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Barriers to Investment

A study into factors impacting small to medium enterprise investment

November 2017

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A STUDY INTO FACTORS IMPACTING SMALL TO MEDIUM ENTERPRISE INVESTMENT

EXECUTIVE SUMMARY

Investment by Australian small to medium enterprises (SMEs) is at a historically low level despite theoretically favourable conditions for investment. To understand this problem more fully and determine possible solutions, the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) has consulted with a range SMEs, representative organisations, advisors and experts across the sector.

Business people invest when they are confident and have access to capital. Information is mixed on business confidence. People are confident about their own business but less so in the broader Australia or global sense. There are challenges around disruption (eg Amazon, Uber, Airnb) where there is a need for proactive and sound Government policy so there is confidence in a level playing field.

Resounding feedback from the sector is that access to finance remains a significant barrier despite a healthy pipeline of businesses suitable for investment. If there are barriers to access to finance then this stifles business growth, employment and investment. Our market simply does not work well for smaller businesses.

A key factor points to policy and regulatory settings that having negative consequences on lending practices, capital availability and a competitive financial services market for SMEs. There are two main reasons:

Traditional bank loans are backed by real property mortgages and a lack of finance alternatives

Australia's prudential rules are focused on system stability and this incentivises banks to focus lending against real property security. This has the effect of increasing the cost of capital on other lending and, to a very large degree, destroying the ability of businesses to obtain funding secured against other business aspects, such as cash flow.

Young aspiring small business operators are particularly disadvantaged and increasingly rely on their parents to provide seed finance. The "Bank of Mum and Dad" offers convenience and flexibility but puts retirement savings at risk. It also raises social equity issues in that the children of affluent parents have greater opportunities.

Australian superannuation regulation and the small contribution to Australian private equity

Australian superannuation funds are not primarily focused on medium to long term returns. Superannuation regulation instead focuses the funds on being able to publicise low fees whilst liquidity requirements mean that investment is biased to liquid assets such as traded securities. The flow-on effect is that Australian superannuation investment then looks to foreign liquid investment opportunities, overlooking the potential for investment via Australian private equity or venture capital markets.

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Challenges faced by SMEs accessing finance in Australia

Australia's 2.2 million (SMEs) employ two thirds of Australian workers and create a substantial proportion of new jobs. Ensuring that businesses have access to capital is important for the growth of their businesses and to create jobs in the economy.

SMEs rely on credit for a number of business activities. According to ABS data[1], the key reasons why SMEs seek debt or equity finance are to:

- maintain short-term cash flow or liquidity;
- replace or purchase equipment or machinery;
- pursue expansion opportunities; or
- ensure the survival of the business.

There is no perfect indicator that measures the gap in lending. Most information is anecdotal or only tells part of the story. For instance, ABS data shows that around 9 in 10 SMEs reported success in obtaining debt finance in 2015–16 (see Table 1). This number seems higher than what 'we hear' anecdotally. One possible explanation is that the data does not account for SMEs that do not apply for loans fearing that it will be difficult to obtain (e.g. due to poor credit history or a lack of assets to use as security for the loan). However, RBA research suggests that the proportion of small businesses stating this as a reason is quite low.[2]

Another possible explanation is that the ABS data measures demand for finance but not necessarily the difficulty in obtaining finance or the cost of finance. Despite their economic importance, SMEs have traditionally struggled to easily access required finance on competitive terms. CPA Australia reports less than half of the 508 small businesses they surveyed found it easy or very easy to access external finance in 2016.[3]

Some possible reasons for the difficulties in accessing finance include:

- SMEs are characterised by high complexity but low scale, making the sector unattractive to less efficient traditional lenders given the high cost to serve each individual client;
- SMEs may lack the skills and resources to handle finance in a sophisticated or systematic manner;
- Traditional lenders view SME lending as risky, especially as in many cases there is a lack of fixed assets to secure against a loan, and SMEs may be more sensitive to macro-economic trends; and

[1] ABS, *Selected Characteristics of Australian Business, 2014–15*, cat. No. 8167.0
[2] Matić M, A Gorajek and C Stewart (2012), 'Small Business Funding in Australia', Small Business Finance Roundtable, Sydney, May 2012. Accessed at www.rba.gov.au/publications/workshops/other/small-bus-fin-roundtable-2012/pdf/02-small-bus-funding-aus.pdf
[3] Based on businesses with less than 20 employees. CPA Australia, *The CPA Australia Asia-Pacific Small Business Survey 2016 – Market Summary: Australia*, February 2017

- Traditional lenders have regulation and prudential capital requirements for loans to SMEs.

