

Australian Senate
Employment, Workplace Relations and Education

Inquiry into Small Business Employment

Dear Senators,

I would like to make the following submission to the above inquiry. The submission is based on information taken from some recent research in the Department of Economics at the University of Wollongong in regional areas of NSW. This research involved a survey of small business as part of the Illawarra Regional Workplace Industrial Relations Survey, published in 2001 and a current survey of regional exporters, which has included a large number of small businesses in the database. For the purposes of this exercise, I have defined small business to mean less than 20 employees.

Business Growth and Employment.

A preliminary analysis of the regional exporters survey did not find direct relationships between sales growth and employment growth in small firms. We did find a strong relationship between sales growth and export growth. However, this does not directly translate into employment growth. Many of the small exporters are new 'start-up' firms. They are established with an initial capacity and workforce and are then able to grow for some time within this establishment without adding new workers. Most of the employment growth associated with the growth of regional exports comes from the increasing number of new firms themselves rather than growth within these firms. As sales grow they do increase employment but it tends to occur in lumps rather than in a smooth statistical relationship. It can be noted, however, that during the 'export boom' in 2001 there was a clear relationship between export growth and employment growth.

Notwithstanding the statement above, it also appears that once these small firms do reach a certain stage, often around 20 employees, they need to make changes before they can accommodate further growth. These changes often involve new premises, updated equipment and managerial / organisational changes. This critical stage should be the focus of more Government assistance. By facilitating the transition from 'start-up' to established enterprise the job creation potential of small businesses would be substantially improved.

The relationship between exports, sales growth and employment growth is not consistent as shown in Table 1. Small firms (less than 20 employees) had the highest export ratios, possibly because these newer firms established with an focus towards exports from the beginning. Export growth was highest in the small / small-medium firms (up to 50 employees). However, these figures are influenced by the presence of these new exporters which experienced high initial growth from a low base. The more established firms, which exported through the 1997 to 2001 period, had lower annual growth and the barriers impacting on small firms' performance are shown more clearly.

Table 1
Growth Performance by Firm Size – NSW Regional Exporters

Company Size	Average Export / Turnover Ratio 2001	<u>Annual Export Growth</u>		Annual Sales Growth All Cases	Employment Increase 1995- 2001
		All Cases	Established Exporters		
1-9 employees	42.23	61.33	36.25	93.67	30.75
10-19 employ.	54.68	88.33	33.26	35.06	78.11
20-49 employ.	35.87	167.66	77.29	48.49	85.87
50-99 employ.	35.55	40.56	39.29	69.60	54.04
100-199 employ.	24.87	87.95	87.95	20.22	34.90
200 or more	33.72	15.50	16.09	23.75	11.12

Very small firms (1 to 9 employees) had high sales growth but this then dropped considerably for the 10 to 19 employees group before improving again as size increased to 20 or over employees. While the export and sales data is expressed as average annual growth rates, the employment data shows the total percentage change 2001 divided by 1995 levels. Very small firms (1 to 9 employees) had low employment growth but those in the 10 to 50 employees range generated the highest rates of employment growth.

Overall, these data, although crude, support the argument that small firms, despite their substantial growth potential, face barriers impeding their growth process at a certain, relatively early, stage in their development. This point should be the focus of business assistance in addition to continued support to assist new start-ups.

Impediments to Growth

(i) Impediments to export growth

Table 2 identifies the problems which small businesses saw as possibly impacting on the future growth of exports. Exports was a major determinant of sales growth and hence these problems give some indirect indication of what may affect the future employment potential of these firms.

As show on Table 2, 50 percent of the regional exporters were small businesses with less than 20 employees. The problems perceived by both small and medium / large firms were very similar. Problems with Government regulation and organisational difficulties were more frequently mentioned by small firms. Organisational issues are commented on below. Issues raised as problems with Government regulation included labour laws such as the unfair dismissal procedures which are discussed further below. However, issues relating to customs and quarantine regulations were also frequently raised. As many rural exporters are involved in the export and import of agricultural materials, quarantine issues were particularly a problem.

Table 2

Barriers to Expanding Future Exports

Barrier	% Small Firms < 20 employees N = 52	% Medium & Large Firms 20 or more employees N = 53
Exchange rate movements	42.3	50.9
Lack of investment funds	32.7	32.1
Problems with Government regulation in Australia	31.2	20.8
Organisational problems	28.8	15.1
Unfair competition by rivals	28.8	15.1
Trade protection overseas	28.8	37.7
Rising labour costs	25.0	28.3
Lack of information on overseas opportunities	21.2	20.8
Problems matching cost reductions	17.3	30.2
Small volumes	13.5	17.0
Costs of patents / IP overseas	11.5	5.7
Problems remaining technologically competitive	9.6	7.5
Problems with partners overseas	9.6	15.1
Difficulties adapting to market	7.7	7.5
Other problems	19.2	9.4

Generally, technical, trade and cost related factors were not particular problems faced by these small businesses. Only the factor, ‘unfair competition by rivals’ was raised more frequently by small firms than medium or large firms. This suggests they may be less able to identify strategies to combat actions by overseas competitors than larger firms, which could be related to the managerial factors discussed below. All firms identified unfavourable movements in the exchange rate as a possible detriment to future export sales. It would be important to ensure small exports are provided with adequate information and support to help them develop strategies to overcome the impact of any appreciation of the Australian dollar. Small business generally had less concern with cost related factors impacting on their competitiveness than did large firms which implies the impact of a rising dollar will be of less concern where they are not competing on the basis of price, but rather on product quality characteristics.

