targeted.

9. The AICD considers that the current complex personal liability environment faced by directors in Australia is unbalanced and unnecessarily onerous with resulting negative unintended consequences, including on productivity. The complex thicket of obligations, across Commonwealth and state legislation, and the resulting risk of personal liability has incentivised a risk-averse compliance focus by directors of organisations of all sizes. This has widespread business and economic consequences through:

    a) A chilling effect on risk-taking and business investment, contributing to Australia's disappointing productivity and innovation performance;

    b) A skewed and costly focus by directors and boards on compliance and managing potential legal risks. The threat of personal liability drives a culture of documenting compliance with regulatory requirements at the cost of director time and attention on strategy and taking risks to innovate and drive the long-term strategic directions of organisations;

    c) A strong disincentive for skilled and talented individuals to seek directorship opportunities. This limits the potential for greater diversity of skills and backgrounds on boards, particularly of larger businesses; and

    d) A Directors' & Officers' insurance market that has been in crisis over recent times.

10. To independently assess Australia's director liability environment, in 2019 the AICD commissioned leading law firm Allens Linklaters to evaluate the frameworks for imposing criminal and civil liability on directors in Australia and comparative jurisdictions (being the United Kingdom, New Zealand, Canada, Hong Kong and the USA).[2] The findings of the analysis indicate that Australia's director liability environment is 'uniquely burdensome'. It is characterised by a proliferation of legislative provisions (across Federal and State and Territory legislation) that create potential personal civil and criminal liability risk for directors.

11. The business judgement rule in section 180(2) of the *Corporations Act 2001* (Cth) (the **Corporations Act**) is often characterised as the key protection or defence against director personal liability under the Corporations Act through limiting hindsight review by the courts of corporate decision-making. Importantly, separate analysis from Allens Linklaters found that Australia's business judgment rule provides less protection when compared with other comparable jurisdictions. This is partly because it attaches only to the duty of reasonable care, skill and diligence.[3]

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[2] Further information on the Allens research on director liability settings can be found here.

[3] Further information on the Allens research on the business judgement rule can be found here.

12. Notably, there is an increasing tendency to regulate corporate behaviour or emerging risks by imposing new forms of personal and criminal liability on directors and officers, without appreciation of the necessary distinction between the role of the board and the role of management. Non-executive directors (**NED**) have an oversight role and must monitor the company while respecting the day-to-day responsibilities of the executive team. The NED role is to bring an independent mind to decision-making and to engage in constructive challenge of management.

13. While NEDs can and should be held accountable for breaches of their core duties, they are not in a position to prevent all instances of corporate misconduct and cannot be made guarantors of corporate compliance through the imposition of personal liability. As Commissioner Hayne commented in the final report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, "the task of the board is overall superintendence of the company, not its day-to-day management."[4]

14. The Australian Law Reform Commission (**ALRC**) also recognised in its 2020 report on corporate criminal responsibility the role of the board as distinct from executive management, and the importance of targeting liability for corporate conduct.[5] The ALRC reflected on the complexity of existing personal liability provisions and the role of the Council of Australian Governments Principles for the Imposition of Personal Liability for Criminal Fault as a framework for guiding new or amended criminal liability provisions. The ALRC ultimately recommended that the Commonwealth should undertake a wide-ranging review of the effectiveness of individual accountability mechanisms for corporate misconduct within five years of the commencement of the Financial Accountability Regime (**FAR**).[6]

15. The AICD considers the timeframe for a holistic review into corporate accountability, as recommended by the ALRC, is too long. The passage and commencement of the FAR is now uncertain. Even assuming FAR commencement in late 2022, a five-year timeframe would mean no meaningful changes would be legislated until at the earliest the end of the decade.

AICD member feedback

16. Surveys of the AICD's members, including the DSI, have consistently demonstrated a link between the complex and compliance-focused regulatory environment, and risk-aversion in boardrooms.

17. The DSI results, covered in detail in **Appendix A**, provides key insight into how Australian directors consider the productivity challenge:

    a) Since 2012, low productivity growth has ranked as the most important economic challenge facing Australian business in three of our biannual surveys and the second most important challenge in a further four.

    b) Reducing short-termism has consistently been cited by directors as the most important factor for lifting national productivity. Recent results show that directors also think that a greater focus on fostering innovation, better standards of education and faster adoption of technology are other

[4] Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, page 400.

