

SMALL BUSINESS – the state of play

Small businesses play a vital role in Australia’s economy, their productivity exceeds 40% of GDP and they represent 95% of all operating businesses - but you wouldn’t know it by the way their contribution is taken for granted!



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The current definition of a small business is one with less than 20 employees and there are over two million of them actively trading in Australia. Survival rates for start-ups are better than imagined at around 70% in the early years and with approx. 55% still operating after 5 years. However since the onset of the GFC failure rates have been rising and this is expected to continue whilst owners remain under the present economic stress.



Australia’s total numbers of businesses by employee size are as estimated below:

1. By category count
 - Micro unemploying businesses = 60%
 - Employing businesses(1-4) = 24%
 - Remaining SME’s (5-19) = 11%
 - Medium businesses (20-199) = 4%
 - Large businesses (200+) = 1%
 - 100%

2. By employing organisations
 - Non- employing = 1,200,000
 - Small Employing = 830,000
 - Medium employing = 83,000
 - Large employing = 7,000
 - 2,120,000

1. Survival Rates

In 2007/2008 survival rates for start-ups were over 80% but had fallen to under 75% by June 2009. Failure rates for 2010 jumped to 10,000 being 2,000 more than in 2009. Countering these falls were the number of new starts at 160,000. However Dun & Bradstreet forecast in early 2012 that economic stress was likely to continue for up to 128,000 small businesses. D&B also published numbers in February 2012 which showed a 48% rise in closures over that of the past three year average. There was also a 95% fall-off in the number of start-ups. The largest number of closures occurred in the service sector which is the most heavily populated sector by SME’s. The hardest hit were those businesses with less than 5 employees

“Managers seek the benefits of promotion inside the corporation whilst owners must create value in their own enterprises...the two cultures are like chalk to cheese”

(57%) and then those with 6-19 employees (40%). The sectors most affected were service firms, finance organisations, real estate and construction. Queensland’s performance was little better with a rise in failures of 37% over past average rates.

2. The effects of lost spending

Total business numbers show SME’s account for 70% of all business employment and more than 80% of that employment is in the services sectors. Obviously if only half (457,000) of the total operating small companies (914,000) could be incentivised to hire one more employee Australia’s unemployment rate would disappear overnight. The multiplier effect of the additional consumer spending would cascade down to the base of the economy which is exactly where it is needed. To look at it another way if 12,000 public servants are laid off at an average wage of \$50,000 per annum the gross spending loss to the economy approaches \$400million after tax. If those 12,000 eventually go onto welfare the costs to the taxpayer is \$150m+ per annum for as long as they remain out of work. Admittedly these figures are raw but they are intended to illustrate the effect of unintended consequences.

3. Big doesn’t understand small

One of the problems aggravating small businesses in a downturn is that big business does not understand small business very well. Managers mostly have little or no real experience in owning small businesses and lack insight into small business operations. The generalist skills required for small business ownership are different to the narrower skills required in management positions. This was illustrated recently in quoted corporate research that showed wages had risen over inflation for the past few years resulting in a \$200+ gain in weekly wages. The statistic was then represented to show how well off Australian families really were despite comments to the contrary. One hopes that corporate manager made it home safely!

Managers work in defined roles (with Job Descriptions) and within the comfort of an organisation bigger than themselves. They receive regular salaries and benefits which can be foreign territory for business owners. The shocks in store for managers who become owners are:

- the inherent insecurities of small business
- the lack of a regular salary – you have to pay employees first
- the absence of support units
- the daunting realisation that they are fully accountable for everything.

Becoming an **A**FEBT (**A**ccountable **F**or **E**very **B**loody **T**hing) can be intimidating and the stress so overwhelming for some that former manager's close the business and go back into regular employment.

Today's managers have also been taught the holy mantra of 'growth is good'. I heard one CEO at an AGM say that as the purpose of a business was to grow and as he had been growing the business he must be considered a success (the business had lost money that year). We can all be great managers in strong economic times but few of today's managers have been taught how to manage in bad times. That's because most have had a dream run during the past 15/20 years but now not knowing what to do could now mean the demise of the business. We have not trained managers how to create, run and manage mature businesses in times when growth is minimal or absent....and we have arrived at that position now.

