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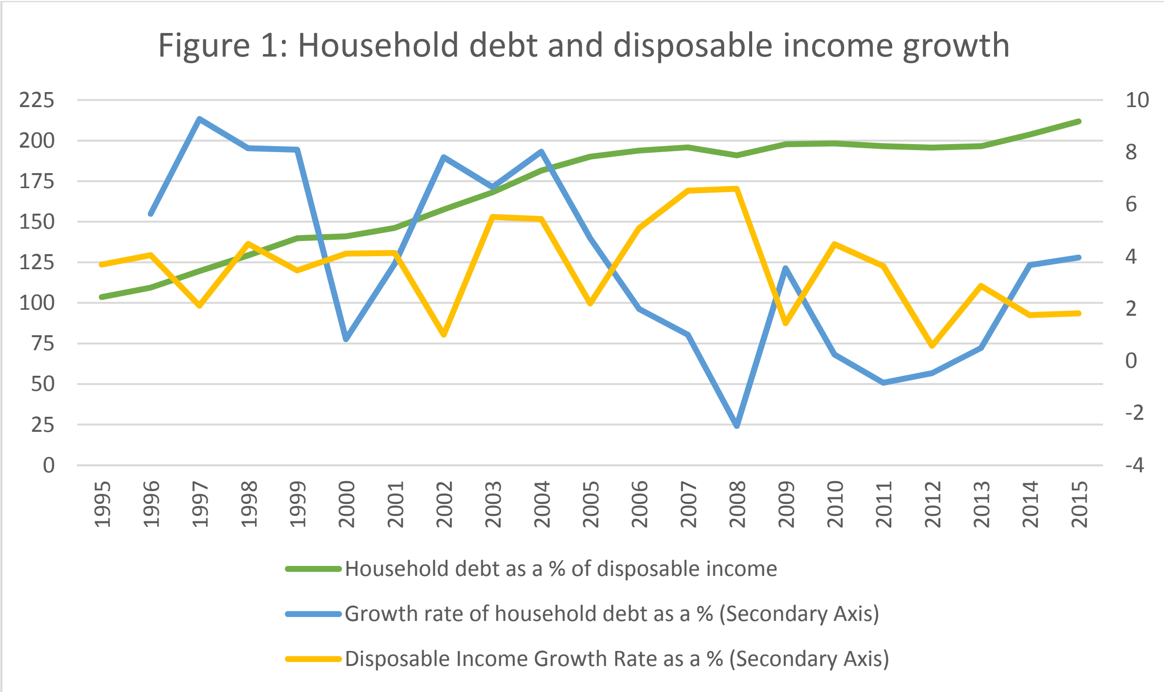
Household investment in small businesses: securing our future through innovation, efficiency and sustainability

Susannah Stearman

Business expansion encourages innovation and efficiencies, providing economic sustainability, job creation and national income growth. Australia is historically a small business nation of hard working individuals and families. Growing the economic pie must include growing the wealth of individual households at all income levels. This essay argues that Australia's future economic prosperity must be concerned with increasing household investment in small and medium businesses to expand innovation, develop efficiencies and create a fairer share of wealth. First, I outline some of the current conditions facing Australia's economic future. Then, I explain why small business is the backbone of our economy and must be supported to ensure future prosperity. Finally, I make policy suggestions to assist expansion of sustainably-growing small businesses, with mutual benefits of both growth in research and development (R&D) and in household wealth.

Australia has fared well in the past two decades. With unprecedented and consistent growth, and our survival of the dot-com bubble, the GFC and the more recent mining contraction, we are a resilient economy. Our GDP growth has remained strong, CPI growth remained relatively stable and national unemployment has, for the most part, remained under 6 percent. However, there are a number of areas of which we must turn our attention to, including; housing affordability and mortgage debt, economy diversification, and, underemployment and the subsequent growing inequality in wealth.