[5] ALRC, Final Report: Corporate Criminal Responsibility, April 2020, Chapter 9.

[6] Ibid, Recommendation 18.

leading candidates for boosting Australia's productivity performance, with improved outcomes between the Commonwealth and States/Territories rounding out the latest top five list.

c) The DSI has asked a regular question on the impact of 'red tape' on business productivity. According to respondents, corporate reporting requirements, workplace health and safety regulations and preparing/paying taxes are the items where the highest share of directors report a moderate or high impact on productivity.

18. Separately, the AICD's 2019 Innovation Study, conducted in partnership with the University of Sydney Business School, revealed that Australian boards are not prioritising innovation or disruption risks to the same extent as their international counterparts.[7] The AICD has responded to these findings through seeking to promote a culture of innovation in Australian boardrooms through the Digital Directors webinar series, the Directors on Digital podcast, the establishment of the Governance of Innovation and Technology Panel and a soon to be published Director Innovation Handbook.

19. We acknowledge the challenges in demonstrating a definitive causal link between the director liability environment and poor productivity outcomes, as well as the perceived self-interest in the private sector attempting to do so. However, data collected by the AICD does suggest the threat of personal liability results in a material chilling effect on innovation and measured risk taking.

Case Study: Insolvency Safe Harbour

20. In 2021, the Government conducted a review of the Safe Harbour, which was introduced in 2017. The AICD's consultation with members and experts on the Safe Harbour to inform engagement with the review panel strongly indicated that it has been a successful policy reform that has driven changes in director behaviour to focus on restructuring businesses.

21. The key messages from the joint AICD Business Council of Australia submission were[8]:

    - the Safe Harbour represents an important step forward in modernising Australia's insolvency laws. The reform has driven cultural change amongst directors to engage early with possible insolvency and take reasonable risks to facilitate the company's recovery instead of simply placing it into voluntary administration; and

    - the Safe Harbour is increasingly utilised by directors to achieve outcomes that are of far greater benefit to creditors, employees and shareholders than the alternative of appointing an administrator or liquidator; and

    - the low utilisation by SMEs does not represent structural weaknesses in the Safe Harbour.

22. Persuasive examples were shared with the AICD of how the Safe Harbour provides a degree of comfort to directors to actively seek to turn around struggling business in innovative and dynamic ways. While not all restructuring efforts were successful, there were cases where the Safe Harbour allowed for turnaround efforts that maintained employment and benefitted all stakeholders, including creditors. In the absence of the Safe Harbour there were businesses that would have been prematurely placed into administration with resulting detrimental economic and productivity outcomes, including the loss of employment.

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[7] Further information on the AICD's Innovation Study can be found here.

[8] Joint AICD BCA submission to the Insolvency Safe Harbour Review, October 2021, available here.

23. The AICD strongly considers the experience of the Safe Harbour reflects the potential for economic enhancing benefits that may result from a more measured approach personal liability.

24. The development and introduction of the Safe Harbour was prompted in part by a recommendation contained in the Productivity Commission's 2015 report on Business Set-up, Transfer and Closure.[9] The AICD encourages the Productivity Commission to assess whether this inquiry represents an opportunity to make the case for further corporate governance reform.

Recommendations

25. The AICD believes that effectiveness of the insolvency Safe Harbour indicates the potential for corporate governance reform focused on stimulating measured risk taking, investment and innovation. We recommend the Productivity Commission consider whether:

    a) a holistic review of the director liability environment across Commonwealth and State/Territory legislation, as was contemplated under the ALRC review, should be brought forward from the timeframe recommended by the ALRC; and

    b) consideration of whether modifications to the business judgement rule under the Corporations Act will promote innovation and dynamism at the board level.

26. We can share with the Productivity Commission in greater detail our thinking on what changes to existing director liability settings may look like in order to promote greater productivity.

3. Overlapping and complex obligations

27. The AICD supports a renewed focus by both the Commonwealth and State/Territory governments on resolving the current complexity in regulatory obligations faced by businesses and boards. Additionally, our strong view is that a coordinated policy response is needed to address emerging issues, rather than a piecemeal approach that risks exacerbating the existing complexity in regulatory obligations. Reducing the current regulatory burden on boards and businesses will deliver genuine productivity benefits, both in cost savings, but importantly also through enabling a greater focus on strategy and innovation.