ABS data shows that the proportion of businesses seeking finance rises as the business size increases (see Table 1). CPA Australia states that growing businesses are significantly more likely to seek external finance.[4] The most common type of finance sought by SMEs is debt finance[5] (over 9 in 10 businesses sought debt finance compared to around 2–3 in 10 businesses seeking equity finance).

Table 1: Small and medium enterprise finance sought that was not successful

Businesses by employment size	Proportion of businesses that sought debt or equity finance	Proportion of businesses that reported the Debt finance they sought was:		
		obtained	not obtained	in progress
0–4 persons	12%	88%	4%	10%
5–19 persons	19%	89%	6%	7%
20–199 persons	24%	95%	1%	9%

Note 1: Businesses could report more than one status for finance sought (finance could have been sought multiple times during the financial year 2015–16 with differing levels of success).
Note 2: Data for large businesses (200+ persons employed) is not included in the table due to the unreliability of estimates (large business estimates have a relative standard error of between 10%–25%).
Source: ABS, Selected Characteristics of Australian Business, 2015–16, cat. no. 8167.0.

Total bank lending to businesses was almost $346 billion in 2016–17. Around 1 in 25 bank lending commitments to businesses were for less than $100,000.[6]

- Traditional banks remain an important source of small business funds.[7]
- There is a demand for small dollar loans by small businesses.
- Small business demand for small dollar loans is not being entirely met by traditional lenders. One possible factor contributing to this is the inability of some small business borrowers to offer property as security.[8]

[4] CPA Australia, The CPA Australia Asia-Pacific Small Business Survey 2016 – Market Summary: Australia, February 2017.
[5] Debt finance includes any finance the business must repay. Equity finance includes finance provided in exchange for a share in the ownership of the business.
[6] RBA Statistical Tables, D7.4 Bank Lending to Business – New credit approval by size and by purpose, accessed 6 November 2017 from www.rba.gov.au/statistics/tables/
[7] In fact, ABS data shows that banks were the most common source of debt finance. Over two thirds of businesses with 0–4 employees and almost three quarters of businesses with 5–19 employees reported approaching banks for debt finance. Only around 27% of small businesses reported approaching finance companies.
[8] Grattan Institute analysis of Census data shows that home ownership is declining among people aged under 55, but particularly in the younger age groups. This could limit the ability of younger generations to access bank lending which traditionally requires some form of property as security. (cont. next page)

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This is consistent with a Harvard Business School Working Paper finding that a gap existed in the United States in small business access to credit and was "particularly persistent in small dollar loans—those defined as under $250,000.[9] This does not mean that fintechs are not competing with banks for larger dollar loans in Australia. Over 1 in 4 surveyed fintechs also have a typical sweetspot amount of $100,000 or more.

This gap in credit availability is increasingly being filled by fintech (and other alternative finance) disruptors, who use technology and innovative business models to originate, assess credit risk and fund loans - with easy application processes and quicker turnaround times. This makes fintech products attractive to time-poor small businesses. According to Federal Treasury, innovative fintech solutions can assist small businesses manage their cash flow and working capital, and can efficiently and effectively provide stable funding for small business growth activities.[10]

[8] Accessed from ABC News, Home ownership in Australia in decline for three decades: Grattan Institute, www.abc.net.au/news/2017-07-17/home-ownership-in-australia-declines-for-decades/8677190

[9] Mills, K and McCarthy B, The State of Small Business Lending: Innovation and Technology and the Implications for Regulation, Harvard Business School Working Paper 17-042, accessed from www.hbs.edu/faculty/Publication%20Files/17-042_30393d52-3c61-41cb-a78a-ebbe3e040e55.pdf

[10] The Treasury, *Backing Australian FinTech, Economic benefits of FinTech*, March 2016

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THE TRADITIONAL BANKING SYSTEM

Current policy settings limit the availability of finance since banks are incentivised to hold particular types of security by the capital holding rules and advantages produced under the regulatory environment. This approach has meant that Australia has a stable financial system compared internationally but this is at a real cost to finance. It means that bank focus on bricks and mortar funding is constraining capital, especially above the level of $100,000 where fintech lenders and unsecured bank lending (such as credit cards) operate. For small business, amounts beyond that level require existing wealth generally in terms of real property holdings (and it is beyond this level that is needed for real business expansion and market penetration). For businesses with good cash flow and business prospects but lacking real property holdings that may be mortgaged, funding is simply unavailable.