Australian household debt is 123 percent of GDP, which is currently the third highest in the world (1). Our debt levels are above levels in the 1980s when nominal interest rates were at their peak in Australia. Mortgage interest repayments, without the principle included, are currently about 7 percent of disposable income and Figure 1 shows how the growth rate in debt is now higher than the growth rate in disposable income (2, 3).



Source: OECD Stat 2017

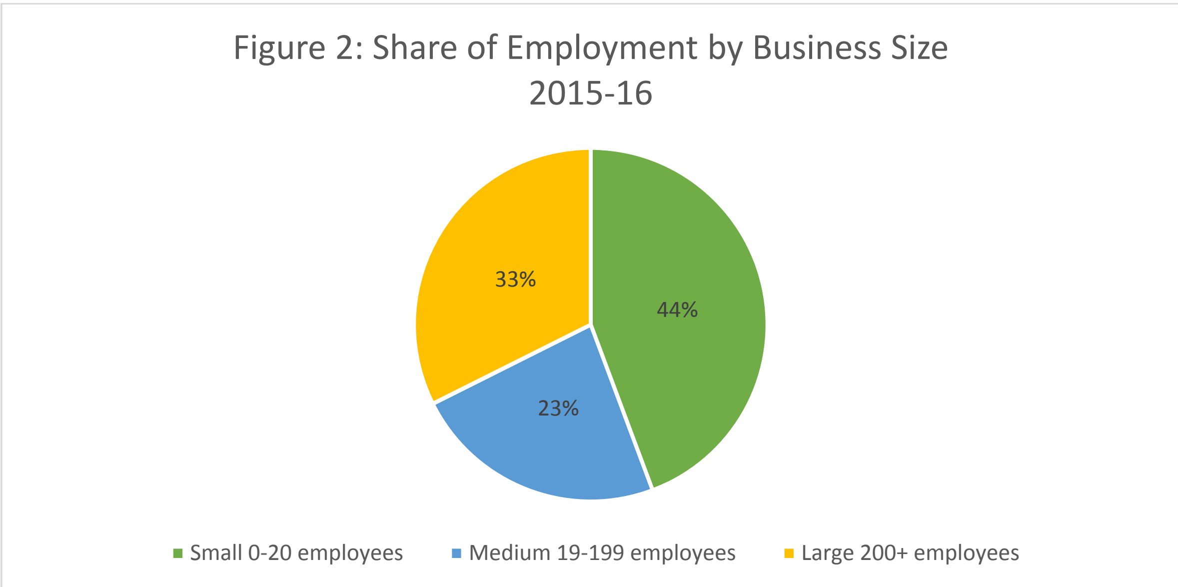
Housing markets in Sydney and Melbourne are over-inflated, driven by capital-gain, rather than an income-generation objective of property owners. As at April 2017, investment property debt in Australia was at $12.8 billion, over a third of all total property debt value (4). The government has made announcements to target our housing bubble, with potential options of removing the CGT discount, capping the number of properties owned, and removing negative gearing, being among policy suggestions of economists. Ensuring sustainable growth for our economy must involve government policies focussed on broadening household investment, shifting away from this 'property-only' investment focus.

Australia is currently ranked 53 according to the Economic Complexity Index (5). While our trade balance returned to surplus last year, a positive indicator for Australia's economy and export market, our reliance on natural resources and exposure to world prices of commodities such as oil, must be minimised through diversifying our export base. To ensure sustainable growth Australia must diversify risk in the goods and services we produce and export. This will also minimise exposure to fluctuations in foreign exchange rates and demand from our export partners.

Unemployment in Australia has remained relatively low by world standards in the past ten years, however full employment cannot be merely measured in the traditional statistical measure of the unemployment rate. Our current employment statistic measures say too little about wages and working hours (6). Importantly, we must consider the total hours worked (or not worked), employee satisfaction and real wage growth. This is often difficult to measure in terms of small business ownership as often owners work many more hours than a standard working week, and often other family members contribute beyond the normal paid hours. Also, the contribution of unpaid work and care, such as stay-at-home parents and volunteer work is not adequately counted in our traditional unemployment rate statistics. Understanding these measures more comprehensively and how they contribute to the economy, will allow policymakers to better plan policies to improve employment in the country in terms of overall satisfaction and wage growth, as well as recognition of and support for informal and unpaid work.