28. The regulatory landscape has been a regular area of focus for the Productivity Commission over the past two decades, including in the *Shifting the Dial* report. The AICD would welcome a return of the annual review of regulatory burdens that were conducted over five years from 2007. Our view is that findings and recommendations contained in these reports have provided impetus for reform in some key areas. Crucially they also provide a stocktake of existing obligations and reveal the vast number of sector specific and general regulatory requirements that a business may face.

29. The DSI results and consistent feedback from AICD members indicate that meeting regulatory obligations consumes an increasing amount of director time and board consideration. The DSI trends, summarised at Appendix A, reveal that corporate reporting requirements, workplace health and safety regulations and taxation obligations are the regulatory obligations where the largest share of directors cite either a moderate or high impact on productivity.

30. Effectively designed, outcomes-focused regulatory frameworks can be productivity enhancing through assisting businesses adapt to changing economic conditions, address particular economic

[9] Productivity Commission Inquiry Report, Productivity Commission Inquiry Report, Recommendation 14.2, September 2015.

externalities and meet shifting community expectations. However, the AICD's view is that too often a piecemeal and uncoordinated approach is taken to introducing new regulatory obligations. This often takes the form of imposing new obligations and penalty regimes on businesses and boards as a mechanism to address emerging and complex risks.

Shifting the Dial

31. Disappointingly, limited progress has been made in implementing the recommendations from *Shifting the Dial* on the effectiveness of government. In particular, the AICD would welcome a renewed focus on a joint Commonwealth and State reform agenda where policy development is coordinated and monitored in the manner envisaged under Recommendation 6.1. Ideally such a reform agenda would contemplate key areas for regulation harmonisation.

32. As noted above, some progress is being made at addressing overlapping regulatory obligations via the Government's deregulation agenda. However, our experience in advocating for harmonisation of fundraising laws for the NFP sector has revealed how challenging and time consuming it can be obtaining agreement across States and the Commonwealth. A nationally agreed reform agenda would provide impetus to drive change in a timely manner, and a degree of visibility and accountability on progress of reform initiatives.

33. The AICD also strongly supports the Commonwealth, States and key regulators continuing to explore opportunities to embrace digital technologies ("RegTech") to assist business and individuals meet their regulatory obligations in an efficient manner. While there has been some progress in RegTech in certain areas, such as taxation and single touch payroll, our view is that there needs to be additional investment and commitment from government and key agencies, including regulators.

34. Just as businesses and individuals have been expected to invest in digital capability during the COVID-19 pandemic, the same expectation should hold for all governments. While identifying RegTech opportunities should not be a substitute for genuine harmonisation and reducing regulatory burden it does offer the potential to reduce the compliance costs that relate to meeting existing requirements.

Case Study: Cybersecurity and the need for a coordinated approach

35. Recent and proposed Commonwealth reforms focused on addressing cybersecurity risk demonstrate how an uncoordinated agenda may result in a piecemeal and inconsistent set of regulatory frameworks that does little to achieve the overarching policy objective.

36. The AICD supports measures to improve Australia's cyber resilience and recognises the increasing threat and sophistication presented by cyber criminals. However, we are concerned that the current policy approach to building cyber resilience is overly focused on compliance obligations and seeks to place responsibility for managing cyber risks solely on a business, and by extension directors of these businesses. There is a risk that this approach will divert attention from senior management and directors in actively responding to cybersecurity threats and building resilience and ultimately add to the existing regulatory burden with negative productivity results.

37. A reflection of the uncoordinated policy making in cybersecurity is reflected in the area of cyber breach reporting. The AICD is aware of the following current and proposed reporting or notification frameworks:

- cyber incident reporting under recent amendments to the *Security of Critical Infrastructure Act 2018* (Cth);
- proposed ransomware reporting applying to businesses with a turnover greater than $10 million per annum under the Government's Ransomware Action Plan;
- notification requirements applying to APRA regulated entities under *Prudential Standard CPS 234 Information Security*; and
- proposed changes to the Notifiable Data Breaches scheme being contemplated under the *Privacy Act 1988* (Cth) Review.

