Discussion

1. Bill Allen

This paper targets a worthy area for investigation in seeking to add to the story behind why some small businesses fail and others do not. In acknowledging that small businesses 'face many operational challenges', this paper goes one step further and asks whether these challenges 'affect the business decisions of small businesses relative to those of larger businesses'.

The paper is successful in this regard, shedding some light on differences in economic decisions regarding selling price, employment and investment spending sensitivity. I also applaud the creative presentation of these results (such as in Figures 14 and 15). It can be difficult to convey results in a way that helps to tell the story, and these figures do it well.

In reading the paper, I encourage readers to consider not only the question examined in this paper – do economic decisions differ between small and larger businesses? – but also the 'follow-up questions': why might they differ? does it matter that they differ? and how can these results be used to create an environment that supports small business? This paper is part of a much longer journey in trying to better understand the reasons behind the success and failure of small businesses.

In my comments, I will focus primarily on the modelling undertaken using data from the Reserve Bank of Australia's (RBA) business liaison program. However, before I do, I want to briefly address the Australian Bureau of Statistics (ABS) data used to look at the share of businesses by size in regional areas (see Figure 3). I suggest caution in interpreting these numbers for medium and large businesses. In particular, for businesses with multiple locations, the ABS only records a single location – usually that of the head office.[1] This fact affects the interpretation of these numbers.

It is also important to consider the nature of business exits in the ABS data. Many people's immediate reaction to a business exit is that the business has failed. However, business exits cover a range of outcomes: businesses that cease to operate; 'dormant' businesses – that is, businesses that have not remitted goods and services tax (GST) for at least five quarters and are, therefore, not included in the ABS data; and even successful businesses, where the business is purchased by and incorporated into a larger business. Dormant businesses can be particularly misleading. These can include new businesses that register for an Australian business number to claim GST credits for set-up costs and then fall into dormancy until business operations commence. Once again, these facts make the interpretation of these data difficult.

Coming back to the RBA's business liaison program, the analysis in the paper can only make inferences about the types of firms covered by the liaison program and, in this respect, there are a number of caveats to bear in mind. This is not a criticism of the RBA liaison program – it has been

1 The Australian Business Register now stores information on multiple locations – at least for larger businesses – and the ABS hopes to incorporate this information into its statistics in the future.

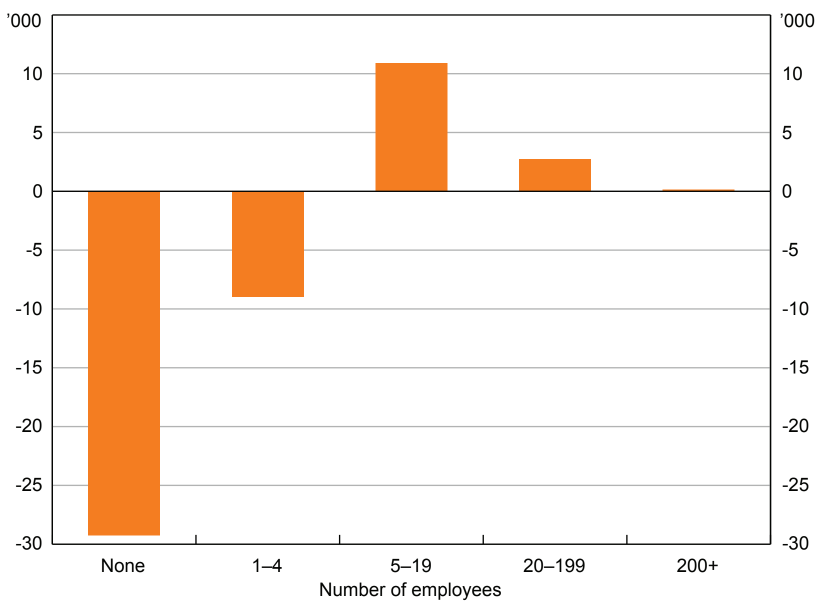
developed to focus on the much broader needs of the RBA, rather than explicitly on the issues surrounding small businesses. However, the analysis can nonetheless provide valuable insights into the business population that it does represent. However, it is not the same as the population of Australian businesses.