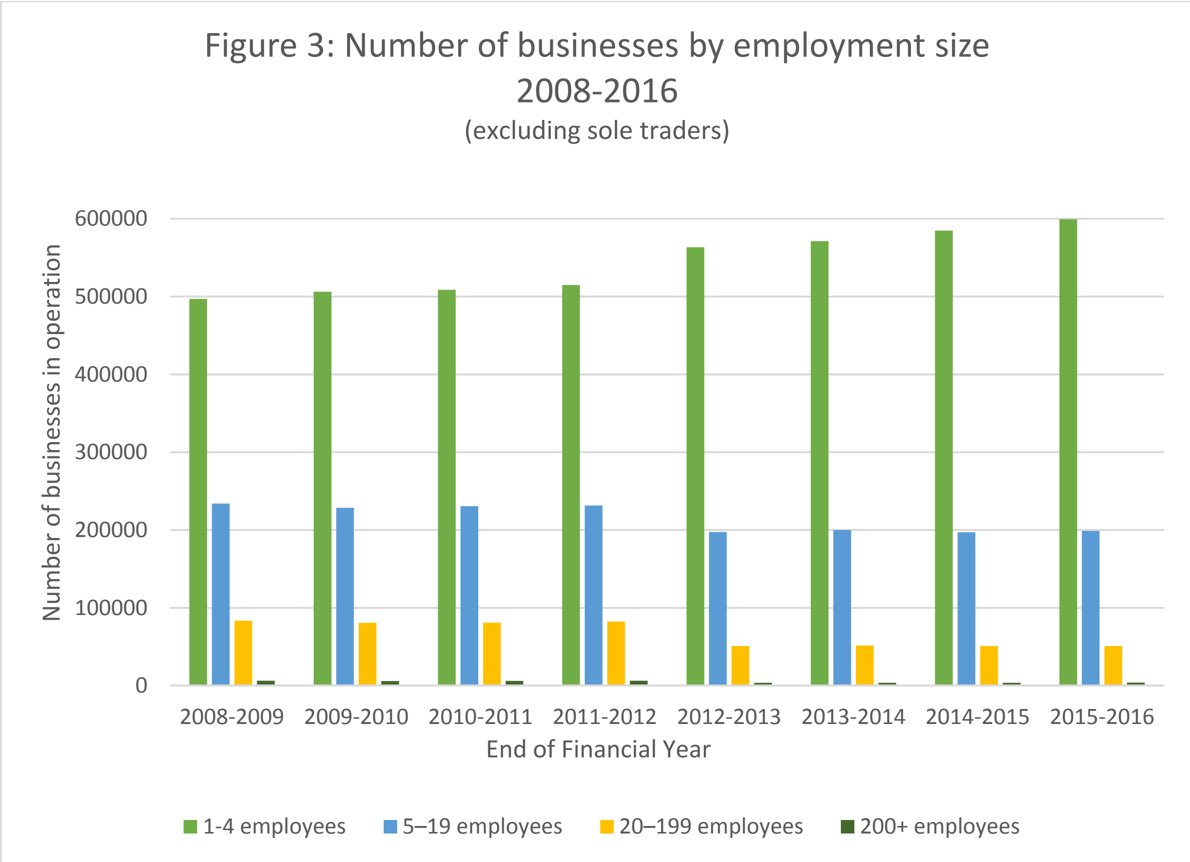
Small businesses are the backbone of the Australian economy and while there are a number of considerations when addressing these conditions as outlined above, fundamentally SME growth is key. Shifting household investment away from capital-driven investment in property markets, diversifying our products and services base, and focusing on real wage growth and household wealth accumulation can all be achieved through an increased focus on innovation and expansion of Australian SMEs.

Figure 2 shows that small businesses employ 44 percent, and SMEs employ 67 percent, of the Australian workforce.