(ii) Managerial Capacity

The critical stage mentioned above is often associated with difficulties inherent in small business management practices which inhibit their capacity to realise all the growth potential inherent in their business. The literature on small business emphasises this cultural aspect of small business ownership, that people tend to start their own businesses

because they want to be in control of the management of all its operations. While they would like it to grow and make higher profits, they still aim to retain 'hands-on' control throughout this process. The consequences of this management style are that:

- (i) They do not introduce expertise from outside the family to help manage the more professional aspects of business, such as exports, purchasing, employee relations, etc to ensure these are undertaken as effectively as possible. This is a life-style issue and, I suspect, little can be done to overcome such problems. It does, however, limit the growth and hence employment potential of the business.
- (ii) Due to this intensive management style, they often do not have the time to attend training sessions, seminars etc which are regularly provided for small businesses, nor do they undertake strategic business planning. There are ways of improving the information on management techniques available to small business owners by using mentors, 'business angels', or other programs for bringing retired business managers and professionals into the firm to work side by side with the manager for a period of time.
- (iii) Small businesses often encounter cost disadvantages as their costs rise with increasing size due to (i) above. This means they are not achieving the efficiency benefits as they introduce new technologies. Thus, it appears as if they are more cost competitive if they remain small. This also inhibits the growth and employment creation potential of small businesses.

Government Issues

(i) *Workplace Relations*

Illawarra Regional Workplace Industrial Relations Survey (IRWIRS) 1996

As found in the exporters survey, the IRWIRS small business survey found that small businesses (1 to 19 employees) were not a major source of employment growth in the Illawarra Region. Small business employment was also relatively volatile and most employment growth occurred in younger firms. The image that small business managers value their workforce was also supported with the vast majority of small businesses in the Illawarra rating their employment relations climate as very good (78%) or good (21%). Industrial action was virtually non-existent and there was a high degree of (usually informal) consultation between management and employees. There was also a high incidence of over-award payments (70 percent of small business compared with 54 percent of workplaces with 20 or more employees).¹

The survey also highlighted that employment practices within small business in the Illawarra are relatively unsophisticated. Recruitment was frequently by 'word of mouth' resulting in the frequent employment of friends or relatives of current employees. Recruitment of experienced applicants was strongly preferred with most training being

¹ Ray Markey, Ann Hodgkinson, Terri Mylett and Simon Pomfret (2001), *The Illawarra at Work*, Industrial Relations Report No. 4, Labour, Human Resource and Regional Studies Center, University of Wollongong, pp. 21-22.

‘on the job’. Employee grievances and discipline issues were handled in an informal, case-by-case approach². These employment practices are aimed at ensuring that small businesses are able to recruit suitable employees and to protect themselves from the disruption which employment disputes can bring to such operations. However, the lack of formal dispute settling procedures means that they can be poorly placed to deal with such disputes when they (rarely) occur. The IRWIRS results suggest that, at least for the Illawarra, special industrial relations provisions for small business are not necessary as they have already developed an employment culture to accommodate such problems.

Perceptions from Regional Exports Survey

- (a) Their labour force is very important to small business. They rely heavily on their workers being efficient, loyal and willing in order to meet sales orders, provide quality customer service, etc. Often close relationships develop between owners and employees. Thus once trust is established, small business owners endeavour to retain their workforce by providing pleasant and flexible conditions.
- (b) However, even in regions experiencing high unemployment, small business owners mentioned difficulties in finding “suitable” workers. The main impediment to taking on new workers was the risk that, haven taken on some-one, they then prove unsatisfactory. The unfair dismissal provisions were mentioned as an issue by a small number of these business owners who feared that, having made a mistake in hiring (remembering the managerial constraint above was that they often do not have the expertise or time to properly screen applicants), they then cannot get rid of them. Thus they are reluctant to hire. This seems to be a more severe problem in small towns rather than larger regional centres, possibly because many of the better workers in such towns either already have jobs or have left to find work elsewhere.

A possible solution would be to provide a moratorium on the implementation of the unfair dismissal provisions for 6 months from hiring to cover this risk period. It could be developed as a special incentive for businesses located outside major regional cities. I suspect it would not be used often in reality but could provide a ‘comfort cushion’ which may encourage such firms to take on additional workers.

(ii) *Local Government and Planning Issues*

There were underlying tensions between business and local government over planning issues in most of the areas covered in the regional exporters survey. However, this came to the forefront in a few local government areas such as Wingecarribee and Griffith. These were growth areas where land shortages were causing tensions between demands for residential uses against industrial / agricultural uses. As residential developments spread towards industrial zones, complaints regarding noise, smells, traffic, etc became more severe. However, often firms were establishing in these areas for the same reasons

² Ray Markey, Ann Hodgkinson, Terri Mylett and Simon Pomfret (2001), *Regional Employment Relations At Work*, University of Wollongong Press, Wollongong.

that they are attractive for residential growth, i.e. business people were making lifestyle choices attracted by a pleasant natural environment.

It can also be noted that in other regions, often nearby such as Shoalhaven and Leeton, relatively amicable relations generally existed between business and local government. It clearly depends on the capacity of local councils to balance these competing land-use demands to support both residential and employment growth. The establishment of economic development units or managers within local government to mediate these problems is one obvious solution.

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