First, the industry distribution of firms covered by the RBA's liaison program differs from that found in the business population, consistent with the broader purpose of the program. For example, in the RBA's liaison program there are more manufacturing firms and fewer firms in the construction or agriculture industries. However, I have been reassured by the authors that variables to look for industry effects were considered in the modelling and found to be insignificant.

Still, the most significant difference between the distribution of the RBA's liaison program and ABS data is that there are virtually no firms with five or fewer employees in the RBA's survey. This needs to be considered in the context of the fact that it is these firms that are most in danger of not surviving.

To put this into context, consider the net change in business counts from 2010 to 2014, by employment (Figure 1).

Figure 1: Change in Business Counts
By business size, from end June 2010 to end June 2014



Source: ABS

From June 2010 to June 2014, there was a net loss of 38 272 businesses with fewer than five employees (including non-employers). These businesses are not considered in the paper's analysis. Further, there was a net increase of 13 784 businesses with five or more employees; this increase must have ultimately come from those businesses with fewer or no employees.

To summarise, it is this sub-population that is not covered by the RBA liaison program which is both of greatest danger of business failure and a feeder group to small and medium-sized enterprises. The RBA liaison program is not structured to address questions about this sub-population; another data source would be required to extend the analysis in the paper to this group.

This raises further questions on the possible differences in economic decisions between small and larger businesses. That is, how do the economic decisions differ between thriving small businesses (which might include growing businesses or 'successful' exits), stable small businesses and struggling or failing small businesses. Further, is the current status of these small businesses deliberate (such as a lifestyle choice), or has it been forced upon them through various circumstances? If it has been forced upon them, is there anything that should be done to advise those small businesses to better equip them to respond to challenges?

The size and nature of the RBA liaison program will not support this type of analysis, so the question is: what data are available to assist with these follow-up questions? Administrative datasets are attractive options because such datasets cover all – or at least more – of these small businesses. For example, taxation data – such as business income tax or business activity statements – can provide longitudinal data on employment, turnover and other attributes. The ABS Business Longitudinal Database also considers factors such as innovation and the use of information technology, as collected in the Business Characteristics Survey. However, these datasets lack the broader qualitative information on economic decisions that are available from the RBA liaison program.

Nonetheless, this paper provides some useful insights on the economic decisions of small business. These are interesting questions and deserve further investigation.

2. General Discussion

Discussion generally focused on the quality of the data and its interpretation. Initial discussion from several participants highlighted potential measurement issues associated with ABS data on business entry and exit rates. One participant noted that some businesses maintain multiple Australian business numbers (ABN) for the same business. An example is when one ABN corresponds to the legal entity that owns the business' assets, while a different ABN corresponds to the entity that employs the business' workers. This implies that some businesses will be mistakenly classified as sole traders. Another example is when a larger business buys a smaller business but keeps the two businesses under separate ABNs for taxation reasons. Related to this, a participant queried how firm 'successions' – where an older firm owner chooses to sell or transfer their firm – are reflected in the business exit data. Another participant noted that not all exits should be interpreted as business failures; for instance, an exit can be a success where a company is bought out by and merged into another company.

In response, a few participants noted that the quality of data related to business exits has improved over the last decade. The ABS has been correcting problems related to multiple ABNs for the same business by linking ABNs for the same economic entity and another participant noted that the ABS data exclude businesses that have not remitted GST in the last five quarters for quarterly remitters, or in the last three years for annual remitters. Underlining the improved quality, one participant noted that exit rates observed in the ABS data are consistent with high-quality data from other economies. The participant went on to argue that the seemingly high exit rates are not a cause for concern, as the vast majority of exits relate to micro businesses (i.e. those with fewer than five employees). The participant argued that many of these exits reflect 'experiments' where an individual has tried running their own firm and has failed, but very few of these failures result in bankruptcy or losses for other entities; that is, the entrepreneur is unlikely to have lost their house or generated losses for customers, suppliers or creditors. Additionally, many of these 'failed' entrepreneurs return to gainful employment.

