



Australian Government
Productivity Commission

Business Set-up, Transfer and Closure

Productivity Commission Issues Paper

December 2014

The Issues Paper

The Commission has released this issues paper to assist individuals and organisations to prepare submissions to the inquiry. It contains and outlines:

- the scope of the inquiry
- the Commission's procedures
- matters about which the Commission is seeking comment and information
- how to make a submission.

Participants should not feel that they are restricted to comment only on matters raised in the issues paper. The Commission wishes to receive information and comment on issues which participants consider relevant to the inquiry's terms of reference.

Key inquiry dates

Receipt of terms of reference	20 November 2014
Due date for submissions	20 February 2015
Release of draft report	May 2015
Draft report public hearings	June 2015
Post-draft submissions	July 2015
Final report to Government	August 2015

Submissions can be made

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The Productivity Commission

The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interest of the Australian community.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

Further information on the Productivity Commission can be obtained from the Commission's website (www.pc.gov.au).

Terms of reference

REVIEW OF BARRIERS TO BUSINESS ENTRIES AND EXITS IN THE AUSTRALIAN ECONOMY

Productivity Commission Act 1998

I, Joseph Benedict Hockey, Treasurer, pursuant to Parts 2 and 3 of the *Productivity Commission Act 1998*, hereby request that the Productivity Commission (Commission) undertake an inquiry into barriers to business entries and exits and identify options for reducing these barriers where appropriate, in order to drive efficiency and economic growth in the Australian economy.

Background

Firm entry and exit plays an important role in fostering innovation, competition, and thereby driving productivity and economic growth. Competition from new firms, or even the threat of potential entry, forces existing firms to be more efficient. The exit of inefficient firms can provide for greater allocative efficiency as their former resources can be put to higher value uses.

Certain barriers to entry and exit have the potential to hinder the efficient operation of markets, with negative consequences for economic growth. Barriers to entry and exit can be a function of market structure, government regulation, industry specific sunk costs or geography. Cultural appetite for risk is also an important determinant of the level of business entry and exit in an economy.

Business insolvency also results in losses to equity and debt holders, and to employees. Different approaches to managing insolvency can affect the efficient provision of finance and labour.

Scope of the Inquiry

The Commission is to conduct a broad ranging investigation into barriers to business entries and exits and how or where it might be efficiency-enhancing to reduce such barriers. In undertaking this inquiry, the Commission is to investigate, analyse and propose recommendations on the following:

1. The nature and scale/extent of barriers to entry and exit that currently exist for firms and their impact on economic performance.
 - (a) Consideration could also be given to the variance in entry and exit rates, for example, between industries, locations, or firm size.

2. Identify appropriate options for reducing these entry and exit barriers, including, but not limited to, advice on the potential impacts of:

- (a) The regulation of product and service markets;
- (b) Transfers and subsidies to businesses, including import barriers;
- (c) Regulations affecting the ease of starting, operationalising or closing a business;
- (d) Time spent on and cost of complying or dealing with government regulation, licensing and bureaucracy; and
- (e) The personal/corporate insolvency regimes on business exits.

Process

The Commission is to undertake an appropriate public consultation process, inviting public submissions and releasing a draft report to the public. A final report should be provided to the Government within nine months of receipt of the reference.

J.B. HOCKEY
Treasurer

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1 What this inquiry is about

This inquiry is about the impediments faced by those setting up or closing businesses in Australia. The entry, transfer and exit of businesses are natural features of a dynamic, efficient and productive market economy and have significant positive impacts. New businesses offer new products and services, place competitive pressures on existing businesses, and can use new processes and businesses models that may provide spill over benefits to other parts of the economy, while the closure of existing businesses can free up labour, capital and other inputs for more productive uses.

The existence of barriers to business set-up, transfer and closure can have a detrimental impact on the efficient operation of markets and on economic growth. These barriers may be related, for example, to the intervention of governments in markets, regulation or arise from the operations of a particular sector or industry. Not all businesses exit as a result of business failure and the Commission will also examine issues surrounding the transfer of successful businesses between owners.

Many government policies and/or regulations that create these barriers have legitimate policy objectives (for example, to provide health and safety standards and protect consumers). A key task of this inquiry will be to identify alternative mechanisms, where the case can be made for change, that both meet the legitimate policy and regulatory objectives of government and reduce or remove unnecessary barriers to business set-up and closure.

The Commission has been asked to undertake a broad ranging investigation into the barriers to business set-up and closure and how overall economic efficiency could be improved by removing or reducing these barriers. In particular, the Commission has been asked to investigate, analyse and develop recommendations on:

- the nature and extent of barriers to entry and exit that currently exist for firms and the impact of these barriers on overall economic performance
 - the Commission has also been asked to examine how rates of business entry and exit vary between different industries, locations and firm sizes
- identifying appropriate options for reducing these entry and exit barriers, including
 - the regulation of product and service markets
 - regulations affecting the ease of starting, operationalising or closing a business
 - the time spent on, and the cost of complying or dealing with, government regulation, licensing and bureaucracy
 - transfers and subsidies to businesses including import barriers
 - the personal and corporate insolvency regimes on business exits.

How you can contribute

The Australian Government has asked the Commission to release a draft report and to provide a final report to Government within nine months (late August 2015). The Commission is seeking submissions from interested parties by 20 February 2015 and will hold public hearings to elicit feedback on the draft report. It may also convene roundtables on selected topics. Details on how to make a submission are provided in attachment A.

This paper sets out some of the issues and questions the Commission has identified as relevant at this early stage of the inquiry. Participants are not expected to address all of the issues raised and are welcome to provide information on any other issues they consider of relevance to the inquiry.

The Commission's approach

While the interests of business will be a key consideration in developing recommendations to remove or reduce these barriers, in keeping with its legislation, the Commission will seek to ensure that its proposed recommendations provide the best outcomes for the wider community.

In preparing its report, the Commission will conduct its own analysis and draw heavily on input from participants through consultations, public hearings, written submissions and stakeholder comments provided through the inquiry website.

