

Promoting economic dynamism competition and business formation

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Working for business. Working for Australia

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Introduction

ACCI welcomes the opportunity to contribute to the House of Representatives Standing Committee on Economics inquiry into promoting economic dynamism, competition and business formation.

A diverse and dynamic business environment is essential to stimulate competition. It encourages individual businesses to innovate and find ways to work more efficiently. Competition drives lower prices, better quality products and services, and more choice for consumers, while increasing prosperity and welfare of all Australians. For competition to stay healthy, businesses must act in a fair and ethical way towards competitors and suppliers.

The key to a dynamic, resilient, competitive economy is the ability of businesses to innovate and increase their productive capacity. Productivity growth is the key to sustaining economic activity, creating jobs and maintaining our future living standards. However, Australia's productivity growth has slowed since the turn of the century, with the dynamism and competitiveness of the Australian economy deteriorating.

There needs to be a concerted effort to put in place the conditions for strong, sustainable, productivity growth. Australia needs greater investment in productive capital, to drive innovation, dynamism and competition. We need reforms that will give the structure, flexibility and entrepreneurial culture to create the dynamism, resilience and competitiveness needed for businesses to thrive.

Business Entries and Exits

A dynamic and competitive business environment can often be observed through the rate of business entry and exit. Business entries bring new, agile and innovative businesses, while exits typically mark the departure of less flexible and less competitive businesses.

The past three years have been abnormal for Australian businesses due to COVID-19 disruptions and unprecedented level of government support provided to both households and businesses. Business entries increased during COVID-19, as small agile businesses emerged to take advantage of new opportunities. In contrast, business exits were suppressed, despite expectations they would rise sharply due to the COVID-19 disruptions. Less competitive and productive businesses were able to hang on due to the large amount of government support provided to enable businesses to remain viable during the COVID-19 lockdowns. Overall, business entries exceeded exits by 87,000 in 2020-21 and 167,000 in the 2021-22 financial year, compared to an average around 50,000 in the years pre-COVID.¹

There are signs that exits have begun to rise, as the economy appears to be normalising following the COVID-19 stimulus measures. Insolvencies have increased in the second half of 2022 and into 2023, returning to their pre-COVID levels. This compares to insolvency rates declining to around 60 per cent of the baseline level between May 2020 and May 2022.²

It may take some time for business entries and exits to normalise and a more competitive and dynamic business environment to be realised.

Market concentration

Australia is a relatively concentrated market in some industry sectors, which advantages a small number of dominant large players. The consolidation and concentration of Australian businesses may arise as a natural result of market characteristics, but this can be a matter of concern if it arises from unfair or anti-competitive behaviour.

It is important to be aware that Australian businesses operate in a global market. The existence of large Australian firms can enable a scale necessary to compete on with large multinational enterprises in the Australian market, and compete in offshore markets.

Examples of market concentration, with a small number of large businesses dominating some sectors, can be observed in retail, with the supermarket sector dominated by Woolworths and Coles, and hardware dominated by Bunnings. Similarly, the airline sector is dominated by Qantas and Virgin Australia, and the banking sector by Westpac, Commonwealth, National Australia and ANZ.

For a small market such as Australia, some sectors are regulated to ensure healthy competition between the main players, giving them the incentive to keep prices low, improve the quality of product and drive innovation.

¹ Australian Bureau of Statistics (2022) Counts of Australian Business June 2022 <https://www.abs.gov.au/statistics/economy/business-indicators/counts-australian-businesses-including-entries-and-exits/latest-release>

² Australian Securities and Investment Commission (2023) Insolvency Statistics (current). <https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-current/>

However, there are also risks that concentration can lead to the misuse of market power, including refusal to deal, restricting access to an essential input, predatory pricing, margin or price squeezing, and tying or bundling.

Australia's competition laws, and regulation by the Australian Competition and Consumer Commission (ACCC), have been instrumental in maintaining competition in Australia. The ACCC has been quick to respond in instances where this misuse of market power has arisen. Also, mergers of major business in an industry sector must be approved by the ACCC to ensure it does not lead to a lack of competition in the sector or give the new merged entity undue market power.

That is not to say that more cannot be done to enable new players to enter the market, either through growth of domestic small to medium enterprises or by encouraging the entry of multinationals to compete in the Australian market.

Regulation

The burden of regulation is a key factor constraining Australia's productivity, growth and international competitiveness. Australia ranks stubbornly low in the World Economic Forum's Global Competitiveness Index, at 80th on the burden of government regulation.

