



18 February 2005

Mr John Carter  
Secretary  
Senate Employment, Workplace Relations  
and Education Legislation Committee  
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Dear Mr Carter

**RE: WORKPLACE RELATIONS AMENDMENT (SMALL BUSINESS EMPLOYMENT PROTECTION) BILL 2004**

Ai Group welcomes the opportunity to express its views to the Senate Committee on the *Workplace Relations Amendment (Small Business Employment Protection) Bill 2004*.

**Overview**

The legislative amendments set out in the Bill are sensible and consistent with 20 years of settled workplace relations practice.

The Bill puts jobs first, particularly permanent jobs. The March 2004 *Redundancy Case* decision of the Australian Industrial Relations Commission (AIRC) which removed the small business exemption has dealt a body blow to jobs. Small business is the largest employer of full-time labour in Australia. There are approximately half a million businesses with less than 15 employees. These businesses employ around two million Australians.

Courts and tribunals operate within the framework of laws created by Parliament. The Parliamentary power to override court and tribunal decisions should be used sparingly and only in exceptional circumstances. The AIRC's *Redundancy Case* decision has created such circumstances.

A supplementary decision handed down in June 2004 in the *Redundancy Case*, in effect, has delayed the imposition of severance pay obligations upon small businesses until 8 June

2005<sup>1</sup>. Therefore, **it is essential that the Bill be passed before 8 June 2005** to avoid the negative consequences which are set out in this submission.

The Bill deserves a speedy passage through Parliament and the support of all political parties.

### **Reasons for legislating to preserve the small business redundancy pay exemption**

There are many powerful reasons for legislating to preserve the small business redundancy pay exemption, including:

- Small businesses play a vital role in the Australian economy and are the largest employer of Australian workers;
- There are important characteristics of small businesses which warrant such businesses being treated differently for severance pay purposes;
- Small businesses cannot bear the cost of redundancy pay;
- The additional contingent liability will increase lending costs for small businesses;
- A requirement to make redundancy payments will lead to reduced employment and firm closures;
- The small business exemption is supported by arbitral precedent;
- The Bill removes jurisdictional conflict;
- The small business exemption is consistent with international practice;
- Small business employees can obtain severance pay via enterprise bargaining when it is affordable.

There were a large number of small businesspeople who were called by Ai Group to give evidence to the AIRC in the *Redundancy Case*. They were all prepared to open up their books to the Commission's and the ACTU's scrutiny. Their lack of financial resilience was obvious. Many of the businesses were operating with marginal or negative profitability with the proprietors in some cases earning less than their employees. Many of the owners had been forced to give guarantees to the banks over their personal assets, particularly their family homes. Many were very worried about the impact of any redundancy pay obligations upon their ability to obtain further finance.

Extraordinarily, the AIRC's *Redundancy Case* overlapped with hearings in a separate case before a Full Bench of the Queensland Industrial Relations Commission (QIRC), relating to state awards. In both cases, significant arguments and evidence were presented about the detrimental impact on small business if the exemption was removed. In both cases, State ALP Governments argued strongly in support of retaining the exemption.

The Queensland *State Termination and Redundancy Test Case* decision was handed down before the federal decision. In deciding to retain the exemption, the Full Bench pointed to the

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<sup>1</sup> The AIRC decided that, in calculating service, small businesses are not required to take into account service rendered prior to the date of the award variation. The awards which were used as vehicles for the *Redundancy Case* were the first to be varied, with such variations becoming operative from 8 June 2004. Under the standard award clause, redundancy pay obligations arise after 12 months of service.

lack of financial resilience of small business, the smaller cash reserves which they possess and the very real potential for redundancy pay obligations to lead to the insolvency of many small businesses. The view expressed by the QIRC could not have been clearer – removing the small business exemption would not be in the public interest.

The Queensland decision followed an earlier NSW Industrial Relations Commission decision in the mid-1990s which also decided to retain the small business exemption.

### **The importance of small business**

According to recent statistical and other information:

- Small business, by employing well over three million people, is the largest employer in Australia, and accounts for 47% of all private sector non-agricultural employment.<sup>2</sup>
- Small business accounts for 96% of all business in the private sector (excluding agriculture), thereby playing a very significant role in the Australian economy.<sup>3</sup>
- Small businesses are a major contributor to employment growth in Australia and are an important source of new jobs in the economy.<sup>4</sup>
- There is enormous diversity within the small business sector. The sector is relatively fragmented, isolated and unorganised.<sup>5</sup>

In the manufacturing sector, small businesses dominate the number of enterprises. 47 per cent of manufacturing sector enterprises are non-employing businesses and a further 46 per cent employ less than 20 persons.<sup>6</sup>

### **Characteristics of small businesses which justify differential treatment for severance pay purposes**

Small businesses are differentiated from larger businesses, by a particular set of characteristics. The interplay of the unique characteristics of small businesses and the economic importance of such businesses makes the small business exemption from severance pay not only justified, but essential.