The Commission will also draw on a large body of relevant work it has undertaken in recent years, including reviews, inquiries and studies on: the regulatory costs placed on business in general and specific industries; the performance of businesses in certain sectors and the operation of specific regulatory regimes, such as planning, zoning and development assessment; the impact of subsidies and assistance as well as the personal and corporate insolvency regimes (box 1). The Commission's approach will be to draw on any new evidence and information as well as previous Commission work where relevant to examine and analyse the regulatory issues facing business. In addition, the inquiry will also draw on any other relevant studies and reviews, to avoid replicating current research.

The Commission will also have regard to the recently released Financial System Inquiry (The Australian Government the Treasury 2014) and its analysis and recommendations to facilitate future innovation in the financial system, particularly the recommendations that aim to:

- remove unnecessary regulatory impediments to innovation, particularly for small business fundraising and in the payments system
- facilitate the identification of innovation opportunities
- strengthen Australia's digital identity framework
- develop data driven business models by improving access to public and private sector data.

The Commission is also aware that the Competition Policy Review is due to report to the Australian Government in March 2015. The report will cover anticompetitive behaviour, competitive neutrality, the national access regime and other regulatory restrictions that can act as barriers to entry. The draft report released in September 2014 noted that technological change has facilitated innovation and new business models and that existing laws and institutions can struggle to keep pace (Competition Policy Review Panel 2014).

1. *Which recommendations made by the Commission and other public inquiries that remain unimplemented are most relevant to this inquiry? Where recommendations have been implemented in part, or in a particular jurisdiction, what have been the outcomes? Are there any examples of leading practices?*

Box 1 Commission studies that considered business set-up or closure

There is a substantial body of previous work undertaken by the Commission that has touched on issues around business set-up or closure. These studies have tended to focus on particular aspects, such as regulatory barriers, or have examined issues through the lens of a particular industry. Some of these studies include:

- As part of a group of studies on the relative costs of doing business in Australia, *The Costs of Doing Business: Retail Trade Industry* (PC 2014b) and *Costs of Doing Business: Dairy Product Manufacturing* (PC 2014a) examined the business costs and policy impediments facing these industries. For retail, this included planning and zoning and trading hour restrictions that act as impediments to setting up a business.
- The *Regulator Engagement with Small Business* study (PC 2013) examined how regulators' engagement practices affect regulatory compliance costs, which could impose a barrier to the entry of new firms.
- The Performance Benchmarking of Australian Business Regulation study included a number of relevant reports. The *Cost of Business Registrations* study (PC 2008) estimated the cost to businesses of obtaining a range of generic and industry-specific registrations required to set-up a business. The *Food Safety* study (PC 2009b) found that food safety regulations could be unnecessarily burdensome, which could act as a barrier to entry of new food businesses. The *Planning, Zoning and Development Assessments* study (PC 2011) included an assessment of the barriers to business entry and operation imposed by planning and zoning regulations and development approval requirements. The *Local Government as Regulator* benchmarking study (PC 2012) found that local governments can prevent businesses from operating or realising opportunities.
- The series of annual reviews of the regulatory burdens on business looked at a number of specific areas including: the *Primary Sector* (PC 2007), the *Manufacturing Sector and Distribution* (PC 2008); *Social and Economic Infrastructure Services* (PC 2009); and *Business and Consumer Services* (PC 2010).
- The inquiry on *Government Drought Support* (PC 2009a) touched on a number of issues related to farm business set-up and closure, particularly around structural adjustment and farm exit, including impediments to farm exit, succession planning and retirement assistance, and the use of industry exit grants.

There are also a number of international indexes including those produced by the World Economic Forum and the World Bank's Doing Business surveys that rank international performance on various measures of competitiveness, regulation and governance that are likely to impact on business set-up, transfer and closure. However, the outcomes of these international indexes and the relative performance vary considerably. As a result, the Commission is actively seeking new and additional data and evidence to support its research, findings and recommendations in this inquiry.

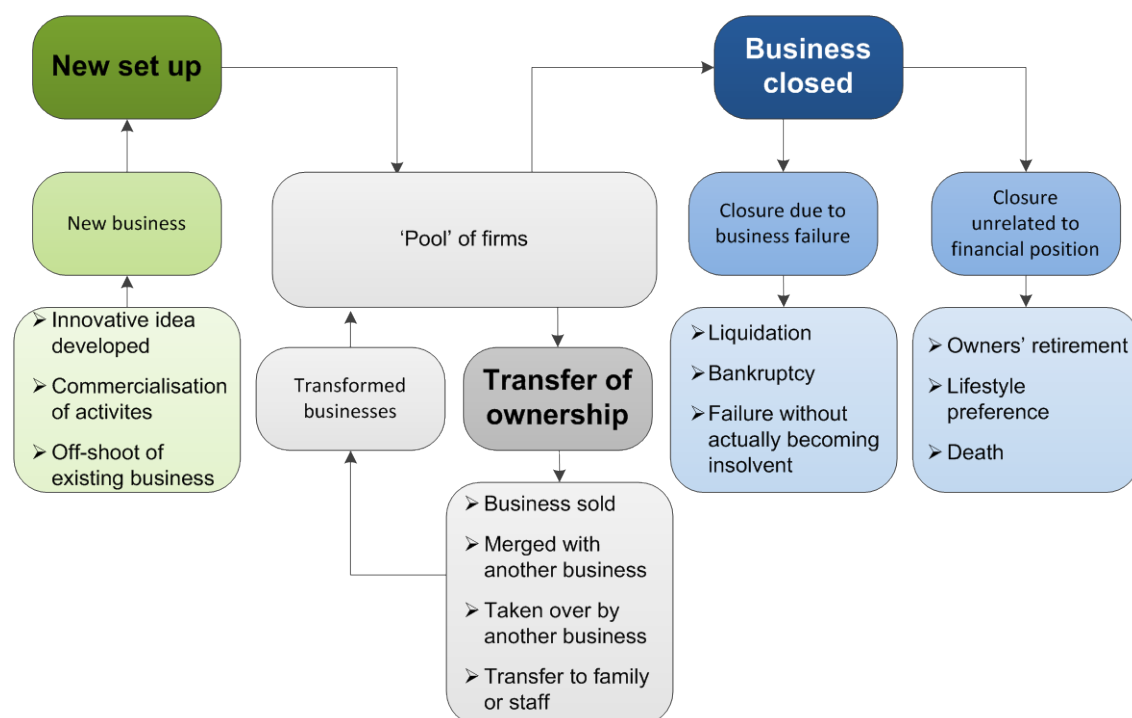
2. *What international research, including published indexes, provide robust insights into the relative ease of, and barriers to, business set-up, transfer and closure?*

2 Trends in business set-up, transfer and closure

The stock of businesses in Australia is not static. The Australian economy consists of a 'pool' of businesses and every year businesses close and are replenished by a flow of new businesses. New business can also result from existing businesses being transformed as a result of sale to new owners, mergers or through a takeover by another business (figure 1).