38. The example of cyber incident reporting, and cybersecurity reforms generally, reflects a tendency for governments and individual regulators to 'go it alone' to respond to an emerging risk. This approach to policy making is also observed in responding to climate risk and clean energy policy. Without coordination across government, organisations and boards risk being swamped by complex, inconsistent and duplicative obligations.

39. The AICD, in a number submissions over the past six months on cyber related reform proposals, has advocated for a cooperative and collaborative partnership between industry and government to build stronger cyber resilience.[10] The focus of government should be on building capability within industry, rather than a punitive compliance focused approach.

Recommendations

40. The AICD recommends the Productivity Commission assess progress against the effective government recommendations under *Shifting the Dial*. This assessment would include consideration of whether a new recommendation focused on a national reform agenda is required to spur greater coordination across government policy making and a renewed focus on harmonisation of regulatory obligations.

41. Government and regulators must continue to embrace digital technologies as a strategy to reduce compliance costs on businesses of all sizes. The AICD recommends the Productivity Commission assess where recommendations focused on stimulating RegTech developments is appropriate as a part of this inquiry.

4. SME and NFP support

42. The SME and NFP sectors are significant contributors to the Australian economy through employing millions of people and providing key goods and services to individuals and consumers. They also represent sectors that have not traditionally been a focus of productivity enhancing policy reform. Our view is that targeted policy interventions and Government support has the potential to drive material productivity improvements for both SMEs and NFPs.

43. The AICD encourages the Productivity Commission to assess whether the 'Help to Grow' scheme that has been implemented in the United Kingdom represents a model that may be appropriate for Australia. 'Help to Grow' is a program that is intended to assist SMEs grow and become more productive coming out of the COVID-19 pandemic. It covers two areas, Digital and Management, and provides support to SMEs (between 5 and 249 employees) on a subsidised basis. In digital it

[10] AICD submission on amendments to *Security of Critical Infrastructure Act 2018* (Cth), January 2022. Available here.

provides 50% discount on approved technology solutions up to a maximum of £5,000 while in management it provides access to management training and a business mentor with 90% of the cost covered by the government.[11]

44. While it is too early to assess the effectiveness of this program, the AICD considers a similar program or scheme covering both SMEs and NFPs would have significant potential in Australia. Feedback from AICD members, for instance during consultation on cyber reforms, is consistent that due to resourcing and time constrains many SMEs and NFPs struggle adapting to digital technology changes and building management capability. A scheme similar to 'Help to Grow' may go some way in addressing these gaps. Importantly, as it involves some cost contribution by the business it would attract organisations that are incentivised and committed to make use of the new skills or technology.

45. The 2010 Productivity Commission research report on the NFP sector 'Contribution of the Not-for-Profit Sector' (**NFP report**) is a benchmark study examining the role of the NFP sector in the Australian economy and society. As found by the report, the level of understanding among the wider community of the NFP sector's role and contribution to provision of key services is poor and deserves attention. This view continues to be consistent with AICD's engagement with members who sit on the boards of NFPs and/or involved in NFP governance and management. The NFP sector, while critical to provision of key goods and services across the Australian community, suffers from a lack of visibility and priority in Government in terms of genuine reform.

46. The AICD is supportive of current efforts to harmonise fundraising and registration requirements for NFPs across Australia, although progress in this area has been glacial. However, key recommendations from NFP report remain outstanding, including the establishment of a Centre for Community Service Effectiveness funded by the Commonwealth government.[12] Our view is that a central source of knowledge of NFP best practice, including governance best practice, is still needed and would make a significant contribution to the productivity of the sector.

47. The AICD also notes that visibility on the contribution of the NFP sector is poor with the Australian Bureau of Statistics ceasing regular publication of specific NFP statistics in 2013 with the Non-Profit Institutions Satellite Accounts. While the AICD has sought to provide sector wide insight and data on trends through the annual NFP Study there is a significant gap in comprehensive statistics and therefore understanding of the NFP sector.[13] Our view is that this lack of data and contributed to policy reform inertia. It has been 12 years since the Productivity Commission's NFP Study and we consider the NFP sector is due for a similar comprehensive analysis, including as a mechanism to identify potential productivity enhancements.

