Kickstarting the Engine

Short-term support for Australia's Small Businesses

Blueprint Institute

A Blueprint for improving access to capital and skills, while offering small businesses the best chance to survive and thrive in the economic recovery.

About Blueprint Institute

Every great vision starts with a blueprint. We help move ideas to action.

Blueprint Institute exists to inspire reform by presenting bold ideas, honest conversations and evidence-based research. We offer fresh thinking so as to help leaders take a step back from the day-to-day to see the bigger picture. We design blueprints for practical action as a step towards creating a more resilient and prosperous Australia.

Blueprint Institute was established in the era of COVID-19, in which Australians have witnessed how tired ideologies have been eclipsed by a sense of urgency, pragmatism and bipartisanship. The challenges our nation faces go beyond partisan politics. We have a once-in-a-generation opportunity to rethink and recast Australia to be more balanced, prosperous, resilient, and sustainable.

For more information on the institute please visit our website - **blueprintinstitute.org.au**.

Our Blueprint series

This paper is part of a series of Blueprints published to help policymakers shore up the Australian economy for the post-COVID-19 future. Forthcoming Blueprints will discuss new, exciting policy opportunities for the National Cabinet to consider — ranging from ideas for regional economic development, energy and climate policy, funding for technology and innovation, and educational reform. Forthcoming research will present new ways to relieve small businesses from the burdensome regulation that threatens to stifle this country's economic recovery.

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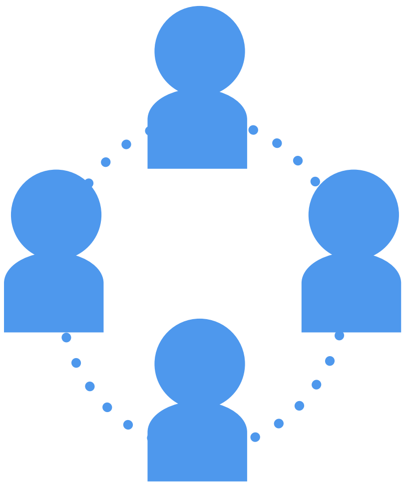
Executive summary

Small businesses are the bedrock of the Australian economy, but they are suffering disproportionally through the COVID-19 crisis. From retail stores to restaurants, from pubs to construction companies, the majority of small businesses have witnessed dramatic declines in revenue. With limited cash reserves and access to capital relative to larger businesses, many small businesses have been riding out the times of lockdown and uncertainty by relying on government support, tax holidays (e.g. federal income tax), concessions handed down by state and territory governments, and the limited personal reserves of SME owners. This situation is exacerbated in Victoria, where the introduction of Stage 4 lockdowns is presenting a significant challenge.

While the Australian Government has extended the JobKeeper program to March 2021, and revised eligibility criteria[1] for businesses and employees as recently as last week, this payment support — a lifeline for businesses and sole traders — will eventually be phased out. The provisions policymakers put in place now to ensure that businesses can survive on their own will be critical for the vibrancy and future strength of the Australian economy.

Some avid free marketeers may argue that we should let these businesses fail. But a pandemic doesn't give you creative destruction — it destroys otherwise-viable businesses that would have been just fine with adequate access to insurance and capital. And business disruption due to COVID-19 is on an unprecedented scale.

A 'laissez-faire' attitude would likely result in a devastating loss of businesses and firm-specific human capital that would set back the Australian economy for years to come. The links between businesses and their workers, as well as suppliers and customers, are valuable; a loss of a business reverberates through the local economy. On a large scale it could be cataclysmic.



Many otherwise-viable small businesses are suffering not due to poor business practice, but because of legally-mandated lockdowns and the economic uncertainty wrought by COVID-19. There was no escaping this economic fallout — the majority of countries that did less to contain the virus than Australia had much larger economic contractions. But having done their part to help halt the contagion, the small businesses affected deserve the support of policymakers.

At Blueprint Institute, we are deeply concerned that governments will miss vital opportunities to ensure the survival of Australia's vibrant small business community. What can governments do to ensure a soft landing? A lot, we believe.

This Blueprint seeks to enrich the public discussion by making policy recommendations that are practical and economically sound. We outline three problems currently confronting small businesses — access to capital, insolvency, and skill shortages — and propose innovative and timely solutions to these problems within three key recommendations.

RECOMMENDATION 1

Capital on tap – New HECS-style loans for small businesses

Publicly-funded loans for private enterprise may seem like a radical idea, but we are living in unprecedented economic times. Capital is the fuel that drives innovation in small businesses. Without it, small business owners will be hampered in their efforts to provide goods and services in a post-COVID economy. Without capital assistance, many small businesses will not survive the lockdowns.

At Blueprint Institute, we believe urgent government action is needed to provide small businesses with fast and unbureaucratic access to capital. We recommend introducing HECS-style loans to achieve this goal. These would offer small businesses certainty and peace of mind because repayments would be contingent on future revenue. We recommend:

A new small business HECS-style loan system

Blueprint Institute recommends that the Federal Government provide time-limited, revenue-contingent small business loans as part of support for the sector.

- A HECS-style loan system for small businesses would drive much-needed business investment and job creation. It should thus be considered separately from the JobKeeper program in stimulus discussions.
- Loan arrangements could be available until the end of 2021, at which point the program should be assessed for its uptake, repayment levels, effect on business investment, and its broader economic return.
- These subsidised loans would be repayable from future revenues — the loans are subsidised in the sense that they offer businesses a zero real interest rate, which may equate to a saving of 3-4% of the loan value per year until it is paid off. Indexation would be added each year in line with increases to

the consumer price index to maintain the true value of the loan.

- A HECS loan system would represent a defensive investment that could decrease overall government spending during the period of virus prevalence and economic recovery. This system may reduce the cost and burden of other schemes (such as JobSeeker) as viable businesses would be provided with the capital they need to lead the economic recovery and support jobs.

End the Coronavirus SME Guarantee Scheme

- The new HECS-style loan program should replace the Coronavirus SME Guarantee Scheme. While we support the Government's commitment to helping small businesses, the existing program has been largely ineffective in driving capital to the sector.
- Funding for the $20 billion Coronavirus SME Guarantee Scheme should be redirected to this new small business loan program. This means that putting this recommendation into practice would not require new spending commitments from the Government.