Source: ABS 8155.0 - 2015-16 Australian Industry, 2015-16

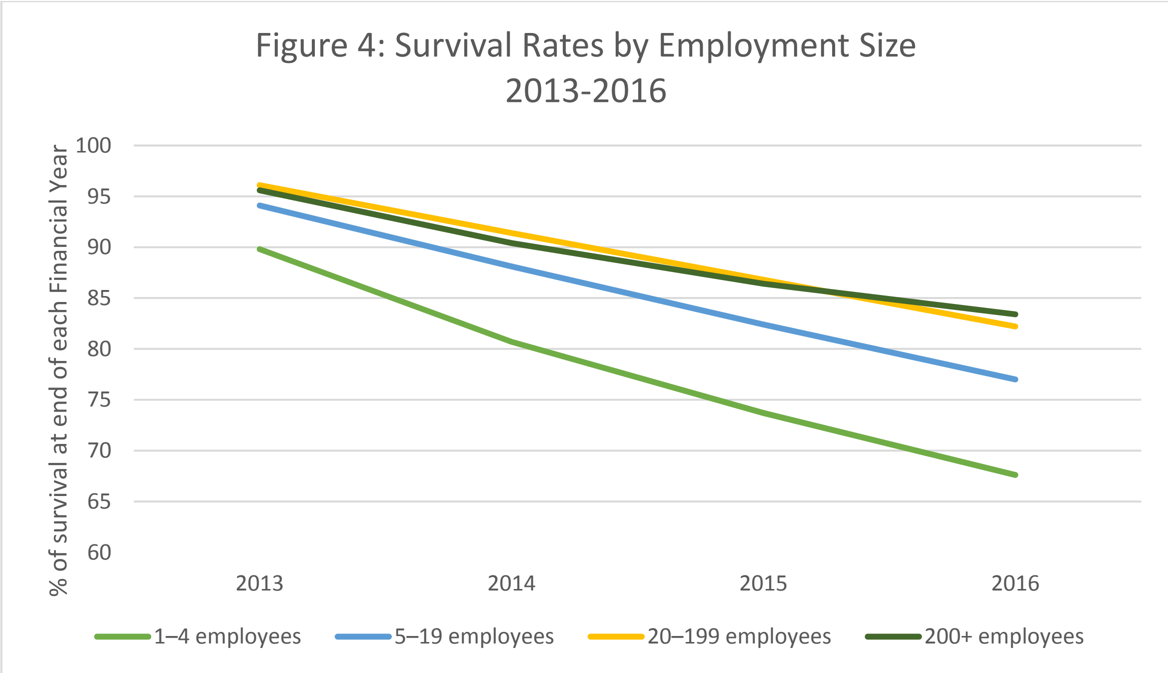
Figure 3 shows 584,744 micro businesses employ 1-4 employees, which has been growing in the past eight years, while the number of SMEs employing between 5-199 employees has declined in recent years.



Source: ABS 8165.0 - Counts of Australian Business, 2008-2016

Possible reasons for this include the scaling back of SMEs after the GFC, however, this 'squeezing-out' of slightly larger SMEs should be a concern for the government. When SMEs expand effectively and sustainably, greater efficiencies and productivity is attained, and more employment opportunities are created. When the opposite occurs, efficiencies and jobs are lost.

Further, Figure 4 shows a considerable decline in micro and small business survival rates, with less than 70 percent of businesses surviving in 2016. This means one-third of micro businesses failed last year, compared with only 10 percent four years ago. Therefore, while Figure 3 showed growth in micro businesses, it seems many are failing each year. The linear survival rate trend also shows a widening gap between survival rates of large and smaller businesses.



Source: ABS 8165.0 - Counts of Australian Business, 2015-2016

SMEs are an important part of our economy's diversification and competition. The lack of fair advancement opportunities for all business sizes creates an inefficiency by-product of industries dominated by large companies, known as monopoly and oligopoly markets, leaving small businesses struggling to grow beyond their local corner store. This is problematic in the long run, with large unnatural monopolies, leading to price increases, less product choice and less labour market power for workers.