There are a broad array of areas where action is needed to make serious progress on reducing regulatory burdens, including infrastructure planning, building and procurement at the state and federal level; labour market testing and employment services; chemical assessments and controls; medicines and medical device regulation; transport, mobility, supply chains and freight; agricultural supply chains; work health and safety; retail trading hours; leasing arrangements; and state liquor laws.

Reducing the regulatory burden in these areas will improve competition and support the entry of new businesses into these markets.

In addition, the unnecessary duplication of regulation administered by the Commonwealth, states and territories is a long-standing issue that needs to be addressed, as it weighs heavily on productivity and competition. For example, in meeting environmental regulations for major projects, national and multinational organisations often spend thousands to millions of dollars, and hundreds of hours, completing complex applications. Cumbersome paperwork followed by lengthy approval times can often dissuade dynamic, innovative new businesses from proceeding, with a loss of economic opportunity and jobs.

Business Investment

Investment in new businesses, as well as upgrades and expansion of existing businesses, stimulates innovation and drives productivity growth. Building at scale helps businesses to reduce production costs which, combined with competition, will put downward pressure on prices. The lower production costs and higher productivity also enables businesses to provide higher-paying jobs by sharing the benefit of productivity gains.

However, business investment has been low over the past decade, a key factor behind Australia's low productivity growth and waning competitiveness. Non-mining capital investment in new plant, equipment

and machinery has been flat since the Global Financial Crisis in 2009, the decade leading up to the pandemic, with annual growth of non-mining investment slowing to an average of less than 0.2 per cent per annum in real terms between 2009-10 and 2018-19.³ This compares to an average of 4.7 per cent for the decade up to 2008-09 and 6 per cent in the decade to 1989-99.

For small and medium enterprises (SMEs), a key challenge has been their inability to access finance for investment over a period of longer than seven years. Banks typically see small businesses as higher risk, adding a premium to interest payments and limiting the payback period on loans to seven years or less. This prevents small businesses from making larger, longer-term investment in capital that would improve their productivity and competitiveness. It contrasts with the situation for larger businesses, with banks more willing to provide credit for larger, longer-term investments, as well as their ability to raise capital both domestically and offshore. This limits the ability of many SMEs to achieve their full potential and make a substantial contribution to productivity growth in Australia.

Particularly for new businesses wanting to start up based on a new innovative idea, the higher premiums and difficulties in accessing finance often limits their ability to commercialise their innovation and scale up to be competitive. Often these innovative small businesses need to move overseas to gain access to finance. Alternatively, they sell their idea to or partner with an existing large business in Australia, which limits competition and add to market concentration.

Innovation

Innovation underpins the growth and dynamism of all economies. Innovation involves applying new ideas to products, processes, services, organisation, management or marketing. But newness by itself is only invention – it only becomes innovation when it yields market value.

Economic growth and dynamism can also come from existing industries evolving over time, through the adoption of new innovative technologies and skills, and adapting to changing markets and circumstances.

The OECD has estimated that innovation accounts for 50 per cent of long-term economic growth in advanced industrial countries.⁴ Innovation is the major determinant of enhanced productivity and competitive advantage at both the business and nation level.

In many developed countries, businesses now invest as much in the knowledge-based assets that drive innovation, such as software, databases, research and development (R&D), firm-specific skills and organisational capital, as they do in physical capital, such as machinery, equipment or buildings.

In recent years, the rapid pace of digitalisation, a greater focus on supply chain resilience and the increasing focus on domestic manufacturing due to the COVID-19 pandemic, together with increasing environmental pressures are acting to drive innovation and transform the economy. These transformative factors are not unique to Australia or any one industry. They are not only driving significant competitive pressure for established firms with mature business models, but they are also creating significant growth opportunities for younger, innovative firms.

³ ABS 2023 Private New Capital Expenditure and Expected Expenditure, Australia. December 2022. <https://www.abs.gov.au/statistics/economy/business-indicators/private-new-capital-expenditure-and-expected-expenditure-australia/latest-release>

⁴ OECD *Innovation Strategy 2015* p.4 <https://www.oecd.org/sti/OECD-Innovation-Strategy-2015-CMIN2015-7.pdf>

Industry Clusters

How companies compete is strongly influenced by the local business environment in which they operate. A business can be highly productive and competitive in any industry if they employ sophisticated methods, use advanced technology, and offer unique products and services.

In advanced economies, clustering of businesses in a location has been shown to benefit competition in three broad ways:

- increasing the productivity of companies based in the area
- driving the direction and pace of innovation, which underpins future productivity growth
- stimulating the formation of new businesses, which expands and strengthens the cluster itself

A cluster allows each member to benefit as if it had greater scale or as if it had joined with others formally — without requiring it to sacrifice its flexibility.