Consider the example of a retail business that is seeking to finance a $500,000 fit-out of premises. Where the business holds real property then a bank may be willing to lend that amount if it obtains a mortgage over the business' real property. However, where property is leased and even where there is excellent cash flow and great business prospects, a bank will not generally lend an amount of that quantum. A business like this will be left to contribute mortgages over personal property (if available) or to otherwise seek loans from family and friends.

A new small business faces many challenges to become successful and can fail through no fault of the operator. Where seed finance has been provided by friends or the "Bank of Mum and Dad" it's potentially risking other people's savings and retirement income which has flow-on social consequences.

As higher-income families are financially more able to support their children with start-up capital it also increases social inequality and makes it harder for lower-income individuals to establish small businesses.

The approach of banks adds to the dilemma faced by SMEs, particularly since banks tend to adopt a short term profit perspective. In order to invest, SMEs need banks to adopt a medium term plan for profitability so that SMEs can properly take advantage of opportunities. It is rare for such opportunities to be realised within a short term 1–2 year perspective.

Banks also use an algorithm-based approach to lending that view lending opportunities within an established prism and limited frame. It also is generally based on real property security (which reduces the bank's cost of capital). This means that small business lending becomes reduced to questions of whether there is sufficient real property security available for the loan.

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CREATING A MORE VIBRANT FINANCE MARKET

THE UK has implemented a government-backed approach to small business lending to overcome some of these barriers.

THE BRITISH BUSINESS BANK

The British Business Bank is 100% Government owned, but independently managed which looks to making finance markets work better for small businesses in the UK at all stages of their development: starting up, scaling up and staying ahead.

It brings expertise and Government money to the smaller business finance markets. It doesn't lend or invest directly but works with over 100 finance partners such as banks, leasing companies, venture capital funds and web-based platforms. Businesses apply for finance through the partners who can then lend and invest more, especially to younger and faster growing businesses.

A commercial arm, British Business Bank Investments Ltd makes investments into providers of finance to smaller business in the UK. It unlocks up to £10 billion of new finance and brings greater choice and information on finance options to smaller businesses.

OBJECTIVES

Increase the supply of finance available to smaller businesses where markets don't work well.

Create a more diverse and vibrant finance market for smaller businesses, with a greater choice of options and providers.

Build confidence in the market by increasing smaller businesses' understanding of the options available to them.

Manage taxpayer resources efficiently and within a robust risk management framework.

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Encouraging small business lending: A Clean Energy Finance Corporation (CEFC)

The CEFC administers a $10 billion fund with commitments of $3.5 billion. The approach is to co-invest with banks and others. The scheme has been successful with $9.5 billion having been lent out over its operation so far and with about $2.5 billion currently being on loan.

The fund was set up due to the barriers to entry into clean energy and the need for a bank-friendly business case in order to entice banks to lend in the area. Banks and the fund share the risk on these loans. The CEFC subsidises loans up to 70 basis points.

The CEFC's key expertise is in the energy waste space so that it can facilitate lending since it knows the right questions to ask. The service also has indirect effects since even when it is not involved in funding, businesses have been assisted to obtain funding from other sources.

The CEFC invests time in SMEs to understand their business and obtains deep knowledge of the niche area (i.e. energy in this instance). Sector specialisation means that it is easier for the CEFC to find the right financier. The niche knowledge and immersion also means that a $70,000 review of a business (that a bank might otherwise require) is not needed. Instead, it is possible to work off conversations around key questions since industry knowledge is already held. This has the effect that you can escape bank dependence on assets, and analysis can then focus on issues like cash flow.

Of course, some banks are better than others in operating in this space, but the benefit of the CEFC is repeat business where it can work with the banks to use the facility offered. For example, with one major bank only a fraction of the facility has been used. However, in working with another bank that is progressive in the area, advertisements and promotions were undertaken and the bank used up the facility in less than a year and the facility was then extended further.

The NSW Government provides loan guarantees for investment in businesses 'left out in the cold' by traditional lenders for reasons that include a lack of assets, growth rate too slow or a traditional industry in a regional area; 30 per cent of the loan funds must go outside metro areas.