When comparing Australian SMEs in our export region, we are not growing and developing our businesses like the rest of the Asia-Pacific. Our small businesses are less likely to; employ more people, innovate, conduct e-commerce, use social media, focus on export markets or focus on training. Further, 33 percent of businesses sourced external finance to fund growth in Australia, compared with 58.5 percent in the region, and fewer businesses experienced easy access to finance compared to 2015 (7). This lack of growth, innovation and technology advancement is a cause for concern for the future of SMEs in our economy. These summarise some of the reasons for the decline of SMEs in recent years in Australia. Considering these factors, I make the following policy suggestions; R&D investment, cheaper financing options and greater tax breaks and incentives.

Governments play a vital role in assisting business innovation through funding support. They need to 'improve pre-financing capabilities of firms' and assist with finance to 'better foster allocative efficiency', while still ensuring firms bear some of the cost and risk to avoid problems of moral hazard and information asymmetry (8). R&D is important for business expansion, however, the empirical evidence shows either little or even negative correlation between government expenditure on R&D and economic growth. However, *growth* in R&D expenditure is positively correlated with GDP growth, as is lower taxation (9). Not only is there an economic long-term incentive to encourage businesses to expand in domestic and international markets, there are considerable societal benefits, for example, in health and high-tech innovations, which increase the wellbeing of Australians. Schemes such as the government's National Innovation and Science Agenda and similar state schemes, should be continued, with growth in SME specific funding.

Financing an expansion can be an extremely difficult endeavour for SMEs, with high financing costs a main reason SMEs never expand. SMEs do not have access to the cheap financing options larger companies have, often due to the lack of collateral assets to secure lower interest rates. For example, according to online comparisons tools, standard variable unsecured business loans of $100,000, can have interest rates up to 12.83 percent, with application fees and annual fees as high as $820 and $750 respectively (10). In practice, the interest rate can be even higher, as commercial lenders add premiums to SMEs deemed as higher risk or with shorter financial histories. Raising capital as an alternative source of funding is costly and finding a suitable buyer can be difficult.

To overcome this, I suggest the government provides government loan schemes, administered and repaid through the Australian Taxation Office, as a pathway for SME employees to purchase an equity stake in the business, similar to a private-equity employee share scheme (ESS). Raising capital through private equity has many benefits for business owners; including cost-effectiveness, responsibility sharing, longer-term sustainability and reducing hours worked. For the employee, it provides a share of the profits, a new form of investment for their household and an increased sense of ownership and role in decision-making. The benefits to the economy of an SME growing with sustainable financing options are numerous. It is also a key option for business succession where older business owners may want to reduce working hours and receive a reward for their many years of hard work.

Finally, to make a scheme like this work, SMEs need greater access to company tax discounts and incentives. Company tax in Australia is one of the highest in the developed world, with the average OECD effective corporate tax rate being 24 percent. To encourage investment in Australia as well as competitive export markets, the government should continue to decrease the company tax rate (11). The current government has recognised this need and reduced small business company tax this year with further reductions ~~to~~ planned to expand to all businesses. However, this company tax rate must continue to decrease for micro and small businesses in our economy. In combination with a Private-Equity ESS, potentially further company tax discounts could be implemented for those employers willing to sacrifice some equity to allow employees to buy-in so that expansion can be funded. Revenue raised through loan repayments and increased taxable income generated through increased operating profits, would offset the company tax rate discounts.

Australia's future economic prosperity must be focussed on increasing household investment in SMEs to expand and develop efficiencies. Current conditions of an over-inflated property market funded by personal debt, room for growth in economic complexity in our domestic production and export markets, and underemployment, must be addressed by policy makers. Recent contraction in SME growth, as well as decreased survival rates, signal problems in the sustainability of our economy into the future. Through providing funding, cheap finance options and tax incentives to SMEs aiming to expand and share profits with employees, a number of these problems in our economy can be addressed. Properly incentivised SME expansion will encourage innovation and efficiencies, create employment and provide long-term economic prosperity for Australia.

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