On the topic of business exits, one participant suggested that there might be a difference between Australia and the United States when it comes to attitudes towards small business failure. The participant argued that business failure is viewed negatively in Australia; by contrast, in the United States there seems to be a sense that the potential for business failure is a natural consequence of innovation and risk-taking. The participant suggested that the relatively low cost of business failure in the United States allowed failed entrepreneurs to attempt other entrepreneurial endeavours, and that perhaps this was due to differences in bankruptcy proceedings. Finally, the participant proposed that improving Australia's bankruptcy laws might encourage entrepreneurial risk-taking.

On the topic of bankruptcy, another participant noted that in the event of a business failing in Australia there is no penalty on the director of the company as long as they have not broken the law. However, there are penalties for entering personal bankruptcy – namely, a three-year restriction on being the director of a company or being involved in its management. The participant also suggested that there are cultural stigmas around bankruptcy, possibly harking back to the notion of debtors' prison from the Victorian era. Additionally, the participant went on to describe the nature of business insolvency proceedings in Australia, noting that about 40 per cent of firms that enter insolvency have no assets, and another 20–30 per cent have less than $250 000 in assets. This implies that there is no scope to restructure most firms that enter insolvency. The participant argued that the fact that the directors of a small business are typically also the owners often means that small businesses trade until they fail. By contrast, independent company directors (who have more separation from ownership) seem to seek restructuring earlier and more readily. However, the participant noted that many administrations commence solely as a more comfortable method of liquidation, rather than as an attempt to restructure to save the company. One participant noted that many cases of business failure are due to relationship breakdown. The participant suggested that this reflects two issues: owner-managers facing relationship difficulties are more likely to put less effort into running their small business; and financially resolving a relationship breakdown often means that a small business needs to be dissolved because the finances of the small business are usually intertwined with the finances of the household.

One participant observed that reductions in business entry rates were puzzling given changes in, among other things, start-up costs, barriers to global trade and access to information. In response, another participant argued that improved availability of information about the costs and challenges of starting and running a business may have discouraged potential entrepreneurs. David Orsmond explained that the RBA's liaison suggests that, despite improved access to information, it is still very difficult for small businesses to understand new markets. Another participant also posited that the state of the labour market was likely to have an effect on start-up rates, as some individuals would start a business to avoid periods of unemployment. Related to this, another participant noted that some individuals start businesses because of the declining economic performance of the larger businesses they are working in. As an example, the participant described how some individuals in the automotive industry have responded to redundancies by starting a business (particularly given a mismatch between their skills and existing job opportunities).

Underscoring the difficulty of interpreting the data, one participant noted that the problems faced by small start-ups are very different to the problems faced by older small businesses. The participant went on to question whether the paper's results around the behaviour of firms would differ with business age, and whether this might not make interpretation of some results easier. Another participant emphasised that it is important to recognise that a small business is not just a 'big business shrunk down' – that is, small businesses do not necessarily behave in the same way as large businesses. The participant suggested that this is particularly the case for micro businesses, whose behaviour is typically driven by the owner's lifestyle decisions. Dr Orsmond suggested that this is contrary to the findings presented in the paper, although some participants noted that the sample of firms used in the paper under-samples micro businesses and so is unlikely to adequately reflect their behaviour. In response, Dr Orsmond acknowledged that the RBA's business liaison program is skewed towards larger businesses and firms in cyclically sensitive industries, and so does not capture a large number of start-ups or micro businesses.