Potential businesses must approach a bank to see if a loan is possible and the bank picks-up the due diligence. Where the bank is unable to provide sufficient funds, there is a strong business case and job creation, Jobs for NSW can step in.

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Jobs NSW and $4m loan guarantee for Gundagai Meat Processors

Gundagai Meat Processors (GMP) had a partnership with Coles for more than 35 years and was confident that investment in expansion of state-of-the-art processing capacity in NSW would strengthen its business relationship.

GMP approached a traditional bank for finance to support the investment strategy. The bank would not support the investment required as they needed more security despite the strong business case. A regional-based meat processor did not fit the algorithmic model used by the bank to assess lending opportunities without additional security.

Through Jobs for NSW GMP secured a $4m loan guarantee from the NSW Government and a loan for the investment was secured through another bank. The $30m investment will increase GMP's annual production capacity by 40 per cent and will create an extra 76 full-time jobs.

GMP have signed a five-year deal as one of Coles' exclusive lamb suppliers and expanding its NSW meat processing capacity to other suppliers.

Analysis of alternative sources of finance

Stable and secure funding is important for SMEs to have the confidence to invest and grow their business.

It is estimated that the volume of alternative finance in Australia has grown to over US$348 million in 2015, from just over US$24 million in 2013. In 2015, balance sheet lending was estimated at US$120 million, invoice trading at US$105 million and marketplace/P2P lending at $US43 million.11

According to the Australian Bureau of Statistics, the key reasons why SMEs seek debt or equity finance are, and in no particular order, to maintain short-term cash flow, replace or purchase equipment or machinery, to ensure the survival of the business or to expand the business.12

However, CPA Australia reports that less than half of the 508 surveyed small businesses found it easy or very easy to access external finance in 2016.13

[11] KPMG et al, Harnessing Potential: The Asia Pacific Alternative Finance Benchmarking Report, March 2016, home.kpmg.com/au/en/home/insights/2016/03/harnessing-potential-asia-pacific-alternative-finance-benchmarking-report.html as cited in ASIC, FinTech: ASIC's Approach and Regulatory Issues, July 2016, download.asic.gov.au/media/3962105/melbourne-money-and-finance-conference-2016-FinTech.pdf

[12] ABS, Selected Characteristics of Australian Business, 2014–15, cat. No. 8167.0, www.abs.gov.au/ausstats/abs@.nsf/mf/8167.0

There is an opportunity for challenger banks to enter into this space (which occurred in the United Kingdom), especially in the $250,000 to $5 million range. Within this range, banks are an expensive source of capital (even where available) and the lending does not go to funding ongoing investment by business. Above that range there is scope for the established banks to take a position in businesses unsecured by real property.

The fintech industry has the potential to fill a gap left by traditional bank lenders in the marketplace, particularly as awareness, trust and confidence in alternative lending grows.

Fintech is a fast-growing nascent industry with an important role to play in improving SME access to finance. Innovative fintech solutions can assist small businesses manage their cash flow and working capital and can provide more stable and secure funding.14

But with the massive growth in the number and variation of fintech products, it becomes more difficult for SMEs to make informed decisions about which products and lenders will suit their circumstances. For trust and confidence in alternative lending to grow there needs to be an industry focus on transparency and disclosure.

The number of fintech startups in Australia has increased from less than 100 in 2014 to 579 companies today. More than 10,000 people are employed in the sector. An increasing amount of money continues to be invested in Australian fintech from domestic and international funds. In 2016, $656M was invested in Australian fintech companies across 25 deals, bucking the global trend that saw an overall dip.

The development of the Australian fintech sector has attracted broad-based support from both sides of Government, particularly in recognition of its potential to improve consumer outcomes and increase competition. The recent Federal Budget announcement in May 2017 saw the announcement of several fintech-friendly policy commitments, including a move toward an Open Banking regime in 2018, and an expanded regulatory sandbox. Both measures were aimed to facilitate the growth of new, viable alternatives by making it easier for fintech companies to establish, and for consumers to switch to them.

Australia's fintech small business lending sector is still young but recent growth figures indicate it has the potential to develop into a strong and healthy alternative to traditional bank lending to the SME sector.