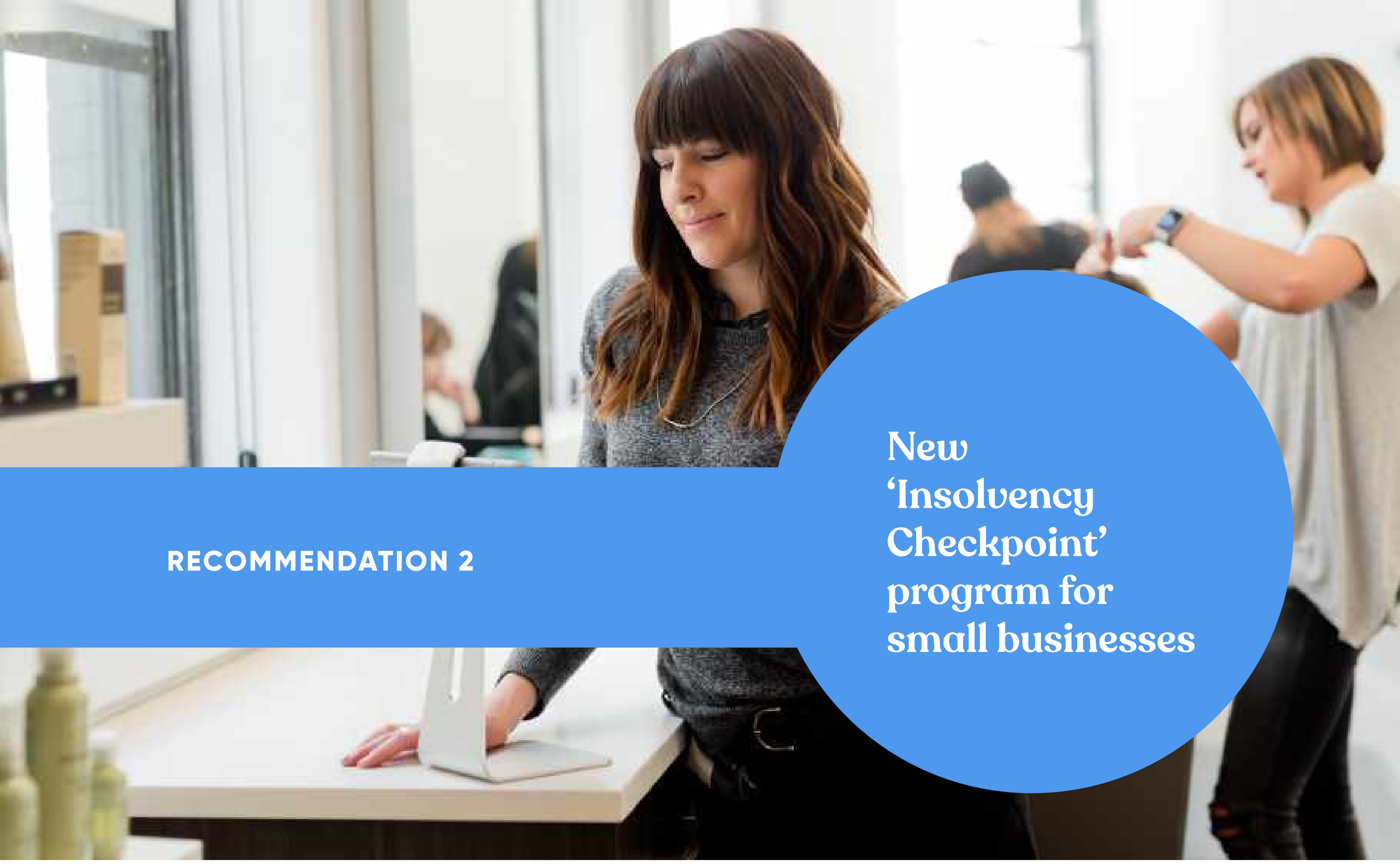
Financial health checks for small businesses

- Loans should only be available to viable small businesses to avoid wasteful spending and reduce exposure for taxpayers. The Government should engage licensed private practitioners to assess, via financial health checks, whether the business was financially viable prior to COVID-19. Small businesses that pass a financial health check would be eligible for the new loans.
- Financial health checks could be funded through a voucher system, paid by the taxpayer and administered by the ATO, with proceeds going to a trusted small business advisor (accountant, bookkeeper or other registered professional) who understands the business in question. Successful applicants could have the cost of the financial health check added to their loan amount to minimise cost to taxpayers. Additional conditions could be applied to reduce risk to taxpayer funds – for example, loans might only be available to businesses that have lodged 2 years of tax returns.
- Extensive public education campaigns should be conducted to inform small business owners about the HECS-style loan program.

COST: $20 billion has already been allocated for the SME Guarantee Scheme, so this should simply be repurposed for a HECS-style scheme. There may be some additional costs to the budget from loan defaults, given the higher uptake of HECS-style revenue-contingent loans and the fact that the Government is funding the entire loan amount, not 50% of the loan (as with the SME Guarantee Scheme).

While it is too early to say what default rates may be for the SME Loan Guarantee, let us conservatively assume a 100% repayment rate for these loans. If an 80% repayment target is set for the HECS-style revenue-contingent loans (the same repayment rate as existing HECS loans), this would represent a cost of $3.85 billion to the Government in loan defaults.

During our consultation process, leading economists noted that default rates are actually likely to be lower with revenue-contingent loans than traditional bank loans, as repayments are only dependent on a business remaining viable and receiving revenue at some point in the future. Default rates will be lowered further due to financial health checks determining businesses' viability prior to loan approval. In contrast, a typical bank loan requires businesses to service ongoing interest payments regardless of revenue, thus adding pressure to already-strained balance sheets. When considering the cost, we must also consider the counterfactual to this scheme: less businesses surviving post-COVID-19.



RECOMMENDATION 2

New 'Insolvency Checkpoint' program for small businesses

Business insolvencies are at record lows, suggesting a large number of 'zombie' companies are currently being propped up by JobKeeper. As JobKeeper payments are gradually rolled back, small businesses must have the ability to restructure their operations in an orderly manner.

The financial health check, discussed above, will provide high quality financial advice to small businesses who are in trouble — small business owners who complete the check would be well-positioned to restructure or liquidate their business. However, to provide adequate time for these processes to run their course, COVID Safe Harbour measures should be extended to the end of March 2021. In addition, Blueprint Institute urges the Government to establish an education campaign to inform small businesses and sole traders on the brink of insolvency of both their legal rights under COVID Safe Harbour and the availability of the financial health check. Such an 'Insolvency Checkpoint' program would take some immediate pressure off businesses that are facing hardship but have good prospects of recovering from the crisis. It would also give small businesses more time to consider the most effective method of repaying creditors to free up capital for investment and job creation.