The findings of the report arising from the recent *Senate Committee Inquiry into Small Business Employment*, together with the evidence given by small businesspeople in the *Redundancy Case*, establish that there are significant characteristics of small businesses which warrant such businesses being treated differently for severance pay purposes, including the following:

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2 *Small Business Employment: Research Note*, Department of Parliamentary Library, September 2002

3 Australian Bureau of Statistics (ABS) *Small Business in Australia 2001*, Cat No 1321.0

4 Report on Small Business Employment, Senate Employment, Workplace Relations and Education References Committee at p.27

5 Ibid, at p.6

6 Productivity Commission 2003, *Trends in Australian Manufacturing*, Research Paper, Ausinfo, Canberra at p.111 – available at <http://www.pc.gov.au/research/crp/tiam/tiam.pdf>

- The determinants of employment in the small business sector are complex and not well understood. The cost of employing staff remains a significant deterrent to employment growth in the small business sector.<sup>7</sup>
- Small business managers are “time poor” and have little capacity to spend time away from business functions which directly generate sales and revenue. Insufficient attention is often devoted to business functions such as accounting and human resource management.<sup>8</sup>
- Many small business operators lack business management skills in the areas of finance, marketing, human resource management, technological change and production scheduling. The lack of business management skills is one of the main causes of small business failure.<sup>9</sup>
- Small businesses face difficulties and disadvantages in obtaining the key inputs of capital and skilled labour, and are treated less favourably by banks, insurance companies and other big businesses in many areas including settling of accounts, terms of trade, interest rates and bank fees and charges.<sup>10</sup>
- Redundancy pay obligations create a potential “catch 22” situation whereby small businesses needing to retrench cannot obtain sufficient finance to fund severance packages.
- The lack of access to finance on reasonable terms is clearly a growth inhibiting factor for small businesses.<sup>11</sup>
- Most small businesses rely on their own equity or borrowings and frequently use the family home as security.<sup>12</sup>
- They are more susceptible to being given risk finance and require a strong cash flow and ability to repay debts. Most small businesses typically face uncertain cash flow streams.<sup>13</sup>
- Many small businesses operate on an overdraft and have a high level of debt.
- Employment levels in small businesses can be highly volatile, and retrenchments are common features in circumstances of financial difficulty.<sup>14</sup>
- Small businesses need to retain a high degree of flexibility in order to survive. Imposing a requirement to make redundancy payments would significantly reduce the labour flexibility of such businesses.
- Business failures are typically extremely hard on small businesses, because of the loss of personal assets which commonly occurs such as the family home.
- The overwhelming majority of businesses which fail are small businesses.
- The fundamental characteristic that distinguishes small businesses from large businesses is their higher probability of ceasing to trade. There is empirical evidence showing an inverse relationship between business failure rates and business size.

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7 *Report on Small Business Employment, Senate Committee on Employment, Workplace Relations and Education References, February 2003, pp.6, 49*

8 *Ibid, p.44*

9 *Ibid, pp.6, 14, 81, 82*

10 *Ibid, pp.6, 13*

11 *Ibid, p.45*

12 *Ibid, p.12*

13 *Ibid, pp.13, 44*

14 *Ibid, p.32*

- Almost half of the small businesses in operation have been in business for less than five years. Larger small businesses (for example those approaching the *Corporations Act* definition of 50 employees) are more likely to have been in business for longer periods.<sup>15</sup>
- Many small businesses are making losses and struggling to survive. Indeed, many businesses are simply kept open to provide jobs and out of a sense of pride.
- Many small business operators earn less than the people who they employ. Proprietors typically work very long hours and receive no leave entitlements.<sup>16</sup>
- Some small business proprietors will actually work for nothing, or bring in family members to work for nothing to assist firm survival.
- Most small businesses are subject to intense competition.
- A large percentage of small businesses are highly exposed to changes in market conditions due to over-reliance on a handful of suppliers or customers. They have a limited product and service range.
- The limited financial resources of small businesses is a constraint on their capacity to weather downturns and grow and compete with larger businesses.<sup>17</sup>
- Many small businesses operate on small margins, with highly variable cash flow, particularly in their early years.<sup>18</sup>
- Late payments are a constant problem.<sup>19</sup>
- Small business proprietors often feel a strong sense of moral obligation toward employees and extremely reluctant to implement retrenchments.
- Profits are typically reinvested back into small businesses to reduce debt levels and sustain ongoing business operations.
- Technology has been very important in lowering the costs of production and improving the capacity of businesses to compete. Unfortunately, the small business sector has been slow to introduce advanced technology and adopt e-commerce, which risks undermining its competitive position.<sup>20</sup>
- The compliance burden falls most heavily on small businesses because the bulk of compliance costs are fixed costs, which apply irrespective of the size of the firm, and therefore account for a greater proportion of small firms' managerial and financial resources. Such burden has long been recognised by Governments of all political persuasions. However, despite a series of inquiries being held, the burden on small businesses is increasing as the regulatory environment becomes increasingly complex and sophisticated. Regulation affects the capacity of small businesses to employ more people.<sup>21</sup>
- Small businesses are often isolated from important forms of assistance and advice. For example, a large percentage of small businesses do not belong to industry associations.<sup>22</sup>