The latest Asia-Pacific Alternative Finance Benchmarking Report from KPMG et al. reported that Australia's alternative finance sector (which includes crowd-funding and fintech consumer lending) is the second largest in the APAC region by loan value originated, second only to China. The value of lending by fintech business lenders in particular has grown dramatically, from approximately AU$10.5

[13] The survey is based on businesses with less than 20 employees. CPA Australia, The CPA Australia Asia-Pacific Small Business Survey 2016 – Market Summary: Australia, www.cpaaustralia.com.au/~/media/corporate/allfiles/document/professional-resources/business-management/small-business-survey/small-business-survey-2016-market-summary-australia.pdf?la=en
[14] The Treasury, Backing Australian FinTech, Economic benefits of FinTech, fintech.treasury.gov.au/economic-benefits-of-fintech/

million in 2013 to over AU$440 million in 2016. But this still represents a tiny proportion of total lending to Australian businesses.

ASBFEO fintech survey

In July 2017, 25 fintech small business lenders were surveyed as part of a collaborative research project by the ASBFEO, industry association FinTech Australia and independent SME finance expert Neil Slonim from theBankDoctor.org.

In keeping with the needs of SMEs who often do not have fixed assets against which to secure a loan, 74 per cent of participants offered a fixed term unsecured loan.

The survey results will inform fintech lenders how they can help SMEs by improving the transparency of their lending products and by clearly communicating the rates, costs, terms and conditions of their products. The final results from the survey are not yet public and are expected to be released in coming weeks. Initial results show some disparity in the sector and appetite for change will be mixed.

Some fintech lenders do not see transparency as being an issue whilst others reported transparency as one of the greatest challenges that the sector faces.

One measure that most of the surveyed fintech lenders are in agreement about is the need for standard definitions of fees across the sector. The clear disclosure of fees in a way that is easily understood by small businesses will aid transparency and comparison of products.

An industry-led charter also seems to gain support from most of the surveyed fintech lenders.

Access to Finance Policy Question

The following policy question emerges:

Is a desire to create stability having unintended consequences for the SME sector and are prudential requirements acting inappropriately to slow growth?

An important part of answering this question and designing options to deal with the issues with access to and cost of finance is to investigate whether banks channel business funding to domestic home loan products and/or to the use of residential security in order to lower their cost of capital. In addition, if banks can use residential lending so lucratively, there is a question as to whether this is unduly biasing banks to residential lending.

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AUSTRALIAN SUPER FUNDS AND ACCESS TO WHOLESALE FUNDS

There appear to be constraints on attracting domestic and foreign capital for private equity (PE) and venture capital (VC) that are acting as a handbrake on business growth and investment. There is a strong, healthy pipeline of candidate businesses for PE and demand is perceived to be outstripping supply and availability of capital. The estimated gap is about ***double*** the number of existing businesses currently receiving investment.

A key element of the problem is that Australian superannuation funds account for less than 0.5% of superannuation fund assets invested as PE. The total superannuation asset pool for PE is 4-5% (i.e. investment predominantly comes from foreign funds). This clearly needs adjustment to ***find the right balance***. There is also some evidence that where Australian funds invest in private equity or venture capital that there is a bias towards doing so via foreign markets on the basis that risk can be reduced smaller stakes in investments. Therefore, we believe that a question that requires additional work is:

How many and to what extent do Australian superannuation funds invest in the PE/VC market domestically and overseas? What should these levels be?

A part of the issue here is likely to be the extent of active asset management required and ongoing involvement with the management of the business utilising PE. A particular benefit for the business of this involvement is that the business can be transformed to become globally competitive. It is also worth noting that currently the emphasis is on information and communications technology and life sciences, although there is significant opportunity to expand into other areas and real opportunities in taking over baby boomer businesses as owners seek to retire.

Australian superannuation policy settings are complex. The administrative costs on Australian superfunds are amongst the highest in the world despite regulatory pressure on fees and the costs of managing funds produces strong incentives to drive to lower cost superannuation products in the competitive superannuation environment. It is cheaper for Australian funds to favour more liquid and favourable assets overseas. PE is more expensive to manage as it requires active asset management and this has a downstream implication for the cost to the super fund. As a result there are further questions that require attention in relation to the operation of superannuation funds:

Why are the administrative costs of Australian superannuation funds high by global standards?

What are the impacts of the focus on fees and costs of superannuation funds?

Are there lessons to be learnt from other countries?

We understand that Canadian pension funds have a view that the Australian superannuation system is still maturing, whilst Australian superannuation funds are going offshore to support other economies.