We recommend:

Extend COVID 'Safe Harbour' provisions

- Introduced in March 2020, COVID Safe Harbour measures provide protection from liability, to directors of small businesses and sole traders, for insolvent trading that occurs in the ordinary course of business — until the end of September 2020. At the same time, it increased the minimum debt that can form the basis of statutory action ($20,000 from $2,000), and the time in which companies must pay that debt (from 21 days to 6 months), providing breathing room for small businesses to deal with financial issues without facing winding up proceedings.

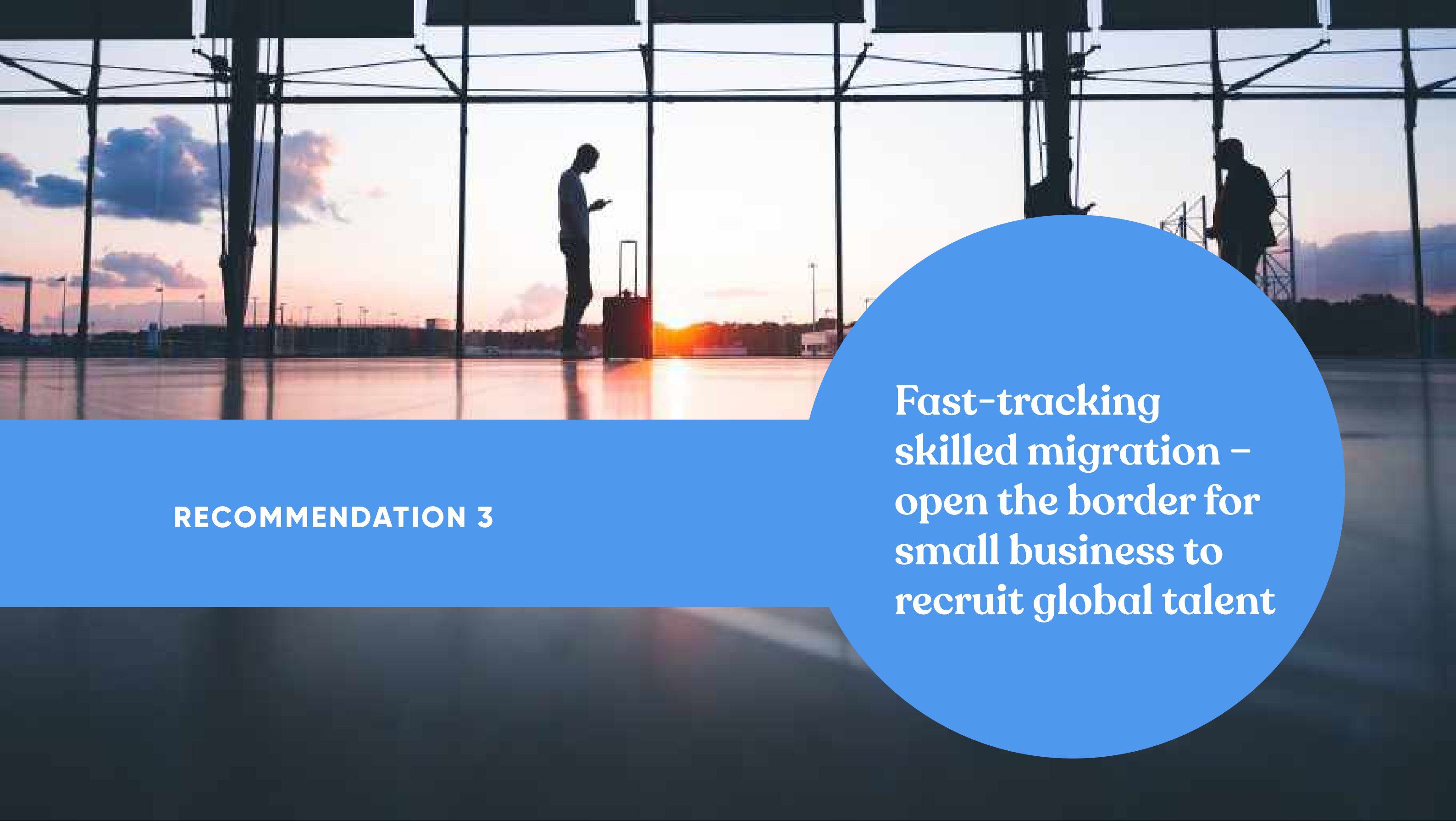
To ensure the efficacy of the proposed insolvency program, the Government should extend COVID-19 Safe Harbour mechanisms until March 2021, in line with the extension to JobKeeper.

Offer taxpayer-funded vouchers for financial health checks

As part of the financial health checks mentioned above, small business owners should be provided with clear information as to their options, whether their business is viable, and if so, which strategy will offer them the best chance to survive and thrive.

- These financial health checks should be delivered by a business' existing trusted advisor, such as an accountant, tax agent or bookkeeper. In this way, the financial health checks can be delivered in a timely manner, and also act as a safeguard against poor advice from non-qualified and/or exploitative actors.

COST: Providing financial health check vouchers to small businesses (assuming 66% uptake) would cost $4.4 billion[2,3]. While this represents a significant investment for the Federal Government, it is a reasonably small amount in the context of overall stimulus spending. Further, it is likely to drastically increase the efficacy of the Government's other policies targeted at saving jobs by strengthening the viability of small businesses through provision of high-quality advice and planning for restructuring. This covers the cost of financial health checks relevant to Recommendations 1 and 2.



RECOMMENDATION 3

Fast-tracking skilled migration – open the border for small business to recruit global talent

At the end of 2019, over 50%[4] of small businesses said that availability of suitable labour was limiting their output; these shortages will likely increase as the continued restrictions on foreign arrivals and a lack of visa extensions limit the capacity of small businesses to access skilled labour.

Blueprint Institute urges the Government to promote a skilled migration and visa pathway for small businesses, even as borders remain closed due to the pandemic. This would require a tiered system that streamlines applications, while giving small business owners lower costs than large businesses when recruiting skilled foreign workers. The skill needs of the small business sector should be prioritised in any scheme to drive innovative activity, both because they are disproportionately affected by the lockdowns and because they are the primary drivers of innovation in our economy.