How readily businesses are able to set-up or close will impact on the overall efficiency of the Australian economy, economic growth and living standards.

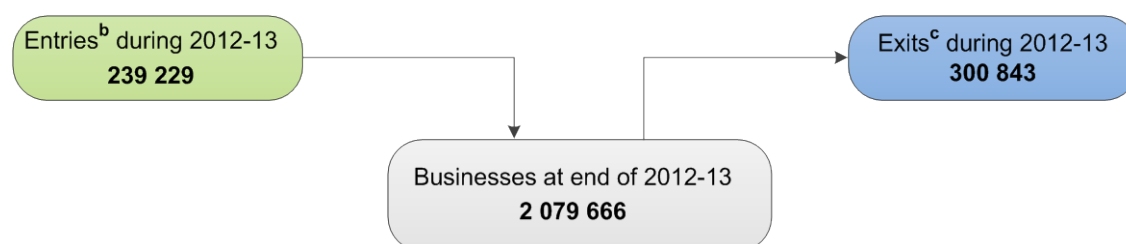
Figure 1 **Business set-up and closure**



What has been happening

Over two million businesses were actively operating in Australia at the end of 2012-13. During the year, around 240 000 businesses entered the stock of active businesses after being set-up or recommencing operations. Over 300 000 businesses exited the stock of active businesses after closure or the suspension of trading. Because exits exceeded entries, the stock of active businesses declined by around 60 000 in 2012-13 (figure 2).

Figure 2 **Businesses in Australia, 2012-13^a**



^a Active businesses are defined by the ABS to be those with a GST role which have reported in one of the last five quarters (or one of the last three years for annual remitters). ^b Entries include business set-ups, reactivations and businesses which have recommenced trading. ^c Exits include closures and businesses which have stopped trading.

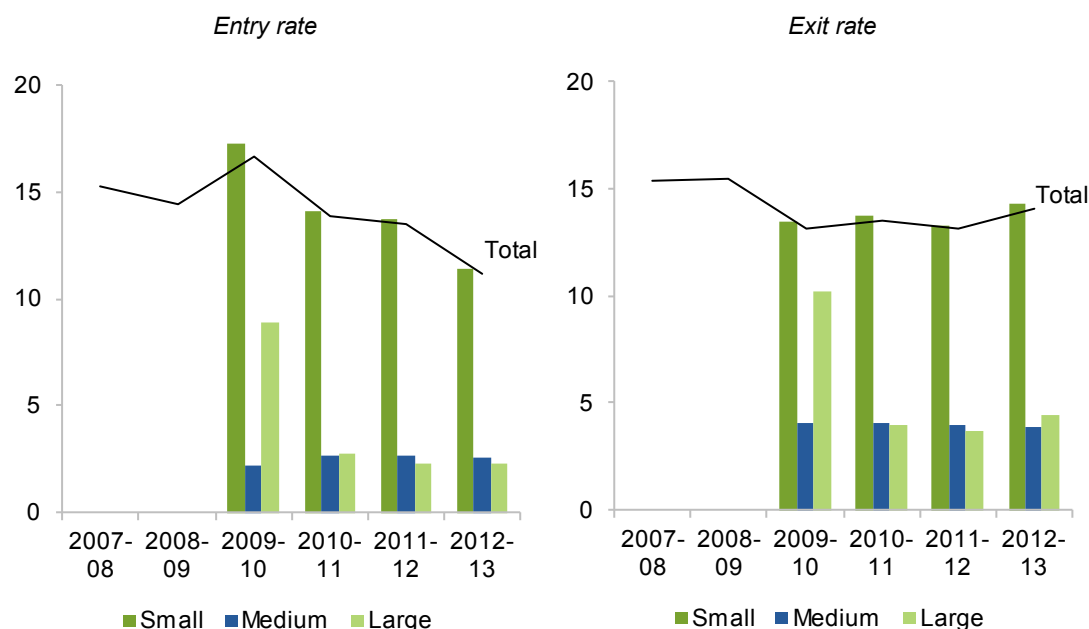
Source: ABS (*Counts of Australian Businesses, including Entries and Exits*, Jun 2009 to Jun 2013, Cat. no. 8165.0).

Businesses constantly enter and exit the pool of existing firms over time. Between 2007-08 and 2012-13, entry rates as a proportion of all businesses declined from 15 to 11 per cent. Exit rates have increased slightly and in 2012-13 the exit rate increased above the entry rate (figure 3). In the four years prior to 2007-08, entry rates averaged around 17 per cent and were higher than exit rates which averaged around 15 per cent. While there have been ABS methodological changes, this points towards a longer term decline in business entries.¹

Entry and exit rates vary with the size of the business. Small businesses — those with less than 20 employees — represent the majority of business entries and exits, with the highest entry and exit rates. Between 2009-10 and 2012-13, small business entry rates declined, but remained higher, on average, than exit rates. In contrast, medium and large businesses had lower entry and exit rates than small businesses over this period, and their entry rates were lower than exit rates. While issues around business set-up are more commonly associated with small businesses, they can also impact on larger businesses and the economy as a whole. Issues around business closure relate to businesses of all sizes.

¹ The ABS changed the GST threshold for the July 2007 and subsequent business count publications (ABS 2010).