Recommendations

48. To drive productivity improvements across the key SME and NFP sectors, the AICD recommends the Productivity Commission explore:

    a) whether a digital and management support scheme similar to 'Help to Grow' would be appropriate in Australia; and

[11] Detail on Help to Grow can be found here.

[12] Productivity Commission Research Report, Contribution of the Not-for-Profit Sector, Recommendation 14.1, January 2010.

[13] More detail on the AICD's annual NFP study can be found here.

b) how to drive improvements in the visibility and best practice of the NFP sector, including whether it is time for a new comprehensive study of the NFP sector's contribution to Australia and opportunities for reform.

5. Next Steps

We hope our submission will be of assistance. If you would like to discuss the DSI survey and results further, please contact Mark Thirlwell, Chief Economist at mthirlwell@aicd.com.au or for any other aspect of the submission please contact Simon Mitchell, Senior Policy Adviser at smitchell@aicd.com.au.

Yours sincerely,

Louise Petschler GAICD
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Appendix A – Directors' views on Australia's productivity performance: Evidence from the Director Sentiment Index (2012 – 2021)

Summary

The AICD's Director Sentiment Index (**DSI**) provides a decade's worth of insights on the economic views of Australian directors, including their opinions on productivity-related matters. An analysis of the history of the DSI finds that:

1. Since 2021, low productivity growth has ranked as the most important economic challenge facing Australian business in three of our biannual surveys and the second most important challenge in a further four. However, in more recent surveys the relative ranking of productivity has tended to decline, with the latest results placing labour shortages, the pandemic, climate change and the health of the Australia-China relationship (as well as several other factors) above it.

2. Directors consider that a reduction in short-termism is the most important measure for lifting national productivity. Every time that the DSI has asked this particular question, a reduction in short-termism has been the highest ranked option. Recent results show that directors also think that a greater focus on fostering innovation, better standards of education and faster adoption of technology are other leading candidates for boosting Australia's productivity performance, with improved outcomes between the Commonwealth and States/Territories rounding out the latest top five list. While still seen as important, broad-based tax reform and increased infrastructure spending have slipped down the rankings of productivity-enhancing measures.

3. While productivity growth has ranked as a top five short-term policy priority across the history of DSI surveys with just one exception (in H1:2020 at the onset of the pandemic), it has again slipped down the rankings in recent years. In the latest DSI, productivity growth was ranked as the fifth most important short-term policy challenge for the government, behind climate change, skills shortages, energy policy and taxation reform. Interestingly, according to the DSI, directors are more inclined to see productivity growth as a relatively more pressing short-term challenge (defined as over the next three years) than a long-term one (defined as the next 10 to 20 years).

4. The DSI has also asked a regular question on the impact of 'red tape' on business productivity. According to respondents, corporate reporting requirements, workplace health and safety regulations and preparing/paying taxes are the items where the highest share of directors report a moderate or high impact on productivity.

A quick introduction to the DSI

The DSI is to our biannual survey of directors and is a composite indicator of director sentiment that is constructed from a regular subset of the questions posed to respondents. The AICD has been conducting the DSI since 2011, with the most recent survey implemented in the second half of 2021.

DSI participants comprise AICD members with current directorships. The sample size varies across surveys but over the four most recent DSIs the average sample size has exceeded 1,600 respondents.

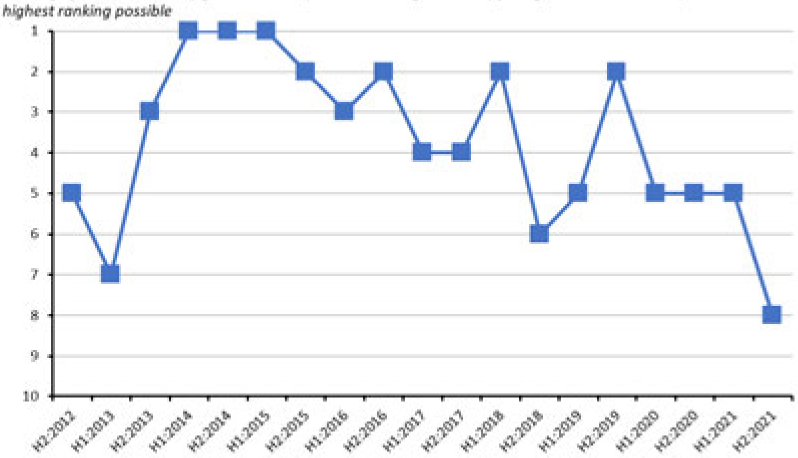
The DSI results for the second half of 2021 are available here.