Being part of a cluster allows companies to operate more productively in sourcing inputs; accessing information, technology, and needed institutions; coordinating with related companies; and measuring and motivating improvement. For example, the University of Wollongong Innovation Campus has attracted leading multinational organisations in technology and ICT (such as NEC), as it offers business the opportunity to collaborate with the university in leading R&D projects and access to a highly educated workforce.

International Experience

International experience demonstrates that industry clusters can excel at attracting and integrating significant new business investment, innovation, competition and economic growth. An example is the German Fraunhofer model, where leading firms in an industry sector cluster and work with tertiary institutions through the Fraunhofer application-orientated research organisation. Another effective industry policy design is Ireland's co-designed mission-oriented approach, which sets clearly defined goals and uses private sector innovation and commercialisation and scalability to achieve them.

A model like Germany's Fraunhofer or Ireland's mission-oriented approach can be replicated in Australia if we refine and incentivise a shift in the key performance metrics of Australian Research Centres to focusing on commercialisation, lifting scalability, increasing the number and quality of application-orientated research projects, and forming greater international linkages and collaboration with industry. Support for an application-orientated research approach that works collaboratively with industry is vital to support the growth and development of Australia's relatively small manufacturing ecosystem and make it internationally competitive.

There is an opportunity in Australia for government to assist in leveraging existing sectoral and placed-based clusters to increase the scalability of domestic manufacturing firms and facilitate the development of high-performing and cooperative clusters.

Summary

A diverse and dynamic business environment is essential to stimulate competition and enhance productivity. However, competition and productivity growth has been shown to be lagging for a number of decades. The Australian economy lacks dynamism and competition, with businesses lacking the entrepreneurial spirit needed to drive productivity and competition.

Business entries and exits are one measure of economic dynamism and competition in an economy. Over the past three years, business entries have grown strongly, but exits have been suppressed due to the unprecedented level of public support provided to businesses during the pandemic. While it has enabled businesses to remain viable and retain jobs, it has come at a cost of low productivity and has undermined competition.

While market concentration can in some circumstances limit competition, in the Australian economy this is only partially the case. For a small economy such as Australia, having a small number of large players can provide economies of scale that increase competition, reduce production costs and lower prices. Australia's competition watchdog, the ACCC, has been effective in maintaining competition in sectors where there is a high level of market concentration.

The burden of regulation is a key factor holding back competition and productivity growth in Australia. Efforts to reduce the regulatory burden on business, as well as the unnecessary duplication of regulation, is likely to stimulate business investment, promote dynamism and raise competition.

Business investment has been waning in recent decades and is a key factor weighing on productivity growth. For many small to medium enterprises, a key factor holding back business investment is the ability to access finance. SMEs are considered to be of higher risk, attracting a higher risk premium and shorter loan payback periods relative to larger businesses. This is limiting the growth and productivity of many SMEs.

Innovation underpins the growth and dynamism of all economies. It involves both the application of new ideas, processes, management and marketing, as well as existing industries evolving through the adoption of new technologies and skills and adapting to changing circumstances. The rapid pace of digitalisation, a greater focus on supply chain resilience, the greater focus on domestic manufacturing and increasing environmental pressures are driving innovation and transforming the economy. This is increasing competition and creating significant growth opportunities for agile businesses.

The environment in which businesses operate can influence productivity and competitiveness, with the clustering of like businesses being shown to increase the pace of innovation and stimulating new business formation. Clustering allows companies to more efficiently source inputs, access information and technology, and measure improvements against similar companies.

International experience has shown industry clusters successful in attracting new business investment and driving innovation, competition and economic growth. The German Fraunhofer model and Ireland's co-designed mission-oriented approach are examples of successful clustering industry to drive innovation, increase scale and the support the commercialisation of new innovation and products. There are opportunities to replicate these models to facilitate the development of similar high performing industry clusters in Australia.

About ACCI

The Australian Chamber of Commerce and Industry represents hundreds of thousands of businesses in every state and territory and across all industries. Ranging from small and medium enterprises to the largest companies, our network employs millions of people.

ACCI strives to make Australia the best place in the world to do business – so that Australians have the jobs, living standards and opportunities to which they aspire.

We seek to create an environment in which businesspeople, employees and independent contractors can achieve their potential as part of a dynamic private sector. We encourage entrepreneurship and innovation to achieve prosperity, economic growth and jobs.

We focus on issues that impact on business, including economics, trade, workplace relations, work health and safety, and employment, education and training.

We advocate for Australian business in public debate and to policy decision-makers, including ministers, shadow ministers, other members of parliament, ministerial policy advisors, public servants, regulators and other national agencies. We represent Australian business in international forums.

We represent the broad interests of the private sector rather than individual clients or a narrow sectional interest.

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