Figure 3 Business entry and exit rates,^a by business size^b
Per cent



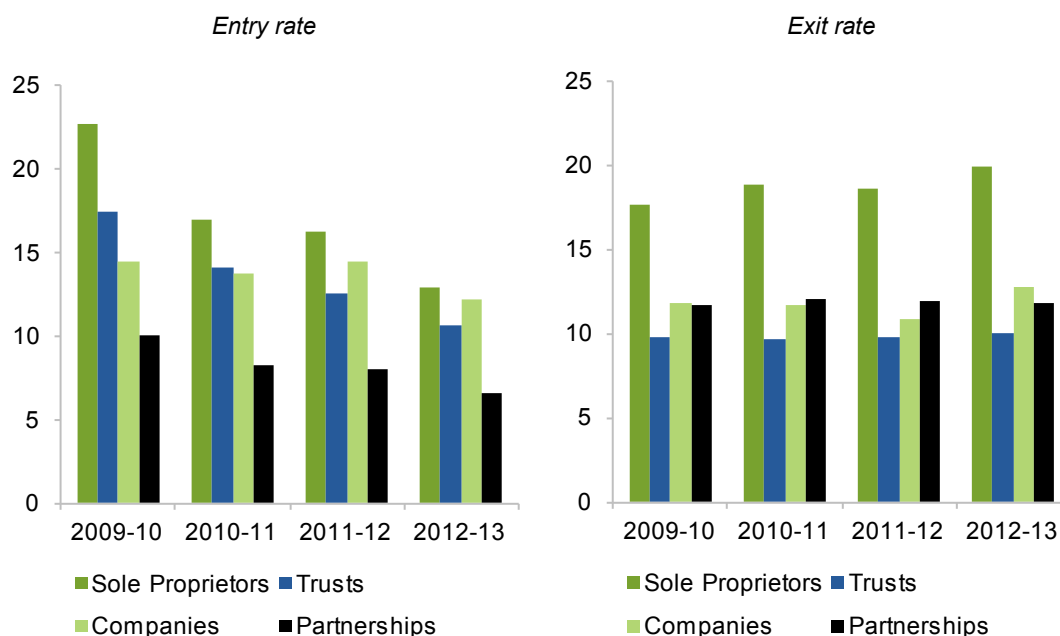
^a Entry and exit rates are calculated as a percentage of businesses operating at the beginning of each financial year. ^b Entry and exit rates by business size are only available from 2009-10. A small business has less than 20 employees. A medium business has more than 20 but less than 200 employees. A large business has more than 200 employees.

Source: ABS (*Counts of Australian Businesses, including Entries and Exits*, Jun 2007 to Jun 2011, Cat. no. 8165.0; *Counts of Australian Businesses, including Entries and Exits*, Jun 2009 to Jun 2013, Cat. no. 8165.0).

Entry and exit rates also vary based on the type of organisation. As a proportion of the existing business types, sole traders, followed by trusts and companies, are most likely to be new businesses (figure 4). However, in absolute terms, there were more new companies in 2012-13 than any other form of business.

3. *What proportion of new businesses display entrepreneurial or innovative characteristics as opposed to new businesses operating established business models providing known goods and services (for examples, operating under an existing franchise or providing outsourced business consulting services)? Does this vary by location, jurisdiction or sector? What data and other evidence is available on this issue?*
4. *Is there an optimal level of business set-ups? Can too many set-ups lead to potential drawbacks for the economy overall?*

Figure 4 Business entry and exit, by organisation type
Per cent



Source: ABS (*Counts of Australian Businesses, including Entries and Exits*, Jun 2009 to Jun 2013, Cat. no. 8165.0).

3 Barriers to business set-up

The existence of barriers to business set-up have a number of negative effects. Depending on their nature and scale, such barriers could deny or delay the benefits to the community of new and innovative products and services, as well as a more productive, efficient and dynamic economy possible through the emergence of new businesses.

Regulation to establish a new business

The regulatory arrangements and requirements (or ‘red tape’) facing a new business can act as a disincentive to setting up that business. These can involve obtaining licences, registrations or approvals to operate the business, acquiring relevant re-zoning and development approvals, establishing the required reporting systems and having the appropriately qualified staff employed in or operating and managing the business. These regulatory requirements to establish a business may (depending on the location and nature of the business) involve dealing with Australian, state and territory and local governments.

There are also the ongoing regulatory requirements or compliance costs involved in operating a business, including annual reporting requirements to regulators and governments, meeting workplace relations and employment requirements, taxation

obligations and the renewal of any relevant ongoing registrations, approvals and/or licences. High ongoing compliance costs may act as a disincentive to establish a business.

Some regulatory requirements may be necessary to meet a government's legitimate policy objectives. For example, certain businesses may be required to be licensed and/or registered before commencing trading to protect community safety. This raises issues as to whether there are alternative mechanisms that would both meet the policy objectives of government and reduce or remove the disincentive effect to set-up a business.

Although the Commission has undertaken extensive research and made numerous recommendations around the unnecessary regulatory burdens placed on business in general and on specific sectors of the economy, in this inquiry the Commission will seek to assess the nature and extent of the regulatory barriers facing those establishing new businesses and acquiring or transferring existing businesses.

5. *What general regulatory requirements act as a disincentive to set-up or acquire an existing business? Are there industry specific regulations that act as a disincentive to set-up or acquire an existing business? What is the right balance between regulatory certainty and flexibility in this area?*
6. *Are there alternative means of achieving governments' policy objectives that would not act as a disincentive to business set-up?*
7. *Are there specific examples where governments and/or regulators have reduced or removed the regulatory barriers to set-up or acquire a business?*
8. *Which specific regulatory requirements — for example, licensing, approvals, reporting requirements — act as the stronger disincentive to set-up or acquire an existing business?*
9. *How do these regulatory barriers differ with the size of business? To what extent do these regulatory barriers provide incentives or disincentives for businesses to be set-up in a particular form, for example as incorporated or unincorporated structures? Do differing regulatory barriers provide incentives or disincentives to setting up businesses in particular jurisdictions within Australia?*

The establishment of larger businesses, such as an overseas entity establishing a subsidiary in Australia or the establishment of joint ventures by existing entities, is likely to face an additional set of regulatory issues.