We recommend:

Streamlining visa approvals for those already in Australia

- For migrant workers who are already in Australia, the Government should prioritise approvals for visa renewals where small businesses wish to employ workers.

Skilled migration targets and fee waivers for small business

- To meet the skill needs of small businesses and ensure the labour market functions smoothly, the Government should set a target for temporary and permanent skilled migration that encourages workers with skills in critical areas (such as medical services, engineering, construction, technology, advanced manufacturing and cybersecurity) to enter the country, even when borders are closed.

- As an additional incentive to draw foreign talent into Australia's small business sector, the Government could consider reducing or waiving expensive fees for visa applications and hotel quarantine.

COST: the exact cost of this program depends on the arrangement the Government settles upon, and whether costs are passed to businesses or taxpayers. The contribution of highly-skilled migrants in economic output and taxation is likely to dwarf even a generous approach to this program. Migrants to Australia contribute far more in taxes than they receive in welfare, and even during the current economic turmoil and recovery, this is likely to remain true.

The Australian public is in favour of the Government supporting small businesses

Blueprint Institute believes that support for small business is a question of values, and that most Australians value fairness and the role of aspiration in our economy. Our recent polling supports this view.

83 per cent of Australians support innovative policy which helps to level the playing field between small and large businesses to make it easier for small businesses to thrive.

Australians also feel for small businesses and want them supported through this crisis. In response to the current economic crisis, 63 per cent of Australians said they would shop local to support small businesses, compared to just 8 per cent who said they would shop at large businesses.

Definition of 'Small Business'

There are a number of definitions for small business in Australia. In recent years, the Australian Small Business and Family Enterprise Ombudsman (ASBFEO), the Australian Taxation Office (ATO) and the Australian Bureau of Statistics have used different definitions of small business. The ASBFEO prefers to use the same definition as the ATO[8]: that a small business is one that has less than AUD$10 million in turnover. This is the basis of our definition of small business, and it applies to 98%[9] of Australian businesses.

A huge proportion of these are very small — 95%[10] of Australian businesses are very small (those with a turnover between $75,000 and $2 million) or micro (those with a turnover of under $75,000) in size. Another approach defines small businesses as those that employ less than 20 people; under this definition, 98% of Australian small businesses are 'small'. Occasionally, we will use these more conservative definitions of 'small businesses' in this Blueprint paper in order to incorporate the widest amount of available data and statistics. Whenever we do so, we clearly note it in the text. Otherwise, all references to small businesses refer to the definition of a company with less than $10m in turnover.

Small businesses are the powerhouse of Australia's economy. Those with less than 20 employees contribute 35%[11] of Australia's GDP. Together, they employ 44%[12] of all Australian workers. Small businesses are also motors of innovation, accounting for 92%[13] of all Australian companies which innovate, thus driving increases in productivity and economic growth.

NOTE: The Government may also find it prudent to support other businesses which fall outside of this definition. For example, some high-volume, low-margin businesses, such as small supermarkets and service stations with turnovers that exceed $10 million, may also benefit from access to the schemes outlined in this paper. These businesses could be identified by the ATO on an industry by industry basis.

The Problem

Australia is at a critical junction. The COVID-19 pandemic has ended the country's three decades of economic growth; a recession is now unavoidable. The Australian Government has rushed to put several stopgaps, safeguards and subsidies in place to shield companies and workers from the worst impacts. However, the next six months will be pivotal. The measures policymakers adopt now will decide whether the Australian economy can continue to rely on its backbone - small businesses.

Small businesses have been devastated by COVID-19 lockdowns. Unable to fall back on the large capital reserves and stable government contracts that often cushion big corporations in times of crisis, thousands of cafes, restaurants, tourism operators, construction firms and others are teetering on the brink of bankruptcy. Consumer confidence is low, further complicating a recovery, as more Australians decide to save their paycheck, rather than spend it.

The full impact of the damage to the economy may only be visible when the JobKeeper program ends. It is already clear that this is the largest economic downturn since the Great Depression in the 1930s.

Many small businesses are currently on life support, courtesy of the Federal Government.

While the Treasurer announced that JobKeeper will continue and Prime Minister Scott Morrison promised that the National Cabinet will have a 'laser focus' on job creation, our concern is that the JobKeeper supplement offers little opportunity for small businesses to hire new workers and grow their business in the post-COVID-19 world. Any 'v-shaped economic recovery' will be led by small businesses growing their way out of the downturn. The Government must set up a stronger, clearer system to support viable small businesses and allow those who are not viable to be wound up fast and with dignity.

The recommendations in this paper will address three problems:

1. **LOOMING CAPITAL SHORTAGE:** Confidence in the small business sector has been damaged by the COVID-19 crisis. This has meant that many businesses do not have the confidence to take on debt and grow. In turn, this has wide-ranging consequences for the economy as a whole. If we are to achieve a business-led recovery, it is imperative that viable businesses have the confidence necessary to make sensible investments, hire staff, and expand their operations. This will help prevent a downward spiral in confidence and economic activity. Current Commonwealth efforts to underwrite loans through the SME Guarantee Scheme have been ineffective, primarily due to low business confidence and relatively high interest on the loans. Further, even if the banks wanted to lend to small businesses, the high level of economic uncertainty makes it virtually impossible to lend to a small business as they journey out of the COVID-19 downturn while also complying with the 'Responsible Lending Practices' enforced by APRA. This is due to the fact that it is extremely difficult to accurately factor in a risk premium to the cost of small businesses borrowing in a COVID-19 world. The severity of the current crisis requires an exceptional response to get capital moving through the small business sector.

2. **LOOMING INSOLVENCY CLIFF:** Large numbers of small businesses have been artificially propped up through JobKeeper payments. When these payments are reduced and eventually wound up in March 2021, a large number of small businesses may find themselves trading while insolvent. It is imperative that these businesses are wound up in an orderly fashion that reduces damage to the economy and lives. Current insolvency laws offer limited flexibility for small businesses to restructure or take on debt, which could have hugely damaging effects when they are reintroduced in September 2020 (having been suspended by COVID Safe Harbour measures). This could lead to many potentially viable businesses failing to restructure and becoming insolvent. In turn, this would have negative effects on the speed of the country's economic recovery and on the lives, livelihoods and mental health of vulnerable small business owners.

3. **LOOMING SKILLS CRISIS:** For the duration of the COVID-19 pandemic, the size of the short-term migrant workforce, which has formed an important pillar of small business employment, has decreased substantially. This will dramatically affect the ability of the sector to recover — without appropriate access to adequately skilled labour, small businesses will struggle.