Productivity as an economic challenge

Since H2:2012, the DSI has asked respondents where ‘low productivity growth’ ranks in their assessment of the main economic challenges facing Australian business.

Productivity growth as a main economic challenge currently facing business

Ranking of 'low productivity growth' as a top three challenge currently facing Australian business, with one the highest ranking possible



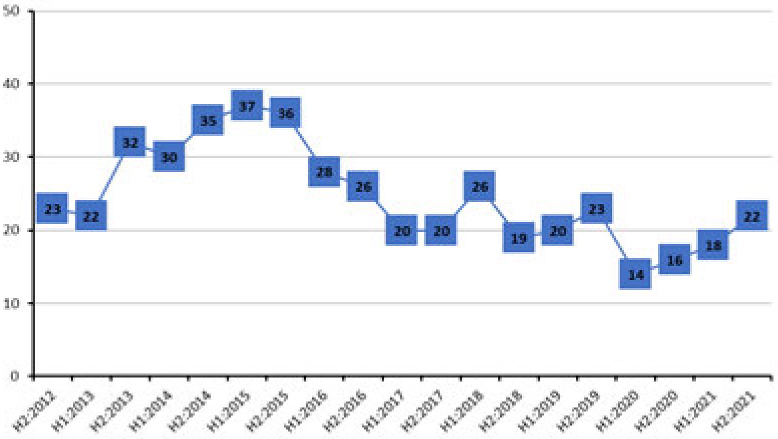
Source: AICD Director Sentiment Index (DSI), past issues. Q. *In your opinion, what are the three main economic challenges currently facing Australian business? (Select three).* Question first asked in DSI 2012 H2. Description changed from 'productivity growth' to 'low productivity growth' from DSI 2013 H1.

When the survey first posed this question, low productivity growth was seen as the (joint) fifth most pressing challenge, behind global economic uncertainty, the level of the Australian dollar, low consumer confidence and industrial relations, and tied with a minority federal government. Since then, low productivity growth has ranked as the most important economic challenge in three of our surveys (between H1:2014 and H1:2015) and second in a further four (H2:2015, H2:2016, H1:2018, and H2:2019).

In more recent surveys, the ranking of productivity growth has tended to fall, dropping to a series low of eighth place in the most recent survey (H2:2021). Labour shortages, COVID-19, climate change, the health of the Australia-China relationship, global economic uncertainty, regulatory requirements or ‘red tape’, and energy policy were all ranked by directors as more important.

Productivity growth as a main economic challenge currently facing business

Per cent of respondents selecting 'low productivity growth' as a top three challenge currently facing Australian business



Source: AICD Director Sentiment Index (DSI), past issues. Q. *In your opinion, what are the three main economic challenges currently facing Australian business? (Select three).* Question first asked in DSI 2012 H2. Description changed from 'productivity growth' to 'low productivity growth' from DSI 2013 H1.

The share of respondents identifying low productivity growth as a top three current economic challenge has fluctuated between a low of 14 per cent (in H1:2020, when the survey was dominated by the impact of the pandemic) and a high of 37 per cent (in H1:2015). In the most recent DSI, 22 per cent of respondents nominated low productivity growth as one of the top three economic challenges.