For example, the 'Doom Loop' principle is alive and well i.e. the loop occurs when an organisation continues in business by cutting costs to preserve itself. Continuing to cut can cause it to reach a point where it is too weak to respond quickly to change or re-service the market. It then falls into a spiral (the loop) because it cannot respond quickly enough to change whilst competitors are taking their business away. It happens more often than we may recognise – some say Wal-Mart is heading that way now caused by staff cutting that is killing customer service. Remember the old K Mart, Fletcher Jones and Darrell Lea....and now Ford and GM who continue to build cars that are out of date but seek huge funding assistance to stay alive (whilst competitors take the business).

Market conditions are such that over the past 6 months some 600 retail stores have closed and 1500+ staff have been laid off (and rising). Some of the biggies are either quietly lying off staff or are off-shoring job numbers like ANZ Bank and Telstra.

When we add the several thousand small business closures already on the books plus the numbers of

closures continuing to occur, we may begin to understand the level of stress for small business. The damage can be widespread in personal terms for the directors, owners, families and employees as well as associated suppliers.

4. **Small business strategy**

Contrary to popular opinion SME's do not require 100 page strategy documents to be successful. This is often an imposition by third parties who need the document for their own reasons.

For example, a 'vision' may be written with clarity but which inevitably needs changing as the business evolves. The key to good strategy for small enterprises lies in planning the evolution to an end game - which is more complicated than a 'dream' run. The real strategy for the business emerges somewhere between the second and fourth years when the initial lessons have been learned and owners face the reality of their markets.

There is no reason why a well-managed business cannot be adequately maintained in the meantime. This realisation can be lost on those who don't understand small business or that the development phases for small business are not linear and may be radically different from those of a big business.

SME owners must take into account issues such as business and demand cycles which are relevant to their particular industry; adapting to discontinuous change in markets and in consumer behaviours. Mismanaging change at micro and small business level is much more dangerous to continuity than for larger organisations.

5. **The days of starting on sixpence are gone**

The World Bank index provided in its '*Doing Business Report 2012*' listed the following countries in order of ease in starting a business:

1. Singapore
2. Hong Kong
3. New Zealand
4. USA
5. Denmark
6. Norway
7. UK
8. Republic of Korea
9. Ireland
10. Iceland



Other lists in 2007 and 2009 rated Canada and Australia in the top 10 also mainly because of an added score for speed at which a company can be created.

Consumers are saving at record rates

It's about 10% and of course they are and it's because they fear the future. Consumers don't

have the past levels of discretionary spending available now and are repaying debt, coping with rising bills and trying to put something in the Bank. What's left is not what it used to be so retail will remain patchy and volatile as it continues in an uneven spending climate.

Consumers are not spending at retail

Doh! See number 1.

One well known TV commentator said that "people must open their purses if retail is to pick up". When people don't have much money they make things do and go without. Farthest thing from their minds is spending just to help retailers out – ask Gerry Harvey!

The rate of employment/unemployment not well reported

The rate of *underemployment* is rising and especially for those under 25 where it is approaching four times the rate of older demographics. The average underemployment is estimated at between 10%-12% and that's a lot of persons doing it tougher now than two years ago. It obviously casts doubt on the consistent claim that our unemployment rate is under 6% - at least now admitted by the Pollies to be a rising figure.

6. Pertinent international plays

China has clearly been slowing for two years and managing down its resource purchasing because it is changing its economic path from investment (building stuff) to consumption (selling stuff domestically). It's got cities to fill, a growing urbanisation expectation, shadow bank loans out of control and a huge property bubble it is trying to bring down softly. We need to remember that China cannot maintain record exports to customers who are broke - but it also cannot shut down its huge manufacturing capability and lose it to competitors. The uncomfortably close pursuit by countries like Korea, Brazil, Vietnam and India have already lured some of our biggest brands to have their stuff made in sweat shops outside China.

We are now in era where more and more independent entrepreneurs are buying directly from China and selling into local markets. They are jumping over the wholesaler channels which as a consequence, are now an industry sector in danger of redundancy! This is one of those destructive/constructive forces at work against small businesses which follow traditional supply chain practice. As they say "Another nail in the coffin" that is very hard to defeat.

When you're importing with a high dollar it's great and margins can be more than adequate but now the game is changing. The lower dollar will cause rising costs that will be passed onto the consumer.