Disproportionate impact on age and gender groups

The issues facing the small business sector disproportionately affect young people and women. According to the National Skills Commission[14], young people accounted for 45% of the total decline in employment in May, despite comprising just 16% of the population. Moreover, female employment fell 7.3% between March and May 2020, compared with a decline of 5.7% for male employment. In this context the coronavirus has been called a 'pink recession' and we argue policy-makers should take account of the disproportionate impact on women in their response.

Existing Federal Government initiatives may not be appropriately supporting vulnerable communities. For instance, the Government has announced a number of measures aimed to boost activity in the construction sector, in which 88%[15] of participants are male. In contrast, the Government decided to defund the free child-care scheme, which had itself been recognised as highly successful in propping up an industry dominated by female workers, who are largely lower paid. If the childcare sector struggles with insolvencies when JobKeeper is ceased, it is women who are likely to suffer the most.

Reforms that benefit small businesses can support a large number of female employees and business owners. One third of small businesses owners in Australia are women, with over 715,300[16] female business operators in Australia. Moreover, heavily-affected sectors employ large proportions of women. Retail, food services and accommodation, for example, employ far more women[17] than men. As such, measures that keep small businesses alive, and save owners time and money, could provide greater security to the female workforce and help reverse increasing divides in gender equality.

Young people are another demographic that has been significantly impacted by COVID-19. Youth unemployment in Australia now stands at 16.1%[18]. Given the significant contribution of small businesses to employment in this country, measures that drive growth and investment may help reduce youth unemployment.

Finally, it is worth emphasising the vulnerability of small business owners themselves. Many small businesses operators in their 40s, 50s, and 60s may have intended to sell their business as part of their retirement plan (i.e. they did not necessarily pay themselves a wage and therefore did not pay superannuation). These groups represent a significant mental health risk as they see the value of their retirement savings (i.e. their business) destroyed by COVID-19. We argue that neglecting the interests of this group will impose a high burden on the Government via pension payments and lead to a rise in mental illness.

Small business people are a highly capable portion of the workforce and possess the skills and experience to increase the nation's productive capacity. If we are to lift national economic output and effectively grow ourselves out of the economic damage of COVID-19, we will need this older cohort of Australians to be supported in continuing to work.

The Evidence

The looming capital shortage

Access to capital is critical for all small businesses. Prior to COVID-19, NAB reported[19] that 1 in 5 small firms report difficulty in accessing capital, and this problem is amplified during difficult economic times.

Fortunately, governments and regulatory bodies have been active in this area by relaxing lending requirements. During the height of the COVID-19 crisis, Australia's financial regulatory system told banks to prioritise lending to small businesses over following the letter of the law. In a joint statement[20], regulators said that they "will take account of the circumstances in which lenders, acting reasonably, are currently operating during the prevailing circumstances when administering their respective laws and regulations".

This groundbreaking statement resulted in more money flowing into small business accounts by allowing banks to lend more freely; it also provides a roadmap for how flexible lending could work once excessive red tape is removed.

However, the most recent lockdown in Victoria, driven by a new surge of COVID-19 cases, has shown that this crisis may be far more protracted than previously hoped. In response, the Victorian Government has announced a AUD$534 million business support package[21]. Grants of up to $5,000 will be available for 80,000 struggling businesses. While these grants are welcome, they are unlikely to have a meaningful impact for many small businesses.

Australian small businesses are more vulnerable to the economic damage caused by COVID-19 than larger businesses. Larger companies have the financial means, knowledge, and time to restructure their businesses in troubling times; large and secured balance sheets allow them to easily raise capital or debt through more preferable loan arrangements. Many small businesses do not enjoy such advantages.

Recognising these facts, the Government has introduced the Coronavirus Small Business Guarantee Scheme[22] (SME Guarantee Scheme). From April 2020 until June 2021, the Government will provide a 50% guarantee of 3 year loans valued up to $250,000 for small businesses with an initial 6 month repayment holiday. This will fund up to $40 billion[23] in loans. The Government recently announced that they will increase the available loan size to $1 million from October 2020, and the repayment period to 5 years.

This scheme represents an unprecedented level of support for Australian small businesses. The Government has moved with exceptional speed to support a critical sector of the economy that has suffered during COVID-19. The Government's responsiveness to the needs of small businesses is also exemplified by the JobKeeper scheme, and recent changes to broaden its availability in response to the lockdown in Victoria.

While many industry experts and small businesses interviewed by Blueprint Institute view the SME Guarantee Scheme as a step in the right direction, there is a need for changes to improve flow of capital to small businesses. This is shown by the fact that, out of the $40 billion ($20 billion in public funding) available under this scheme, just 15,600 loans, worth $1.5 billion ($750 million in public funding), have been approved[24].

There are multiple reasons for this low uptake. Firstly, the loans have been subject to relatively high variable interest rates (around 4.5%[25]), which decreases their attractiveness for small business owners. Secondly, the loans are only available for up to 3 years, which is a reasonably short loan period given the uncertainty surrounding COVID-19 and the economic recovery to come. Thirdly, the loans require that businesses make no repayments for the first 6 months — an inflexible system which fails to account for the variable nature of a small business' revenue – they may wish to pay down capital in their first six months but are unable to.

Finally, industry insiders have informed us that, while these loans are espoused to be 'unsecured', many banks are still requiring personal guarantees before loans are administered.

In normal times it might be reasonable to ask businesses to secure loans against personal assets, but in the midst of this pandemic the requirement appears out of touch with the dire circumstances faced by our most vulnerable business community, and the risks this poses to the economy as a whole.

Increasing the size of loans available, as the Government has done, does little to alter the fundamental conditions of the loans, which are difficult for depressed small businesses to countenance. Ultimately, the existing SME Guarantee Scheme is only likely to aid those businesses that are in a strong financial position and are sufficiently optimistic about their revenue streams to take on debt. A large number of small businesses do not fit this description.

The 2019 Bushfire Recovery Loan Scheme

Interestingly, the SME Guarantee Scheme has offered loans at far less attractive terms than the loans made available to businesses affected by the most recent bushfire season. Jointly funded by the Commonwealth, state and territory governments, these loans[26] were up to $500,000 in value and offered at rates as low as 0.82%[27] over 10 years, with a 2 year interest- and fee-free period.

