

Box A: Small Business in the Economy

There are over one million small businesses in Australia, accounting for 95 per cent by number of all businesses and around 30 per cent of private sector output.¹ These businesses cover a wide range of activities, from tradespeople, to professionals, to small manufacturing or retailing concerns. Over half of small businesses consist only of the owner (or owners in the case of a partnership), with no employees. The average

number of employees across all small businesses in 1999/2000 was around three. Consequently, small businesses employed around 40 per cent of the total workforce, or around 50 per cent of the private-sector workforce. In recent years, the number of people working in small businesses has grown broadly in line with that of the economy as a whole.

Table A1: Small Business in the Economy ^(a)

1999/2000

	Number of small businesses '000s	Employment		Sales ^(b)	Operating profit before tax ^(b)
		'000s	Share of industry	Share of industry	Share of industry
Agriculture ^(c)	100	249	74	na	na
Mining ^(c)	2	9	12	12	36
Manufacturing	86	275	29	13	28
Construction	209	474	82	55	68
Wholesale trade	64	244	43	31	24
Retail trade	165	590	48	43	69
Accommodation, cafes & restaurants	31	183	44	40	44
Transport & storage	64	163	52	21	19
Finance & insurance	24	58	20	30	40
Property & business services	207	584	55	47	57
Education	25	65	31	na	na
Community services	69	230	43	46	71
Culture & recreation	38	91	47	15	18
Personal & other services	77	184	71	52	43
Total private sector ^(d)	1 175	3 430	49	30	39

(a) Excludes public sector

(b) Data are for 1997/98 and exclude agriculture and non-employed businesses

(c) Number of businesses and employment data are for 1998/99

(d) Includes utilities and communications

Source: ABS Cat No 1321.0

1. A business is generally regarded as small if it is independently owned and operated, and is closely controlled by owners/managers who contribute most, if not all, the operating capital. For statistical purposes, the Australian Bureau of Statistics (ABS) defines a small business as one that employs less than 20 people. It defines medium businesses as those employing between 20 and 200 people, while large businesses are those that employ 200 or more people. The ABS excludes public companies, businesses that are in a parent or subsidiary relationship and cooperatives and associations from its definition of small business. Most of the data used in this Box are from the ABS survey, *Small Business in Australia*, ABS Cat No 1321.0.

Small businesses are found in all the industry sectors of the economy, though they are more prevalent in some areas than others. The largest numbers of small businesses are in the property and business services, construction and retail sectors (Table A1). These industries account for around one-half of total employment in small businesses. In the construction sector, over three-quarters of the workforce are employed by small businesses, reflecting the importance of independent contractors in this industry. Small businesses account for a similarly large share of employment in agriculture. In contrast, small businesses employ less than 20 per cent of the workforce in the mining and finance and insurance sectors.

While small businesses account for around 50 per cent of total private sector employment, they account for only around 30 per cent of sales and output. In part this reflects the concentration of small businesses in labour-intensive industries such as construction and retail trade. For the same reason, the investment rate of small businesses (measured by capital expenditure as a share of industry value added), at around 16 per cent in 1998/99, was lower than for large businesses which was around 27 per cent. The average hours worked in the small business sector tends to be higher than in the rest of the economy. In 1998/99, over one-quarter of small business operators worked at least 51 hours a week, compared with less than 20 per cent for the workforce as a whole.

The rate of turnover of small businesses tends to be higher than for the rest of the economy. According to the Productivity Commission, in 1995/96 almost 8 per cent of small businesses ceased operations compared with around 5 per cent for medium and large businesses. The rate of small business formation is also much higher than for large firms. This implies that each

year a disproportionately large share of new jobs tends to be created by small businesses. For example, in 1997/98, half of all the new jobs created in the economy were in small businesses, spread equally between new businesses starting operations and existing businesses expanding their operations. However, at the same time, half of all the jobs lost in the economy were also in small businesses, with the majority of these in businesses that ceased operations during the year.

The commercial structure of small businesses differs quite markedly from larger businesses. In 1998/99 around 43 per cent of small businesses with employees were incorporated, compared with 70 per cent for larger businesses; 17 per cent of small businesses were sole proprietorships and 38 per cent were partnerships and trusts. In the first half of 2000, there was a noticeable increase in the rate of incorporation, some of which may have been related to the introduction of the new tax system. Subsequently, the number of incorporations has slowed significantly to be around two-thirds of the rate in the first half of 2000.

ABS data suggest that, measured in simple terms, the rate of profitability is higher in small firms than larger firms. But this comparison is potentially misleading, since the income of the manager, who is often also the owner, might be taken as profits in the case of small firms but as a wage or salary in the case of larger firms. Hence no strong conclusion can be drawn from this comparison. Small firms tend to be more reliant than larger firms on borrowing from financial institutions as a source of funding. They generally do not have easy access to raise money from capital markets directly either in the form of equity raisings or by issuing corporate bonds, but rather depend on intermediated finance. ↗