China's GDP is projected to run at about half of its previous high (6% v. 13%) and that is admirable by any comparative measure but it's a kick in the pants for us with a 50% falloff. For reasons I won't go into here I can predict that we will be told the GDP figures coming out of China will be around the 6-7% as the baseline.....in other words we may never really know what the accurate GDP is! It's known China will continue to buy our resources because of quality but at lower prices and in lesser quantities. Some of the coal mines will soon be underwater in profitability terms and our miners will continue with their good bets - but adjust their investment on the poorer return models and the smart ones will innovate away from the marginal bets. That will mean less employee intakes for the industry as has already been the case with some layoffs in certain mines.

So what could be done for small business?

FIRSTLY

We need to appreciate how different the present downturn is because of factors not experienced previously. The creation of easy money based on the shonky derivatives which produced both the boom and the resulting huge debt

overhangs is unique. If Keynesian economic theory is used for recovery under his 'General Theory of Employment, Interest and Money' published in **1936**, we will be at it for years. The cutting of costs on the one hand and trying to spend our way out with infrastructure builds on the other isn't a sinecure now. Whilst infrastructure builds are good for specific employments, no broken economy under present GFC conditions has enough money to pull that off quickly because of the volume of spending required – it can only be a palliative in a mix of efforts.

This has been recognised by the USA and Japan who have demonstrated their understanding that more money **MUST** flow to the base of the economy before anything lifts. Punishing the base by letting companies fail, rising prices, laying off employees, raising taxes and cutting back Government expenditures are in effect sure ways of extending the pain and destabilising small business - you don't generate base level spending

In 1936 the Australian economy was smaller with a population under 7 million, GDP was around £485m (\$18bn then v. \$1.5trn today). Unemployment reached 25-30% of the available workforce i.e. approaching 1 million persons

that way, you only add to stress to existing business burdens.

Another compounding effect arising from the public saving money rather than spending it, is tightening in the domestic economy which in turn hurts retailers and small businesses.

The experimental Quantative Easing (QE) of the USA and Japan may follow Keynesian theory in that on-spending under his *Multiplier Effect* which recognises the cascading effect of spending can be as great as 7 times as it passes down the consumer chain.

What is needed is:

- substantial reduction in worldwide debt so that cash can flow into consumer spending

What we have are:

- broken European economies cutting back, countries like USA and Japan playing with QE of enormous size and lowest cost suppliers like China cooling off at a time when we need their spending

No-one believes that throwing more debt after existing debt at broken economies will work any magic. Greenspan said in late 2006 that “I didn’t see the crash coming because I thought self-regulation by the Banks would not let it happen”. How naive is that for an economist running the Federal Reserve? We have also allowed the dangerous situation to arise where some corporations have become ‘too big to fail’.....this is scary stuff in a *laisser-faire* economy like ours and borders on monopolistic thinking.

SECONDLY

My primary argument is we don’t only need some spending at the top of the economy we also need plenty at the bottom to stimulate the domestic economy and help drive up recovery.

necessarily out of control. However we must be alert to this burden for a country as small as ours i.e. there is little room to move given our inability to pay debt down quickly. The Govt. is telling us we will return to surpluses in 2016/17 which is simply a guess...to which Treasury figures will no doubt be matched. There are no fundamentals presently in the base of the economy to drive such a rapid response.

We will be 5/8 years away from surpluses unless we adopt an austerity regime for political reasons. We are already six years into the GFC and it will get a bit worse before it gets better. The old economic formulas of cutting costs, inhibiting spending and increasing redundancies won’t do it anymore (see Europe). It’s more sensible to plan a recovery over a longer term, account for falling international trade and concentrating on the cooling of our domestic economy. We need time to stimulate small business - which will be helped in Queensland one assumes by the upcoming Commonwealth Game activity.