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Canadian superannuation funds are seemingly keen to invest in Australia as there is little competition and they have been present in Australia for a long time.

In contrast to the rest of the Australian superannuation industry, the Future Fund has an incentive to generate good returns over a longer period (rather than simply having lower management fees). This gives rise to the question as to whether this same approach is appropriate more generally in Australia:

Should the objective of generating great returns that is central to the Future Fund be adopted by the Australian superannuation industry more generally?

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A STABLE AND SUPPORTIVE COMMERCIAL ENVIRONMENT

Business confidence

Business confidence is impacted by regulatory settings, the availability of funds and the types of assets available for use as security. SMEs are particularly impacted by the inability to hedge risks and this results in the need to use personal assets (larger businesses are in a very different situation). Another factor is that SMEs are caught in supply chains with little bargaining power over price and margin, and consequently they have little ability to manoeuvre. Where there are slender margins SMEs cannot invest in their business especially after fixed costs are taken into account. Further, flat profit levels restrict the ability to operate at a loss to gain expansion into new markets. At this point, it becomes a question for businesses of simply surviving.

A key approach to assisting SMEs is to ensure security of payments along supply chains. Governments can be (mostly) applauded on their approach to security of payments since they by and large do this, but the markets are not providing this to SMEs who inhabit the bottom of the supply chain – even in government contracts. Reform around payment terms and times will also be of assistance in dealing with this issue. However, once businesses are growing, investment to continue on a particular trajectory becomes a more obvious need, and a significant injection of capital/investment is generally required to avoid being trapped as a middle tier domestic business.

The ASBFEO Payment Times Inquiry recommended that:

The Australian Government to adopts a 15 business day payment time by July 2018 and require its head contractors to adopt the payment times and practices of the procurement through its supply chain.

Workplace relations

It is common for SMEs to report that they do not take on permanent staff as it is too difficult to firstly recruit and then to remove staff for business needs. Those that do employ are likely to seek to keep staff numbers to a bare minimum to avoid as far as possible the disincentives created by regulation. In particular, difficulties in removing staff for underperformance are commonly cited for restricting staffing levels with “go away money” being known as a common practice to deal with cases where there is no merit. This is done in order to avoid spending in the vicinity of $20,000 to fight a case within the regulatory system.

It is also worth noting that larger business has greater flexibility around issues like the payment of penalty rates since they are able to negotiate deals with unions to produce wage rates that allow for more flexible work practices. Small business is simply unable to make these sorts of deals with unions. Small businesses don’t have access to Enterprise Bargaining Arrangements (EBA) and this creates an un-level playing field. This gives rise to the following questions:

What could be done to review the policy position for small business to make workplace relations requirements simpler, easier to understand and proportional?

Regulation

Regulation occurs across three levels of government. There have been numerous programs to reduce red tape but the outcomes have been perceived to be mere "window-dressing" with little inroad being made into "significant" or "tough" regulatory burdens. Meanwhile, additional regulation is added to already substantial stocks of regulation. This regulation is commonly in place to deal with consumer issues, but also fails to recognise that the protection afforded to consumers is often just as relevant to small business given its vulnerable position in supply chains. However, we must also recognise that it is not a simple matter of translating consumer law to the small business context due to the disruption to competition that would follow.

Larger businesses can afford to bring compliance specialists in-house, utilise tools and outsource to external specialists to deal with regulatory requirements. They are also more able to pass on regulatory cost to other businesses and customers. Again, SMEs are disproportionally impacted due to the owner operators needing to personally bear the compliance burden and a lesser ability to fund access to specialist assistance.

This results in a tendency in Australia to "narrowcast" business due to the regulatory burden. By remaining small and operating in the market in limited ways, small business is able to minimise the cost of regulatory burden albeit at the cost of market expansion. This also helps avoid risk around changes in the "rules of the game".

Regulatory uncertainty (including the way that regulation is administered) is a real dampener on investment, particularly longer term investment. Stable policy settings and clear signalling of policy stances and change is critical to ensure longer term performance.