10. *Are there particular regulatory barriers surrounding the establishment of a large business? Are there particular barriers to overseas entities establishing a subsidiary business in Australia? Does the establishment of a joint venture arrangement, either between private sector entities or government and private sector entities, face any specific regulatory barriers? Is the existing regulatory framework able to facilitate the development of new and innovative joint ventures?*

Access to markets

In some areas of business activity there is regulation that inhibits new business entry and protects the incumbents. Examples of this include the regulation around the ownership and location of pharmacies, taxi licensing, occasional childcare centres, coastal shipping and the production of potatoes in some states.

Such restrictive arrangements — despite having been subject to scrutiny and reviews that have highlighted the costs imposed on the wider community — remain in place.

The competitive behaviour of the incumbents in a particular market such as pricing strategy, product bundling, advertising and the nature of their relationships with downstream and upstream markets and suppliers can also act as a barrier to new business entrants.

Restrictions imposed by other countries on access to their domestic market such as tariffs, quotas, product quality or composition specifications and licensing can act as a disincentive to the establishment of exporting businesses.

11. Which particular sectors have restrictive barriers to entry that exclude new set-ups and potential competitors and what is the nature of these barriers? To what extent are these barriers, in their current form, necessary to meet broader welfare objectives?

12. To what extent is access to export markets a barrier to business formation? What is the appropriate role for government in this area?

Reducing these regulatory barriers

There has been a focus by the Australian Government and the state and territory governments in recent years on reducing the regulatory burdens or ‘red tape’ placed on business by regulation. Apart from regulatory impact analysis prior to regulation being introduced, this has involved regular reviews of regulation in specific sectors, sunset periods for other regulation, requirements for the introduction of new regulations to be accompanied by identified reductions in regulatory burdens elsewhere, and regulatory audits to cull out of date or unnecessary regulation.

There is also the issue of regulatory duplication and overlap between different levels and areas of government. The Commission has also found that the behaviour and resourcing of regulators (particularly local governments) can have significant impacts on the ease of establishing businesses.

The introduction of new business models, often using digital platforms, can also be frustrated by the inability of the existing regulatory arrangements to respond to and facilitate their introduction and growth. Some regulation may specify certain methods of delivery for products and services and may act to prevent the introduction of new and

innovative business models. For example, there has been ongoing discussion around the digital disruption resulting from the establishment of online businesses such as Uber and Airbnb and how such business models fit into the existing regulatory arrangements. In regard to the financial system, the Financial System Inquiry (Australian Government the Treasury 2014) recommended that priority areas of regulation be amended to be technology neutral and the principle of technology neutrality be embedded in the processes to develop future regulation.

- 13. How could regulatory processes be improved to reduce barriers to business entry or exit? Are the existing regulatory arrangements able to manage with these new business models in a consistent manner? Should the principle of technology neutrality apply to regulation in general? To what extent are the current regulatory processes acting as an unnecessary impediment to new digital based business models?*

Access to finance

Access to finance, from either debt or equity sources, is crucial for business set-up and expansion. Efficient capital markets are a key requirement of a dynamic and productive economy. This enables capital to be allocated efficiently and priced to reflect different categories of risk. Ideally, capital markets should be able to provide a range of funding sources and financing methods to take into account the risk profiles and financing needs of different size and types of businesses. New businesses could face difficulty accessing debt financing due to the loan application process, requirements on loan security, covenants on loans and access to alternate lines of credit.

There is also the availability of and access to various equity financing sources, such as venture capital, crowd sourced equity funding and the ability of the market to develop new and innovative equity financing arrangements to meet the needs of new businesses and new business models. It is often the lack of equity available to the business that requires business owners, or people associated with them, to provide guarantees and security such as residential real estate. The ability to access finance is also important for a business's ongoing viability and may play a role in any decision to close or transfer the business.

- 14. What type of barriers do potential business set-ups face in accessing finance? Do these barriers differ across sectors and by business size? What barriers are specific to accessing debt or equity financing?*
- 15. What do investors look for in starting up a new business? Has inability to access finance resulted in potentially viable businesses never having come into existence? Are financial markets and institutions able to adequately assess risk around business set-ups? Are financial institutions too risk averse relative to the actual business failure rate? Is the focus of financial institutions in assessing funding applications on the current credit worthiness of the business rather than the ongoing viability of the actual business?*

16. To what extent does difficulty with access to finance play a role in the sale or closure of established businesses?

Improving access to finance

The Australian Government has a significant involvement in Australia's financial sector. Policy oversight relating to the Australian financial system is the responsibility of the Commonwealth Treasury and the Reserve Bank of Australia (RBA) while two other Australian Government bodies, the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) are responsible for the implementation of policy through their regulation of the industry. APRA undertakes the prudential regulation of the financial system and ASIC is responsible for regulating financial markets, investor protection, the regulation and conduct of the governance of corporations and consumer credit. The finance sector is also subject to the normal application of the competition law administered by the Australian Competition and Consumer Commission.

A major policy focus of Australia's financial system has been the need to balance stability of the system with competition (PC 2010). Over time, successive Australian Governments have implemented policies designed to increase competition in the financial sector. These have reduced costs and increased the range and type of financial products available to consumers and businesses. This 'opening up' of the financial system, to overseas institutions and allowing other institutions to provide financial services, has been balanced against the need to maintain financial stability, particularly in the wake of the global financial crisis between 2007 and 2009, and to protect consumers.

Beyond technology neutrality for general regulation, an emerging issue is how the financial system responds to new and evolving funding arrangements based on digital platforms. The Financial System Inquiry (Australian Government the Treasury 2014) found that technology driven innovation was transforming the financial system through the emergence of new products such as mobile banking, cloud computing and payment services which posed challenges to the existing regulatory framework and the ability of regulators to respond.