Productivity as a Commonwealth policy priority

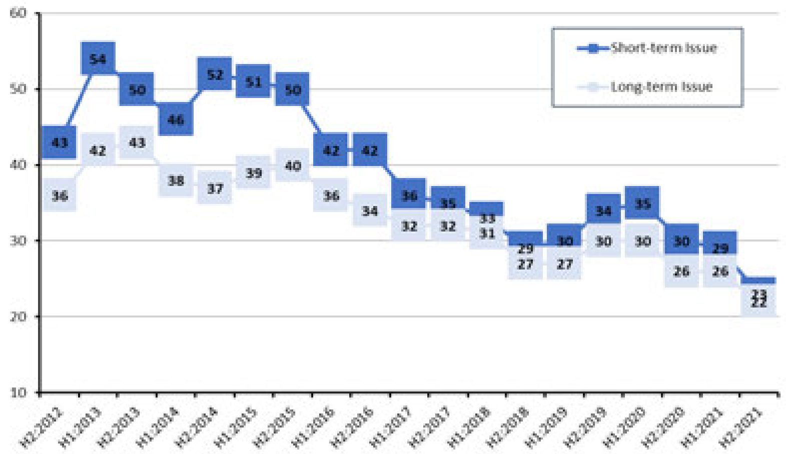
The DSI asks respondents to identify which issues that directors think should be a priority for the Federal government, with ‘productivity growth’ as one of the options. This question is asked both about the short term (defined in the DSI as in the next three years) and the long term (defined as the next 10 to 20 years).

According to the DSI, while directors viewed productivity growth as a key policy priority in the years between 2012 and 2014, it has since fallen down the rankings somewhat. That said, with just one exception (in H1:2020 at the onset of the pandemic), productivity growth has consistently ranked as a top five issue. In the most recent DSI, productivity growth was ranked as the fifth most important short-term policy challenge, behind climate change, skills shortages, energy policy and taxation reform.

Interestingly, when productivity growth is treated as a long-term issue for government, the relative ranking in the DSI is typically lower than as a short-term issue, although on three occasions rankings have been the same, including in the most recent DSI in H2:2021.

Productivity as a Commonwealth policy priority

Per cent of respondents selecting 'Productivity growth' as one of the top issues the Cth Gov should be focusing on



Source: AICD Director Sentiment Index (DSI), past issues. *Q. Please nominate the top five issues of importance, in your opinion, that the federal government should address in the short term (i.e. in the next three years) / in the long term (i.e. in the next 10 - 20 years) where 1 is the most important and five is the least important.*

Measures to lift productivity

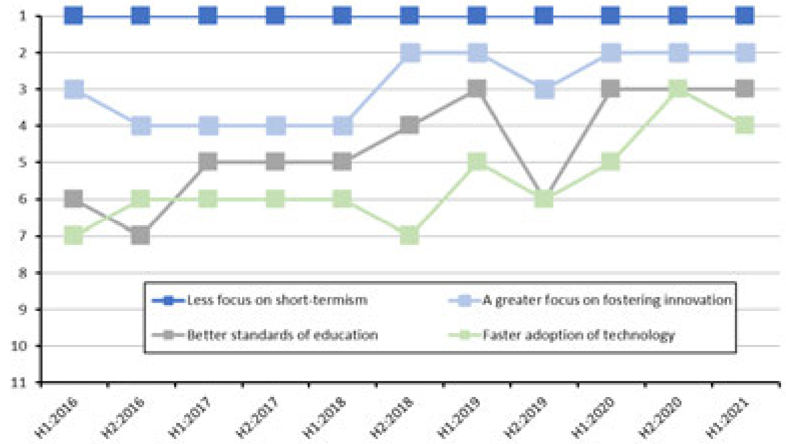
Since 2016, the DSI has also asked respondents to rank a selection of policy measures that in their view would do most to lift national productivity.

The standout result here is that for every iteration of the survey that asked this variant of the question (between H1:2016 and H1:2021), respondents have nominated less focus on short-termism as the most important measure to boost productivity.

In recent years, the top four suggested measures have also included a greater focus on fostering innovation (ranked second in five of the last six DSIs) and better standards of education (ranked third in four of the last six). Faster adoption of technology has also moved up the DSI rankings.

Measures to lift national productivity (group one)

Ranking of the selected measure as a top three measure to lift national productivity, with one the highest ranking



Source: AICD Director Sentiment Index (DSI), past issues. *Q. What measures would do most to lift national productivity? (Select three).* Question first asked in DSI 2016 H2 and last asked in DSI 2021 H1.