A successful attempt in dealing with the regulatory burden was undertaken by the NSW Government "Easy to do business" pilot project in relation to the hospitality industry in Parramatta. It was found that there were in excess of 50 pieces of regulation applying to setting up a hospitality business in Parramatta and that the regulation meant that it took up to 18 months to commence trading. However, instead of cutting red tape by removing individual pieces of regulation, the question was asked as to how many of the regulatory processes could be run in parallel. A review of the information requested under various regulations was also run and it was found that much of the information requests were duplicated between processes. The initiative brings together Commonwealth and State agencies, local councils and industry bodies and as a result, a system was created to ask for information once only and share it between relevant regulators, whilst processes were run in tandem rather than consecutively. The red tape was not cut but was instead sped up and made invisible. This is a smart way of using systems and technology to relieve regulatory burdens on business that has been shortlisted for the 2017 Prime Ministers Award for Innovation and the 2017 NSW Premiers Award.

A recommendation is that:

The NSW Parramatta "Easy to do business" project is replicated across additional industry sectors and by other State/Territory Governments.

Energy costs and stability of supply

Energy costs and system stability are having a very large impact on the ability of small businesses to invest and grow.

Previously, Australia has been internationally competitive due to its low energy costs despite being otherwise a relatively high cost/low productivity country. Low energy costs underpinned investment and offset labour and the costs of the regulatory market. With energy costs rising significantly (new energy contracts have been subject to massive increases in cost) and with concerns over reliable supply, Australia's competitive advantage is lost with small business being disproportionately impacted.

Particular areas that are being impacted by the issues with energy are hospitality and tourism. These areas are also severely impacted by the regulation of labour laws and local regulation that commonly mean limited hours of operations including closure over weekends.

On the 16 October 2017 the ACCC has published a preliminary report into the electricity market highlighting significant concerns about the operation of the National Electricity Market, which is leading to serious problems with affordability for consumers and businesses.

The *Retail Electricity Pricing Inquiry preliminary report* details the ACCC's initial assessment of information it has gathered including documents and data from industry, consumers, businesses, representative groups and other government and non-government organisations.

FURTHER RESEARCH AND SOME WAYS FORWARD

In this paper, we raised the following critically important questions for further research:

Prudential impact on bank lending: *Is a desire to create stability having unintended consequences for the SME sector and are prudential requirements acting inappropriately to slow growth?*

Lack of super fund investment in PE: *How many and to what extent do Australian superannuation funds invest in the PE/VC market domestically and overseas? What should these levels be?*

Super fund focus on fee minimisation: *What are impacts of the focus on fees and management costs of superannuation funds?*

Foreign super funds operate differently: *Why are the administrative costs of Australian superannuation funds high by global standards?*

Are there lessons to be learnt from the superannuation fund investment approaches of other countries?

Regulatory focus on medium to long term returns: *Should the objective of generating great returns that is central to the Future Fund be adopted by the Australian superannuation industry more generally?*

Business confidence: *The Australian Government to adopts a 15 business day payment time by July 2018 and require its head contractors to adopt the payment times and practices of the procurement through its supply chain.*

Workplace relations: *What is available at EBA level that could be applied more broadly across small business?*

What could be done to review the policy position for small business to make workplace relations requirements simpler, easier to understand and proportional?

Regulation: *The NSW Parramatta "Easy to do business" project is replicated across additional industry sectors and by other State/Territory Governments.*

Energy costs and stability of supply: *A review of the outcomes from the ACCC inquiries into electricity supply and prices and the Australian gas market. The ASBFEO are liaising with the ACCC on the impact on the small business sector.*

Depending on the answer to these questions, we could see a shift in regulation to encourage more expansive approaches in bank lending and a superannuation system that is seeking out strong medium to long term returns with more diversified investment portfolios. Such a shift might be further supported by targeted approaches such as government involvement in helping businesses to create bank-friendly loan applications and take some of the risk of loans (per the Clean Energy Finance Corporation approach), and the expansion of the work that was undertaken in respect of the hospitality industry in the Parramatta pilot project. Reforms in the areas of workplace relations and energy cost and supply are also critical.