The Financial System Inquiry noted that amending restrictive regulation that prevented smaller firms from seeking finance online from the general public could encourage innovation in the provision of finance. It recommended that the Australian Government should graduate fundraising regulation to facilitate securities-based crowd source funding (or crowd source equity funding) and consider more holistic regulatory settings to facilitate internet-based financing (Australian Government the Treasury 2014).

17. Does the financial system meet the needs of business set-ups? Are there changes that could be made that would make access to finance easier for business set-ups?

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18. *Is there an appetite for risk within any part of the financial system to provide funds to small and innovative businesses? Are the existing regulatory settings able to incorporate and regulate new and innovative financing methods, such as crowd source funding and peer to peer lending, into Australia's financial system? Are there are other innovative financing methods that are excluded by the current regulatory settings?*
 19. *How efficient are Australian security exchanges in providing start-up companies with access to debt and equity capital? What reforms would improve access to capital and reduce costs? Are there examples of superior practices in other countries?*
 20. *Could superannuation funds be utilised more effectively as a source of both debt and equity funding for businesses set-up? Should specific restrictions be placed on different types of funds, such as self-managed funds?*

Access to payments systems

Payments systems enable consumers, businesses and other organisations to transfer funds held in an account at one financial institution to others. These systems include cash, cheques and electronic funds transfers used to make payments. Payments systems in Australia are overseen by the Payments System Board of the RBA. The *Payment Systems (Regulation) Act 1998* provides for the RBA to regulate 'designated' payments systems. The RBA is able to designate a payment system where it is considered to be in the public interest to do so. Where a payment system has been designated, the Payments Systems Board can impose an access regime, make standards for compliance, arbitrate disputes relating to the system and give directions to the participants in the system. The legislation provides for access to a payments system and the use of a payments system on a commercial basis on terms that are fair and reasonable (Reserve Bank of Australia 2014).

For example, these arrangements provide for an access regime for EFTPOS and debit cards and set the maximum interchange fees on transactions to be paid to the card issuing institutions by the card acquiring institutions. There is also the standard applying to merchant surcharges on the use of credit and debit cards. These standards allow card scheme rules to limit a merchant's surcharge to the 'reasonable cost of acceptance'. This provides for merchants to recover their costs of accepting a customer's card and is not limited to the fee the merchant pays to its financial institution (Reserve Bank of Australia 2014).

21. *Are there any barriers to accessing payments systems? Are the costs involved in operating in the systems a disincentive to business set-up? Are there any issues associated with the payments systems in closing a business? Has the current system been effective in allowing and regulating emerging electronic payment systems?*

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22. *Is there scope for online payments systems, such as PayPal, to provide increased competition to the existing payments system? Are these payments systems able to offer an alternative source of finance for business set-up?*

Foreign investment

Foreign investment in Australia is regulated by the *Foreign Acquisitions and Takeovers Act 1975*. The objective of the legislation is to allow the Government to review foreign investment proposals to consider if they are contrary to the national interest. Australia's foreign investment policy provides guidelines to foreign investors and identifies different investment categories that need to be notified to the Government for prior approval.

For example, all foreign government owned investors have to notify the Government and receive prior approval before making a direct investment regardless of the value of the investment. For private foreign investments there are value thresholds in place which require prior approval before the investment can occur. There are also variations to the thresholds for private investors from certain countries, such as the United States and New Zealand, resulting from bilateral trade agreements. There are sectoral specific requirements and limits on foreign investment from other legislation in regard to the banking sector, certain airports, Qantas, shipping and Telstra (Treasurer 2013).

23. *To what extent has the foreign investment policy acted as a deterrent to business set-up? Are the existing review processes timely, efficient and transparent?*

In addition to regulation, there may be taxation issues around foreign investment. Differences in taxation arrangements between Australia and an investor's home country and the different tax treatment of earnings, although efficient for those countries individually, may influence the decision to establish a business in Australia and the form of the business.

24. *Have Australia's taxation arrangements acted as deterrent to overseas firms establishing and investing in new businesses in Australia? How do tax arrangements affect the structuring of businesses and what inefficiencies and distortions are involved in these responses to the tax system?*

Other barriers

The type of business structures available to establish a new business and the characteristics of these structures may also impact on the decision to set-up a business (and ultimately on the way in which it can be closed). For example, the existing business structures of sole trader, incorporated entity, partnership and trust available may not meet the needs of a potential business and the business may never be established or its set-up delayed. The existing structures may create incentives and/or channel new businesses into ownership structures that are 'second best' to meet their needs.

25. *Are the existing business structures able to meet the needs of new business set-ups? Does this vary by sector?*

There are also a range of other factors that can impact on business set-ups. The willingness of the community (and investors) to accept both the risks associated with new businesses and market turnover in businesses, is likely to have an effect on the number and type of business set-ups.

The size of the existing market for a product or service, the structure of the market, the relative competitive position of the incumbents and their size and scale may also act as disincentive to a potential entrant. Of course, some of these features are beyond the control of governments whereas other market features can be a direct result of government policy. For example, the geographic and demographic features which may influence the size and scale of a particular market are generally outside the control of governments whereas regulatory controls around ownership can influence the scale and structure of a particular market.

There are likely to be other disincentives facing potential business set-ups that apply generally and to specific product and service markets that have not been canvassed above.

26. *Are there features of particular markets which are a result of government policy and act as a disincentive to setting up a business? Are there any specific barriers facing Aboriginal and Torres Strait Islander people in setting up a business?*

27. *Are there other factors that act as a disincentive to business set-up? To what extent can, and should, governments intervene to overcome these factors?*

4 Barriers to business transfer and closure

Business closures, particularly where businesses fail, have a number of negative effects. They can impose costs on government to organise and regulate orderly exits through the insolvency regime; losses to creditors, personal costs to business owners and employees; transition costs as those previously employed search and relocate for work; and the costs of transferring and disposing of assets and the re-organisation of assets more generally. Moreover, any expected difficulties associated with closing a business may create a disincentive to set-up a business in the first place.