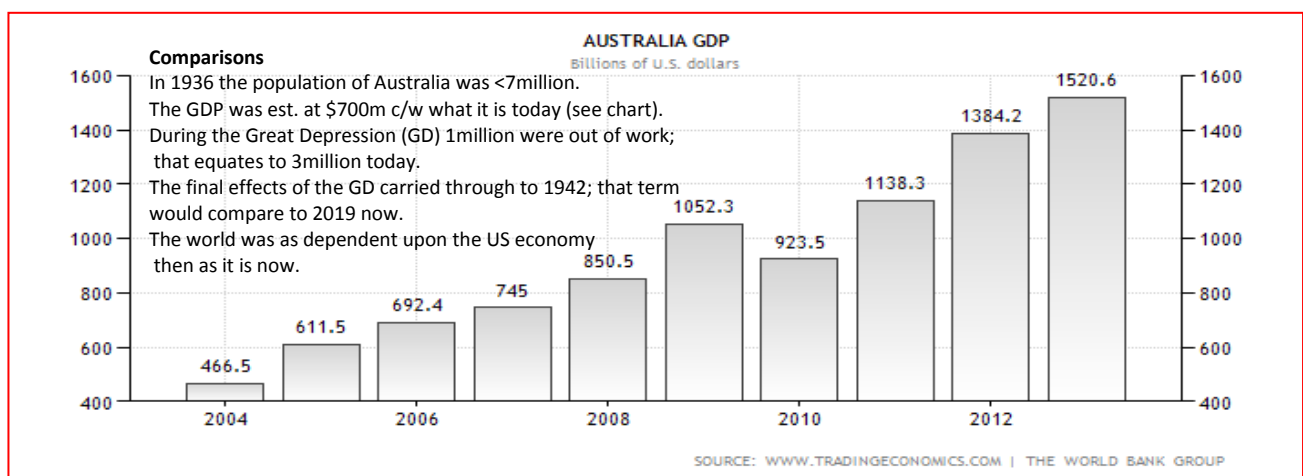
7. What can people & politicians do

We are not without things to do; it’s whether or not Governments have the guts to do them!

There is a general belief that things will get better ‘soon’ when what is needed is a plan of action to make that happen over sensible timeframes. We expect our politicians to look after Australia first even if it takes more time to get it right – that’s their job responsibility!

The lower dollar will begin to help us grow competitive export trade and I am a fan of a sinking dollar. Government can get in behind our genuine exporters to help them rebuild trade.

Lower interest rates are needed *now* and one hopes the Reserve will actually get on with the job



Cutting spending at the top can help because Commonwealth debt is currently around \$274bn compared to our GDP \$A1.3trn, providing a ratio around 20% which for Australia is high but not

sooner rather than later as has been its habit in the past. We urgently need the effect of putting more cash at the disposal of the consumers by lowering key costs (like mortgage rates).

It's a tough lesson to learn that giving away manufacturing is a step to destruction because it's so hard to get it back. Look at what's happened to the mighty British ship building empire - which they will never recover:

World's largest shipbuilders by marketshare:

South Korea	= 51.2%	
China	= 31.2%	
Japan	= 4.7%	
Philippines	= 2.0%	
Marketshare	= 89.0%	UK = 2%

We will need to foster internal manufacturing and primary industries and focus on them as replacement industries to fill the mining gap. Yes, agriculture has to be in the mix but let's not sell off the farm in the process. China's has an agricultural investment focus on Australia because of our quality so our Pollies will have to strike careful policy on what will and won't be sold off. What we have now are parts of our farming and horticultural industries underperforming financially or failing, some of which is caused by big retail players pressuring supplier costs down to bare minimums and overpowering small business competition.

Gas exports are on the cards because we have a lot of it and its use will grow worldwide as an energy replacement - that's why our Government/s are rapidly dishing out gas exploration permits during the 'fracking fever'. Whatever the real training and employment possibilities are in this industry they have not yet been fully explored but by the nature of the product and process they are less than hard mining.

Government can sell off whatever specific assets are appropriate to create business activity such as land and buildings that could be sold for agreed purposes and enter into contracts with buyers local or foreign to build specific projects over given periods (with local labour). However I'm not sure we still have billions of assets we can put up for sale anymore!?

Use tariffs or direct assistance to block excess/dumping of trade that does not benefit Australia. Example: the foreign imports in the local auto industry which is forced to compete against the world giants. We simply do not need the number of auto brands here which are now 40 plus with over 300 model variations currently available. See my earlier paper No. 27 June 2013

Government must push cash into the base economy:

- **Grants must be placed effectively** to help generate economic activity. Include the Charities which deliver maximum effect for the minimum dollars and who do

not operate with high administration costs.