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Appendix A – Issues raised from ASBFEO consultation with the small business and family enterprise community from April – June 2016

Payment terms and times	Businesses reported difficulty in achieving fair payment terms and getting paid on time. The experience of businesses was that payment terms and times were steadily worsening.
Treatment by banks	Businesses reported difficulty in accessing capital and fair treatment following entry into loans.
Procurement	Businesses expressed difficulty in accessing contracts to supply governments with goods and services. There were also issues of payment along supply chains under these contracts.
Taxation	The tax compliance burden and the disincentive of certain taxes/approaches (particularly, payroll tax) were raised. Payroll tax was expressed to result in a perverse result of punishing businesses that sought to expand and employ beyond certain limits.
Infrastructure	A particular frustration of small business is the inability to access the NBN, and once connected, and the very slow NBN connections (that were reported as being in many cases as slower than ADSL). The cost of postal services was also raised as an issue to businesses seeking to expand nationally and internationally (compared to foreign postal charges).
Workplace relations	Inflexibility around hiring and firing and the lack of availability of apprentices were viewed as real impediments to effective running of businesses.
Unfair competition	Various issues were raised under the banner of unfair competition, including issues with franchising, retail tenancies and insurance. The operation of the Unfair Contracts Terms legislation is now also impacting to assist in this area.
Access to justice	The availability of non-court options to deal with disputes and, where appropriate, lower cost legal actions was seen as an impediment to running business and maintaining business relationships.
Red tape	The issue of red tape crosses all regulation but is commonly raised in respect of planning and zoning regulation (size, extended time frames etc.), and trading hours.

Regional issues Businesses reported restrictions on access to markets and training/mentoring services and cost differentials between regions

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Appendix B – Summary of specific issues raised at Ministerial roundtable meetings

A summary of the specific issues raised over the course of the roundtables is:

Business environment	Access to capital (and ongoing treatment by banks) and payment terms and late payments were viewed as the most important issue for businesses. Market disruption and ensuring a level playing field were also viewed as important. Access to local produce (used as business inputs) in an international economy is also being viewed as an increasing issue for small business.
Government working better	Cross border issues (such as different regulations), and lack of good and consistent regulation, access to procurement, and government support around regulatory compliance (with a sharp focus on compliance costs) were expressed to be significant impediments.
Taxation	Businesses reported the need for a level playing field with all paying their fair share of tax, whilst payroll tax was viewed as a drain on business and employment. The $20,000 instant asset write-off was viewed by many businesses to be of particular importance to their ability to continue investing in their business.
Infrastructure	A range of infrastructure issues were raised, including energy costs and reliability (with business operators increasingly viewing personal generators as an essential part of running a business), telecommunications infrastructure, the need for a good rail network and availability of cost effective coastal shipping (coastal shipping was identified as the key issue for Tasmania).
Employment and business costs	There were a variety of issues raised in this area, including access to apprentices and skilled staff, penalty rates, inflexibility in respect of hiring and firing and merchant fees on electronic transactions.

Regional and local issues Given that the roundtables were held regionally, there was a local focus that covered particular issues for the businesses present, such as rental costs and building vacancy levels, extended periods for road and other maintenance, and major infrastructure works disrupting business for prolonged periods.

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Appendix C – Expert consultations

1	Mr Peter Anderson	Deputy President of the Fair Work Commission and previous CEO of the Australian Chamber
2	Mr Tony Shepherd AO	Businessman and previous President of the Business Council of Australia
3	Professor Gary Banks AO	Professorial Fellow of ANZSOG and previous Chairman of the Productivity Commission
4	Professor Mike Woods	Professor Centre for Health Economics Research and Evaluation, UTS Business School and previous Deputy Chair of the Productivity Commission
5	Dr Don Russell	Chief Executive of the South Australian Department of State Development and previous Secretary of the department of Industry
6	Mr Glenn McCrea	Chief Policy Officer at the Association of Superannuation Funds of Australia
7	Mr Yasser El Ansary Mr Christian Gergis	Chief Executive and Head of Policy & Research respectively, Australian Private Equity & Venture Capital Association Limited
8	Mr Chris Oliver Mr Frank Versace Mr Matt Conroy	Judo Capital, Product & Relationship
9	Ms Jillian Broadbent AO	Chair of the Clean Energy Finance Corporation
10	Ms Rosalyn Bell	Assistant Commissioner, Productivity Commission
11	Ms Katrina Squires Mr Will Peterson Mr Denis Gorey	Senior Manager Policy Development, Head of Credit Risk, Senior manager Policy Development, Australian Prudential and Regulatory Authority
12	Mr Peter Kell Mr Michael Saadat	Deputy Chair and Senior Executive Leader, Australian Securities and Investment Commission
13	Ms Karen Borg Mr Tony Stephens Mr Chris Allen	Chief Executive Officer, Jobs NSW
14	Mr Sebastian Paphitis Mr Clive Cheong	Partner & Joint National Head of Capital and Debt Advisory Ernst & Young