However, business closures can also have a number of positive effects. For example:

- productivity growth is enhanced when inefficient and unprofitable businesses are replaced by efficient and profitable businesses
- closures may be the result of longer-term structural changes that provide for the resources in the economy to be reconfigured in new and better ways

-
- the experience gained by entrepreneurs involved in closures will provide lessons to enable them to ‘do better’ next time

Personal and corporate insolvency regimes

The insolvency regime is invoked when a business is unable to meet its financial obligations. These regimes contain regulations setting out how the claims of creditors and employees against the business are settled. They also affect the timing of closure and, in some cases, the reorganisation of the business and set out the restrictions on the failed proprietor (Bickerdyke, Lattimore and Madge 2000).

The type of insolvency regime in place is important. It affects economic incentives, including the willingness of financial institutions to lend to businesses and the level of prudence adopted by entrepreneurs which in turn affects the overall business environment. For example, a regime that is more ‘debtor-orientated’ may impact on the availability and cost of finance while the severity and length of any sanctions against an insolvent proprietor or directors of businesses facing solvency issues will likely influence the level of entrepreneurial activity (Bickerdyke, Lattimore and Madge 2000).

In Australia, personal insolvency and corporate insolvency operate under separate regimes. The *Bankruptcy Act 1966 (Cth)* deals with personal insolvency and the *Corporations Act 2001 (Cth)* deals with corporate insolvency. Both bankruptcy and insolvency can be initiated voluntarily by the individual or company or involuntarily by creditors or the courts. For an individual, bankruptcy involves a trustee taking charge of the individual’s assets and handling their liabilities. The role of the trustee is to sell the assets to attempt to pay the creditors.

For a company that is insolvent, there are a range of options that include:

- *liquidation* where a liquidator is appointed to wind the company up with the assets being sold to meet the outstanding debts after which the company is wound up and ceases to exist
- *voluntary administration (possibly leading to a Deed of Company Arrangement)* where a voluntary administrator investigates the financial position of the company as to whether to return the company to the control of the directors, arrange with the creditors for the company to continue to operate under a Deed of Company Arrangement (this permits the company to make a binding compromise or arrangement with creditors) or for the company to be liquidated
- *receivership* which involves a receiver or manager appointed by creditors or the court to sell the assets for the benefit of secured creditors (this can occur at the same time that a company is in liquidation or voluntary administration).

Improving insolvency arrangements

The underlying incentive structures within the insolvency arrangements have major impacts on business closure and flow through to the decisions surrounding the setting up and closure of business. The Australian Government's legislative responsibility for the corporate and personal insolvency arrangements provides it with the policy levers to set incentive structures and balance the needs of creditors and debtors. For example, in regard to corporate insolvency it organises the priority of different types of creditors, the role of administrators and receivers and who can undertake these roles, the obligations and requirements placed on directors and how a company can make arrangements with its creditors to continue trading. With personal insolvency, it stipulates the sanctions that apply to individuals from bankruptcy including the duration of these sanctions, their obligations to disclose their bankruptcy status, the assets and property that are protected from bankruptcy, the role of the bankruptcy trustee in disposing of assets and the use of debt or insolvency agreements. It can also provide incentives for assets to be distributed in particular ways.

The Financial System Inquiry noted proposals to use 'safe harbour' provisions for directors to seek expert assistance and permit restructuring efforts for firms in financial difficulties without invoking external administration processes. Such protections could also be extended to the expert advisors to avoid them being considered de facto directors. However, the Inquiry noted that more work was required to assess the potential value of these proposals (Australian Government the Treasury 2014).

In addition to the incentive effects of the regime, another issue is the efficient functioning of the insolvency process itself. The Commission notes that the Australian Government has recently released a draft bill, the Insolvency Law Reform Bill 2014, for comment. It contains a package of proposals to remove unnecessary costs in the insolvency process, promote competition in the market, increase confidence in the insolvency profession and improve transparency between stakeholders.

If insolvency processes are unnecessarily burdensome and costly, time and money can be unnecessarily consumed. This could delay the redeployment of assets and reduce the capital available to creditors to reinvest in other activities. For example, costs could increase when courts and highly qualified practitioners are required for every step of every process, especially when some matters could be dealt with in a less formal and more expeditious manner. While some of these costs might be inherent to Australia's legal system, less costly alternatives may be available.

28. *To what extent do the existing insolvency arrangements facilitate or hinder business closure? Are these arrangements a disincentive to business set-up? How do these arrangements affect the choice of business structure?*
29. *Is the underlying incentive structure within the corporate and personal insolvency arrangements able to effectively and efficiently facilitate business closure without discouraging new business set-ups? Where should the balance lie between*

creditors and debtors in the arrangements? Are there feasible alternatives to the existing corporate insolvency arrangements? Is the use of safe harbour provisions for firms seeking to restructure a feasible alternative?

- 30. How should the sanctions in personal insolvency or bankruptcy apply to individuals? For how long should these sanctions around bankruptcy apply? Are these sanctions a disincentive for entrepreneurial activity? Is there adequate enforcement of the existing sanctions? Are there feasible alternatives to the current bankruptcy process?*
- 31. Are the insolvency arrangements able to transfer assets and capital effectively? Are insolvency procedures timely to ensure assets do not become 'stranded' and unable to be used elsewhere?*
- 32. Is the insolvency process unnecessarily costly and lengthy? How might this additional cost be measured? Is it simply a transfer between participants in the process or does it represent a loss in the overall efficiency of the economy?*
- 33. Are there legal impediments to reforms in this area, such as relying on alternative forms of dispute resolution (appellable administrative decisions, tribunals or alternative dispute resolution based solutions) for simple or uncontested matters? Are there any barriers to innovation by insolvency practitioners?*

Employee entitlements

When businesses fail, employees can be left not only without their job, but also being owed entitlements such as unpaid wages, annual leave and long service leave. The Australian Government provides a safety net scheme of last resort to provide assistance for unpaid wages, annual and long service leave, payment in lieu of notice and redundancy pay. The General Employee Entitlements and Redundancy Scheme (GEERS) applies for employees of employers who entered bankruptcy or liquidation prior to 5 December 2012 and the Fair Entitlements Guarantee (FEG) for those after this date.