- **Lower tax rates** to ensure businesses generate more profits; that way in turn more taxes can be generated; employment can rise and small business can endure.
- **Stop the ATO charging interest** on outstanding debt which makes it harder for small businesses to pay. Creating new money (interest) for itself is not an option at any time but especially in the middle of a GFC.
- **ATO to write off SME tax debts up to \$10,000** which would immediately assist small businesses cash flows. Such action would be a direct injection or retention of cash for some SME's and an immediate investment in small business continuity.
- **Remove hurtful taxations** such as the FBT tax which is totally unhelpful at this time and simply puts more stress on business operators.

ASIC: Become a helping organisation and less a penalising one e.g. cut charges for minor offences; helpfully educate businesses to better understand their obligations.

Cut Foreign Aid and direct it into the urgent needs of Australian businesses. Restore it when we are financially able.

Reduce Local Council costs:

- Improve local operating efficiencies, Reduce expenditures by 10% and outsource Council services to small business
- Close down the competing internal agencies that duplicate the services of the business sector
- Pass on savings to lower rates and utility costs for an agreed period
- Put a hold on rating and utility costs for three years
- Provide free parking days to boost retail visitations

Spread GST over all goods and services but do not raise the current rate. GST is a discretionary tax that is the taxpayer's choice to pay when purchasing goods. It is fairer in some ways than higher imposed taxes

Reduce Government dividends from its operating agencies and revenue earning units and put that money into direct small business assistance and Tourism

Reduce Government taxes within fuel prices, at least for a given period (say three years).

Ensure real jobs are created for Australians which go to Australians including our indigenous peoples

Restore the subsidies (secretly) cut in the Pharmaceuticals Benefits Scheme which will cause price rises to medicines, placing people under stress if unable to pay - plus it would assist pharmacies to stay in business

Cut the Carbon tax and ETS completely and provide incentives and direct assistance to effect real environmental change. The polluting sectors are too slow in doing what they should be doing and will simply pay ETS fees to keep doing it. Every large polluting business to have an alternative energy plan which it must achieve.

Put a sinking lid on Government employment in all Departments for 5 years. Then review staffing needs based on provable requirements.

Devote time, money and effort into recovering the tourist sector. We can't afford NOT TO attract tourists in droves. It's ridiculous that a State Minister is limited in the funding needed to make a splash with the Commonwealth Games looming. Provide investment in tourism *now* and as private/public investments if necessary.

Cut bureaucratic red tape but in so doing ensure it makes life easier for small business. The State Government has declared a 20% reduction goal and should include the issues that plague owners - across all levels of Government.

Govt. to work closely with small business.

- Ministers and their advisers to have real small business experience as must members their advisors (we don't need more theoreticians).
- Reduce MP spending allowances
- All politicians to be subjected to salary stops for three years
- Create State/Federal planning committees to determine real thing that help small businesses

Don't overlook Indigenous small businesses
They could make significant progress with the right financial and other assistance, either within their own communities or competing in the mainstream economy. Help them 'Close the Gap' to become independent businesspeople free from subsidy and become employing businesses in their own right. They are a national resource waiting to advance into contemporary society.

The suggestions in this paper are by no means exhaustive and have been made with the view that spending at the base of the economy is the best way to relieve pressures on small businesses, especially in the present economic climate. Further taxing businesses of any size in any way is senseless because it reduces cash flows, leads to unemployment and lower productivity.

The largesse being handed out by our Politicians at this time is astonishing in view of the need to be cautious in burdening the economy with further debt.

Trying to bring the economy to surplus' through austerity measures is not vote catching because the public do not care about a particular timeline or about losing the national AAA credit rating - they want firstly to survive and secondly to be able to maintain their business livelihood which may be the only cash generating mechanism they have.

Returning the economy to surplus is laudable and obviously beneficial in expanding national capacity but it's not seen as the only way to protect Australian business - we need better thinking than that.

Our economy is about to transition through discontinuous change and the party that understands that best and realises we need to embrace innovative thinking to emerge with new and/or more robust replacement industries will win. Then again, that will take a deal of long term thinking which of course we cannot trust our short term thinking politicians to engage in!

I think it's also time to help each other because we (small businesses) represent 95% of the registered operating entities in Australia. We can be more adept at changing our ways and making quicker business decision that the big companies can but they can out-lobby us with their collective powerbases. We need to make our presence felt and heaven help the politicians that ignore us at voting time!

Next paper in this series will be:
'How Small Businesses can beat the Big Guys'