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15     Ibid, p.22

16     Ibid, p.21

17     Ibid, p.12

18     Ibid, p.12

19     Ibid, p.12

20     Ibid, p.13

21     Ibid, pp.4, 6, 45, 110-111

22     Ibid, p.14

In its 2002 report, the Senate Committee inquiring into Small Business Employment stated that “*there are some common features to small business that justify a special focus.*”<sup>23</sup>

Further, the report observes.<sup>24</sup>

“4.2 *Small business is also seen as deserving of support because of its distinctive economic and social contributions. The OECD made the following argument for appropriate government support for small business:*

*SMEs [Small and Medium Enterprises] are at the core of future economic growth in OECD countries. Productivity growth is fuelled by competitive processes in industry, which, to a large extent, build on the birth and death, entry and exit, of smaller firms. Over 95 per cent of enterprises in the OECD are SMEs, which account for 60-70 per cent of jobs in most countries. They are the source of most new jobs and make significant contributions to innovation and high-technology employment. In addition, they are of considerable importance for regional developments and social cohesion. However, less than one-half of small business start-ups survive for more than five years and only a fraction develop into high-performance firms. Governments need new and improved approaches for maximising the small firm contribution to economic and social well-being.”*

Legislating to preserve an exemption for small business from redundancy payments removes a harmful deterrent to entrepreneurship and innovation. The Senate Report aptly noted the important role of small business as a “*seedbed for entrepreneurial talent.*”<sup>25</sup>

### **The small business exemption is supported by arbitral precedent**

Small businesses have long been exempt from redundancy payments.

In its 1984 *TCR Supplementary* decision, the AIRC decided to exempt small businesses from the impost of severance payments.<sup>26</sup> This followed the presentation by employers of detailed and compelling evidence about the vulnerability of small businesses.

Ten years later, a Full Bench of the NSW Commission decided to maintain the small business exemption due to “*the relative lack of financial resilience of small business.*”<sup>27</sup>

Most recently, in August 2003, a Full Bench of the QIRC in the *State Termination and Redundancy Test Case* was not prepared to remove the small business exemption from severance payments. The QIRC decided to retain the exemption on the following grounds.<sup>28</sup>

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23 *Ibid*, p.25

24 *Ibid*, p.51

25 *Ibid*, p.4

26 (1984) 9 IR 115 at 136-137

27 (1994) 53 IR 419 at 444

- Many small businesses operate in marginal circumstances;
- Severance has the very real potential to result in the insolvency of a number of small businesses;
- The lack of financial resilience in small businesses has not changed since 1994 (or 1984);
- Small business would generally have smaller cash reserves to meet severance pay requirements;
- Redundancy costs would represent a greater proportion of the overall labour costs within small business;
- It is likely that a small business facing a downturn or restructure sufficient to generate redundancies would not have sufficient cash reserves to launch a case in the Commission against a union (with perhaps greater access to financial resources) seeking an exemption from the application of severance pay provisions;
- The majority of other States and the federal jurisdiction (at that stage) had retained a small business exemption.