- 34. How have these employee safety net schemes impacted on business closure? How have these schemes operated alongside the insolvency arrangements? Do these schemes present a moral hazard problem?*

Transfer of ownership

Not all businesses closures or exits involve the failure of the business. Businesses can be sold, taken over, merged with another business, closed by the owner for non-financial reasons or transferred to a family member(s) or other people associated with the business, such as employees or other existing owners (see figure 1). The efficient and timely transfer

of ownership or control may be complicated by taxation issues, the transfer of leases and assets and the establishment of future income streams for the retiring owner.

There is also the sale and transfer of government owned assets to the private sector. Any conditions attached to the sale of these assets may have an impact on their efficient transfer to the private sector. For example, the vendor government may impose certain employment, financial and tax conditions around the sale of an asset. The broader regulatory settings applying to the particular market or sector can impact on the transfer and sale of government assets to the private sector. Also, regulation surrounding foreign investment may also impact on the efficient sale and transfer of government owned assets through the different treatment of foreign and domestic investors.

35. Are there any barriers to the sale or transfer of a business? Are there any particular issues faced by the owners of unincorporated businesses in selling the business or transferring the business to a family member or members?

36. Are there any specific barriers relating to the sale and transfer of government assets to the private sector? What has been the experience from previous sales of government assets?

Government support as a barrier to closure

Government support and other policies that protect businesses from competition can stop or delay businesses from closing and allow inefficient and unprofitable businesses to remain in operation. For example, the provision of drought assistance may act as a disincentive to agricultural producers to exit the industry and pass the land on to more efficient producers. Of course, the availability of support and subsidies provided by government could work in reverse and attract business set-ups (for example, the provision of government subsidies for home insulation resulted in a growth in insulation installers).

37. To what extent does government support and subsidies impede business closure? In what sectors of the economy are such arrangements impeding business closure?

Some barriers to closure may be more general and exist across all businesses whereas others are likely to be specific to particular industries or sectors.

38. Are there any other potential or existing barriers to business closure?

Reducing the distortionary effects of government support and subsidies

Ideally, governments would reduce the distortionary effects of support and subsidies by ceasing their provision. However, governments can and do provide support and subsidies to meet particular policy objectives. This raises the question as to whether or not there are non-distortionary or less distortionary policy alternatives available to meet these policy

objectives. Also, where the distortionary effects surrounding the use of particular government support and subsidies are not easily identifiable by the wider community, there may be little pressure on government to seek alternative instruments.

39. *Given that governments use support and subsidies to meet particular policy objectives, what processes could be used to examine less distortionary alternatives? Are there approaches that could apply greater transparency to the use of government support and subsidies and their broader costs and benefits?*

5 Attitudes to risk and innovation

There are also likely to be certain cultural attitudes towards risk and innovation within the community. This is likely to be reflected in the willingness of individuals and businesses to innovate and take on risk and the existence of an entrepreneurial culture. The focus of business set-up in an entrepreneurial culture would be on businesses experimenting through providing new products or services, utilising new technologies and introducing new business models into the economy. Such a culture would recognise those who achieve financial success through setting up a business while allowing those who fail to do so to attempt again.

40. *Is there a need to improve the overall attitude to risk and innovation in Australia to increase business set-ups in Australia? How should risk taking be appropriately rewarded and mistakes not excessively penalised? How should the balance between rewards and sanctions be set to maximise overall community welfare?*
41. *Is there a need to systematically encourage a more innovative culture, for example, through the education system?*
42. *Should governments provide incentives, such as grants, through the tax system and insolvency arrangements, to increase the willingness of individuals and businesses to take on risk and innovate?*
43. *What should governments **not do** to reduce barriers to business set-up and closure?*

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Attachment A

How to make a submission

This is a public inquiry and the Commission invites interested people and organisations to make a written submission.

Each submission, except for any information supplied in confidence (see below), will be published on the Commission's website shortly after receipt, and will remain there indefinitely as a public document. Copyright in submissions sent to the Commission resides with the author(s), not with the Commission.

How to prepare a submission

Submissions may range from a short letter outlining your views on a particular topic to a much more substantial document covering a range of issues. Where possible, you should provide evidence, such as relevant data and documentation, to support your views.

This is a public review and all submissions should be provided as public documents that can be placed on the Commission's website for others to read and comment on. However, under certain circumstances the Commission can accept sensitive material in confidence, for example, if it was of a personal or commercial nature, and publishing the material would be potentially damaging. You are encouraged to contact the Commission for further information and advice before submitting such material. Material supplied in confidence should be provided under separate cover and clearly marked 'IN CONFIDENCE'.

How to lodge a submission

Each submission should be accompanied by a submission cover sheet. The submission cover sheet is available on the inquiry web page. For submissions received from individuals, all **personal** details (eg home and email address, signatures, phone, mobile and fax numbers) will be removed before it is published on the website for privacy reasons.

The Commission prefers to receive submissions as a Microsoft Word (.docx) files. PDF files are acceptable if produced from a Word document or similar text based software. You may wish to research the Internet on how to make your documents more accessible or for the more technical, follow advice from Web Content Accessibility Guidelines (WCAG) 2.0 <<http://www.w3.org/TR/WCAG20/>>.

Do not send password protected files. Do not send us material for which you are not the copyright owner – such as newspaper articles – you should just reference or link to this material in your submission.

Track changes, editing marks, hidden text and internal links should be removed from submissions before sending to the Commission. To ensure hyperlinks work in your submission, the Commission recommends that you type the full web address (eg <http://www.referred-website.com/folder/file-name.html>).

Submissions sent by email must not exceed 20 megabytes in size as our email system cannot accept anything larger. If your submission is greater than 20 mb in size, please contact the Administrative Officer for the relevant project to organise another method of sending your submission to the Commission.

Submissions can be accepted by email or post:

Email*	business.inquiry@pc.gov.au
Post	Business Set-Up and Closure in Australia Productivity Commission GPO Box 1428 Canberra ACT 2601

* If you do not receive notification of receipt of an email message you have sent to the Commission within five working days of sending, please contact the Administrative Officer.

Due date for submissions

Please send submissions to the Commission by 20 February 2015.