One would expect that, with such business-friendly rates on offer, the uptake of these loans would have been high. This was not the case[28]: just 21,405 out of 600,000 bushfire-affected businesses took up these loans or the available grants. From our engagement with small business owners and industry experts, we heard that this low uptake was due to two key reasons, namely: small business owners not having the confidence to take on debt, and a burdensome documentation and approval process within the bureaucracy. Both lessons should inform the design of future loan schemes.

Economic uncertainty is filtering down to every level of the economy. What seems certain is that the economic struggles faced by Australian businesses — and small ones in particular — will last beyond September. Even with the extended JobKeeper wage support, many will likely be starved of the capital and confidence necessary to grow their business and employ new staff. The Government's policies have not succeeded in increasing small business access to loans. A step change is needed to overcome low confidence amongst small business owners, spur investment and drive job creation.

The looming insolvency cliff

The majority of small businesses fail, even in normal economic times. A Treasury study of new firms with less than 20 employees shows[29] that over a 36-month period, 31% had reached operational status (i.e. where sales regularly exceed costs), 35% had been terminated and 34% were still trying to find their feet. Let that sink in: 3 years from business inception, only a third of new businesses had reached operational status.

These problems are likely to be compounded now that Australia has slipped into recession[30]. Our local cafes, restaurants, tourism operators and construction firms, to name just a few sectors, have been devastated by COVID-19 lockdowns. NAB[31] has shown that payment inflows for small businesses have been affected to a much greater extent than emerging, medium or 'corporate' businesses. For NAB customers from April 2020 to June 2020, small businesses saw an average fall of 16%, compared to a rise of 15% for large businesses.

These figures are reflected in the numbers of JobKeeper applicants. Small businesses are only eligible for the JobKeeper program if they have experienced a 30% reduction in revenue due to COVID-19, and **it is our smallest businesses, or those with a turnover of under $2 million per year, who have accounted for 87%[32] of the enrolments in JobKeeper.** 44%[33] of all Australian businesses said that the JobKeeper scheme influenced their decision to continue to employ staff.

At the same time, the latest available data shows that business insolvencies are at record lows, which appears at odds with the hardships caused by the COVID-19 crisis. It is likely that a large number of 'zombie' companies are currently only kept alive with government support programs. When these programs end, we will likely face an 'insolvency cliff'. Chartered Accountants Australia and New Zealand have determined[34] that insolvencies have decreased by 34% since March, equating to an expected shortfall of 3,700 insolvencies[35] by the final quarter of December 2020 — not including any additional increase on account of COVID-19.

At the end of September, as JobKeeper payments start to be wound back and some loan, rent and utility payment holidays end, the small business community will begin to feel the pressure. With the economic impacts of COVID-19 likely to continue to impact revenue, many businesses may become insolvent. In fact, 52%[36] of small business owners in Australia fear for their long-term survival if business does not pick up. Small businesses will be particularly vulnerable to changes to existing stimulus packages later this year. The Government cannot continue to prop up the Australian economy indefinitely.

The looming skills crisis

Whatever the exact shape of Australia's recovery from this crisis, as demand increases governments must ensure Australian small businesses are prepared to take full advantage. An important part of this equation for all small businesses is having appropriate access to labour and skills to operate and grow one's business.

Even before COVID-19, small businesses often struggled to find the labour they required to flourish. At the end of 2019, over 50%[37] of firms said that availability of suitable labour was limiting their output. Each year, the Australian Government publishes a list of skilled occupations for which there are shortages. As of 2018-19[38], the list is long.

Of the 63 skilled occupations assessed by the Former Department of Employment, Skills, Small and Family Business, Australia has a national shortage in 41 occupations. Moreover, there are local shortages of many of the other occupations listed; while these may not amount to a national shortage, they still create significant difficulties for small businesses, particularly in regional and rural areas.

To help bridge these skills gaps, Australia has been increasing its admission of skilled permanent and temporary migrants over the past two decades. In 2000, 78,200[39] migrants were classified in the 'skilled' stream of permanent migrants, as outlined by the Government. This has increased rapidly in recent years, with 128,550[40] skilled migrants settling in Australia in 2015, and 160,000[41] in 2019. Temporary skilled and unskilled labour also plays a significant role in Australia's labour market. In December 2019 there were 119,160 skilled temporary migrants in Australia, as well as 180,221 other skilled or unskilled migrant workers.

During the COVID-19 outbreak, Prime Minister Scott Morrison barred all foreign international arrivals from entering the country. Australia closed its borders[42] to all non-citizens and non-residents on Friday, 20th March 2020. This included not only tourists, who make up the bulk of international arrivals, but also visa holders who were not currently in Australia. The most recent data[43] available from the Government shows that 406 'settler arrivals' occurred in April 2020. This is down from an average of 7,435, a decline of 94%. This dramatic fall in immigration has been accompanied with statements by the Government advising[44] those migrant workers who are already in Australia, but who had lost employment due to COVID-19, to return to their country of origin. In the recovery stage, Australia may need these workers more than ever.

At this time of reduced immigration, the Federal Government is coming under pressure to lower arrivals into Australia further. The Prime Minister has outlined a proposal[45] to reduce the 'overall level of returning Australians'. This comes amidst pressure from WA Premier Mark McGowan, who has called for a cap on international arrivals into the state; indeed, international arrivals at Perth have already been capped at 525 per week. While Victoria is in lockdown, international arrivals to Melbourne have been halted completely, while Sydney recently reduced its daily arrivals to 350 per day.

Even if lockdowns ease in the near future, and economic activity resumes, political pressure is likely to result in international borders being closed for some time. This means significant skill shortages are likely to remain despite government training programs and high unemployment. If skilled migrant workers find it increasingly difficult to enter Australia, Australian businesses will find it increasingly difficult to recruit skilled workers that could play an important role in the recovery. Persistent skill shortages decrease labour market efficiency and productivity while increasing recruitment costs for firms[46]; this would impede the nation's economic recovery.

Some may argue that such limits on arrivals will be short-lived. If a vaccine is discovered, or herd immunity is attained, for instance, borders will be able to reopen and normal life could resume. However, such claims are imprudent and harmful. The World Health Organization[47] has highlighted that an ambitious trajectory for a vaccine would involve development of a successful candidate within 18 months from the start of the outbreak, and to vaccinate 20% of the world's most vulnerable people by the end of 2021. It is possible that it could take even longer, or never come at all.