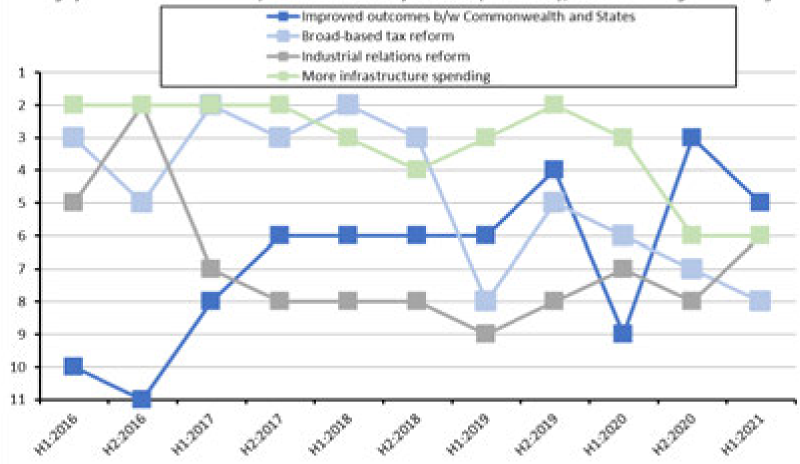
Other developments of note in the DSI rankings include falls in the relative importance of more infrastructure spending and broad-based tax reform as well as a rise in the relative importance of improved outcomes between the Commonwealth and States and Territories.

Reviewing the top five DSI responses on measures to lift national productivity in the H1:2017 DSI (which in timing roughly corresponds to the release of the Shifting the Dial report) shows that directors' top five suggestions in 2017 comprised less focus on short-termism (chosen by 49 per cent of respondents), more infrastructure spending (33 per cent), broad-based tax reform (also 33 per cent), a greater focus on fostering innovation (31 per cent) and better standards of education (27 per cent).

By the H1:2021 DSI, the top five responses still put less focus on short-termism (37 per cent) as the top priority, but this time along with a greater focus on fostering innovation (35 per cent), better standards of education (30 per cent), faster adoption of technology (28 per cent) and improved outcomes between the Commonwealth and States (26 per cent). Although infrastructure spending (24 per cent) and broad-based tax reform (22 per cent) were still cited by a significant share of directors, they no longer made the top five.

Measures to lift national productivity (group two)

Ranking of selected measure as a top three measure to lift national productivity, with one the highest ranking



Source: AICD Director Sentiment Index (DSI), past issues. *Q. What measures would do most to lift national productivity? (Select three).* Question first asked in DSI 2016 H2 and last asked in DSI 2021 H1.

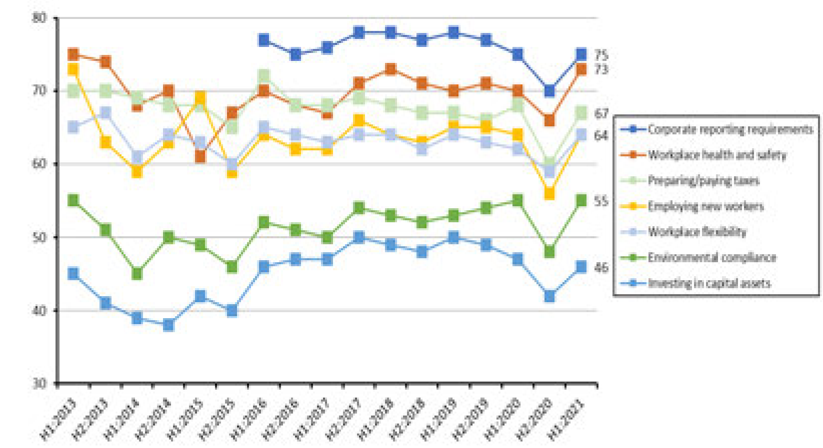
'Red tape' and business productivity

Finally, the DSI has asked a regular a question about the extent to which 'red tape' has impacted the productivity of business.

The responses indicate that corporate reporting requirements, workplace health and safety regulations and preparing/paying taxes are currently the regulatory measures where the largest share of directors cite either a moderate or high impact on the productivity of their business. The relative ordering of these seven areas of 'red tape' has remained quite consistent over time.

Impact of 'red tape' on business productivity

Share of respondents indicating that selected issue has moderate or high on productivity



Source: AICD Director Sentiment Index (DSI), past issues. *Q. What impact (cost/time) does 'red tape' have on the productivity of your business in the following areas?* Question last asked in DSI 2021 H1. Question on Corporate reporting requirements only asked from DSI 2016 H1.