Following the handing down by the AIRC of its *Redundancy Case* decision and the consequent removal of the small business exemption in Federal awards, the Queensland Council of Unions (QCU) lodged an application with the QIRC seeking a review of the Queensland decision and the removal of the exemption. After hearing from the parties, the QIRC declined to do so and re-stated the reasons why it had declined to remove the exemption during the Test Case:

*“In our view, the small business exemption should be retained. Many small businesses operate in marginal circumstances. An obligation to make severance payments has the very real potential to result in the insolvency of a number of small businesses. The lack of financial resilience previously referred to has not changed since 1994. We accept the Queensland Government’s submission that small business would generally have smaller cash reserves to meet severance pay requirements and redundancies occurring would represent a greater proportion of the overall labour costs of the business...”*<sup>29</sup>

The lengthy nature of the arbitral precedent was acknowledged in the *Redundancy Case* decision:

*“We acknowledge that the weight of arbitral authority supports the retention of the existing exemption. In most state jurisdictions small businesses are exempt from the obligation to pay severance pay and that is clearly a factor which supports the retention of the exemption in federal awards.”*<sup>30</sup>

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28 *QCU v QCCI*, 18 August 2003 at para 100

29 *QCU v QCCI* , 17 December 2004 at para 100

30 [PR32004] at para 274

## The Bill addresses the current jurisdictional conflict

The AIRC's decision to remove the small business exemption in the *Redundancy Case* has created conflict between Federal and State jurisdictions. Different small businesses in the same area now have vastly different redundancy obligations on the basis of whether or not they are covered by a Federal award.

Given the importance of the current exemption for small business employers, the inconsistency which now exists between the Federal and State jurisdictions will have undesirable consequences. Small employers covered by Federal awards will have a significant incentive to exodus the jurisdiction and seek refuge under State systems if the Bill is not passed to reinstate the exemption.

## The small business exemption is consistent with international practice

To assist the Full Bench in its deliberations in the *Redundancy Case*, Ai Group commissioned Mr Mark Roberts, a researcher with Melbourne University, to carry out an international comparative study of redundancy pay obligations across jurisdictions. The study showed that relatively few advanced countries provide for employer-funded severance payments to be made to employees upon redundancy. Nevertheless, exemptions for small business from employment protection legislation are relatively common amongst other OECD countries. The study highlighted that even in countries like France and Germany with relatively strict employment protection legislation, small businesses are treated differently from larger firms.<sup>31</sup> Therefore, the small business exemption is not out of step with international regulatory practice.

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31 The report prepared by Roberts notes the following:

- **United States** - firms employing less than 100 employees are not required to give advance notice of lay-offs (p.42);
- **Austria** – firms employing less than 5 employees are exempt from making notice and severance payments. In addition, firms engaging 20 employees are exempt from negotiating a “social plan” designed to ease the impact of redundancy on employees (p.56);
- **Finland** – firms employing less than 10 employees are not required to consult with employees prior to redundancies (p.63);
- **Japan** – firms employing less than 10 employees are exempt from consulting with a union (p.70);
- **Netherlands**– firms employing 35 employees or less are exempt from consultation obligations dealing with redundancy (p.76);
- **France** – a threshold system applied whereby employee rights and employer obligations are adjusted according to the size of the firm's workforce (p.97);
- **Germany** – firms with less than 10 employees are exempt from consultation requirements and firms with less than 5 employees are exempt from unfair dismissal laws (pp.102-103). The report also notes that “*considerable effort has recently been directed toward easing the restrictions placed on small business by EP legislation in the context of a problematic labour market [in Germany]*” (p.104);
- **Italy** – employees dismissed from firms employing 15 persons or less cannot pursue reinstatement claims (p.109).

## **Small business employees can obtain redundancy pay via enterprise bargaining when it is affordable**

The Bill would not prevent employees of small businesses pursuing severance pay benefits through enterprise bargaining. This is a sensible approach which ensures that small businesses will only be required to make redundancy payments when they capable of doing so.

## **Provisions of the *Workplace Relation Amendment (Small Business Employment Protection) Bill 2004***

The Bill seeks to exempt businesses employing fewer than 15 employees from redundancy pay obligations through:

- Limiting the allowable award matter of “redundancy pay” (s.89A(2)(m)) to businesses with 15 or more employees;
- Ensuring that the Commission would not be able to make an exceptional matters order (s.89A(7A)) or an order under s.170FA of the Act, imposing a redundancy pay obligation on an employer with fewer than 15 employees;
- Invalidating State and Territory laws, State awards and State authority orders to the extent that they require employers of fewer than 15 employees, which are Constitutional Corporations, to pay redundancy pay.

The Bill requires the inclusion in the calculation of the number of employees, casuals who have been engaged on a regular and systematic basis for at least twelve months, but other casual employees would not be included. The Bill also protects redundancy payments to which an employee became entitled prior to the commencement of the Bill. These are fair and appropriate provisions.

The exemption of businesses employing less than 15 employees from redundancy pay obligations is a sensible and much needed legislative change. Ai Group urges all political parties to support the passage of the Bill.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Heather Ridout', is written over a vertical line that serves as a separator between the signature and the typed name below.

**Heather Ridout**  
CHIEF EXECUTIVE