Furthermore, the science is unclear whether herd immunity to COVID-19 is possible; we do not know whether exposure to the virus (or a potential vaccine) produces effective antibodies or how long any potential protection might last. In fact, recent studies[48] suggest that immunity after infection is short-lived. In these uncertain times, governments should prepare for the worst scenario— that COVID-19 will be the new normal for some time. Remember that prior to COVID-19, significant skill shortages existed in the Australian economy. As such, we cannot expect the economy to bounce back quickly without any skilled migration. It should be a priority for the Government to ensure that Australian businesses are provided with the skills they need to invest and grow with confidence.

Reskilling Australian workers already in the labour force

The discussion above has not addressed the opportunities for reskilling Australian workers through targeted training courses that are responsive to the needs of business. The retraining/reskilling of displaced workers in all age groups is essential to lift national economic output in the next 3 to 5 years, as health risks may reduce the opportunity for the importation of skilled labour from other international economies.

This issue will be examined in a subsequent Blueprint Institute paper, which will focus upon potential reforms to the Australian skills sector to ensure that workers are prepared for the jobs of the future, and skill development is geared towards the needs of businesses and industry. We chose not to address the issue of skills training in this paper because this Blueprint is focused on short-term support for small businesses; skills gaps in complex or highly-skilled professions are unlikely to be filled completely in the short term by increasing the effectiveness of any domestic training schemes or pathways.

The Blueprint

RECOMMENDATION 1: CAPITAL ON TAP

New HECS-style loans for small businesses

Access to capital is critical to small businesses recovering from the impending recession. A sudden drop in revenue, due to changing consumer habits during periods of lockdown and social distancing, may impact businesses' ability to manage stock or their capacity to retain staff. Others still may be forced into bankruptcy.

Every business failure has negative consequences for the wider economy. When a viable business fails, the loss weighs even more. Resultant job losses and insecurity lead to significant amounts of economic and mental stress for employers and employees. This is especially true for small business owners who have invested time, money and effort to create a viable business venture.

Once the pandemic-induced crisis abates, viable small businesses will form the foundation of our economic recovery. The country will rely on them, as it already does, to drive productivity and innovation. Against this backdrop, the Government will need to do everything it can to prevent structurally sound small businesses from failing. The inability to design adequate safety nets for these businesses would mean missing a vital opportunity for value creation in the form of new goods and services in a post-COVID world. Access to flexible and low-risk capital is essential to achieve this vision.

We recommend:

Recommendation 1.1.
Replace the Coronavirus SME Loan Guarantee with a HECS-style, revenue-contingent loan system.

Recommendation 1.2.
Vouchers for financial health checks to determine a business' suitability for the loans.

RECOMMENDATION 1.1.

Replace the Coronavirus SME Loan Guarantee with a HECS-style, revenue-contingent loan system

COVID-19 requires us to rethink capital arrangements for small businesses. In normal economic times, 40%[49] of the Australian businesses that fail do so because of inadequate cash flow. We are likely heading for an extended recession, with small businesses set to suffer from reduced demand and uncertain economic conditions for the long term. Indeed, during the current crisis, nearly 60%[50] of small business owners are either extremely worried or seriously concerned about their cash flow. With industries such as tourism, accommodation and entertainment unlikely to return to their previous levels after this crisis has passed, as well as a more general reduction in trade and economic activity, the OECD has argued[51] that Australia will rely upon its "fiscal policy to provide additional stimulus". We agree with this view.

To achieve this goal, and in line with ASBFEO's COVID-19 Recovery Plan[52], Blueprint Institute recommends that the Federal Government provide time-limited low-interest small business loans in a HECS-style loan arrangement as part of stimulus measures for the sector, with repayments to come from future revenue (revenue contingent). These loan arrangements could be available until the end of 2021, at which point the program should be assessed for its uptake, repayment levels, effect on business investment, and return (in terms of economic activity). In order for these loans to produce the intended impact, small businesses could be incentivised to spend capital over a 2-year time period.

Benefits: Fully public-funded loans may seem like a radical idea. But we are living in unprecedented economic times — even former President George W. Bush's economic advisor, Greg Mankiw, has expressed support[53] for the idea of revenue-contingent loans for businesses and individuals. For those small business owners with innovative ideas about how they can provide new goods and services in a post-COVID economy, an injection of capital would be an opportunity to invest and grow their business with the peace of mind that the loan will only be repaid from future revenue. A HECS-style revenue-contingent loan for small businesses could be a productive economic investment, driving increased innovative activity and job creation as the economy rebounds.

Furthermore, as explained[54] by ANU economist Shiro Armstrong, "the scheme acts as what economists call an automatic stabiliser, providing income cover when it's needed and automatically recouping it when it's not."

COST: Importantly, this policy would not require additional government spending commitments. Rather, funding could come from reallocating the $20 billion earmarked for the SME Guarantee Scheme, which, as we have discussed, has been largely ineffective at improving the flow of capital to SMEs. We will discuss potential budgetary impact later in this section.

Repayment conditions: Many conditions of the existing SME Guarantee Scheme are sensible and could be mirrored in the new HECS-style system (these conditions are summarised in Table 1). Like the SME Guarantee Scheme, revenue-contingent loans should be unsecured — that is, small business owners should not have to provide assets to guarantee the loan. As we wrote earlier, it is common practice among banks to request personal guarantees before approving a loan. Government involvement will put an end to such practices.

Crucially, these loans would not be a grant; rather, they would be established under flexible terms that allow small businesses to pay back the loan from future revenues. While businesses should initially only be able to apply for the loans until the end of 2021, there should not be a time limit on paying back the loan. This would help to improve business confidence and encourage investment in new equipment, staff or services, minimising risk for small business owners who may be concerned about the impact of further lockdowns on revenue.

We argue that the loan limit should be set at $250,000, rather than increasing it to $1 million as the Government has done with the SME Guarantee Scheme. A HECS-style loan system would likely see much more significant uptake, and we think it is important to provide access to the maximum number of viable small businesses.

Table 1: Comparison of SME HECS-style loans vs SME Loan Guarantee

	SME Loan Guarantee to September 2020	SME Loan Guarantee from October 2020 to July 2021	SME HECS-style loan system
Interest rates	4-6% p.a., depending on the bank	Unknown	Interest charged in line with indexation, which would be added after 11 months.
Repayment period	Up to 3 years, with a 6 month repayment holiday (where payments are prohibited for 6 months, even if cash flow is sound)	Up to 5 years	No limit on loan length – repaid from future revenue
Secured vs unsecured	Unsecured	Either secured or unsecured (excluding commercial or residential property)	Unsecured
Loan size	$250,000	$1 million	Up to $250,000
Publically funded?	50% public funds, 50% private funds	50% public funds, 50% private funds	100% publicly funded
Approval for loans	Private banks	Private Banks	Approval through financial health check
Delivery	Private Banks	Private Banks	Private banks or through the Government's Business Portal or the ATO
Draw-down capacity	Businesses can be approved for larger loan sizes, but are only charged interest on the capital they draw	Businesses can be approved for larger loan sizes, but are only charged interest on the capital they draw	Businesses can be approved for larger loan sizes, but are only charged interest on the capital they draw

Why not reform the SME Guarantee Scheme?

As has been explained, while the SME Guarantee Scheme was an unprecedented reaction to the current economic crisis, with good intentions at its heart, it has mostly failed in its aim to provide small businesses with access to flexible and low-interest capital. Perhaps some would argue that we should reform the SME Guarantee Scheme rather than adopt a HECS-style loan system. Some members of our expert panels suggested that the Government could underwrite more than 50% of the loan (say, 75% of the total value) or work with the banks to reduce interest rates offered to small businesses. While this would reduce the administrative burden and the Government's risk, we argue that tweaks to the SME Guarantee Scheme are unlikely to solve the structural problems with the program, nor adequately benefit small businesses. There are three main reasons for this.

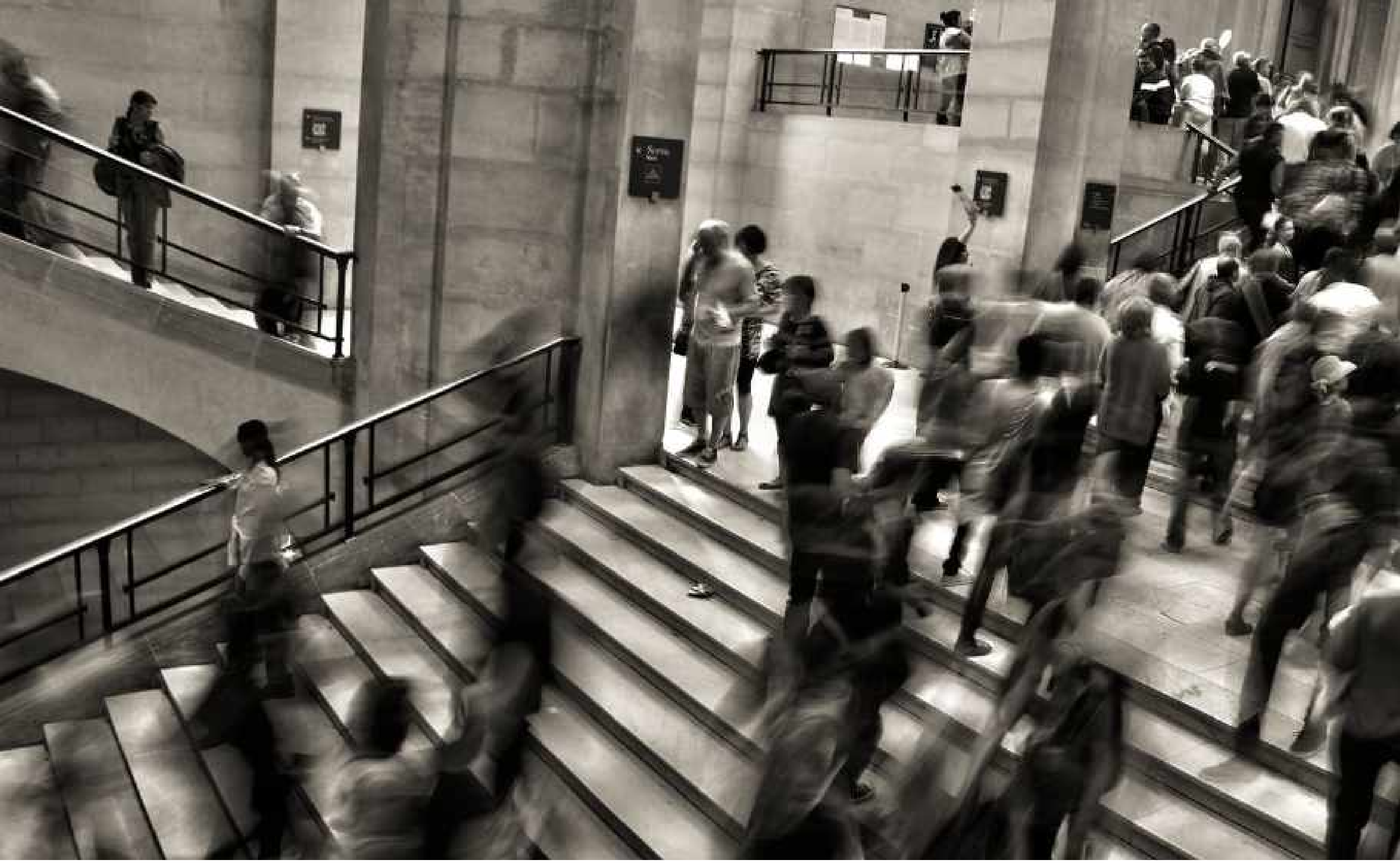
Firstly, as we have argued, in these uncertain economic times small businesses simply do not have the confidence to take on traditionally structured debt. This is especially the case in light of the Victorian COVID-19 outbreak, with the virus also threatening to take hold in New South Wales. Even if the SME Guarantee Scheme offered loans with lower interest rates over a longer repayment period, it is unlikely that small businesses will take up these loans at the level required to spur growth and investment. This is illustrated by the example of the 2019 Bushfire Loan Scheme, as outlined above. These loans were offered at exceptionally low interest rates with long repayment periods, but uptake remained very poor. One could argue that the poor uptake of the bushfire loans was as a result of inadequate communication from the Government. However, given that this poor uptake has been mirrored in the SME Loan Guarantee Scheme, it is more likely that the underlying issue relates to small businesses being unwilling to take out traditional loans in an uncertain operating environment.

Secondly, industry experts interacting with small businesses have told Blueprint that the banks are simply not well placed to administer the current SME Loan Guarantee. Industry experts report that part of the reason for the program's poor uptake is that banks lack experience delivering unsecured loans. In some cases, we heard of banks requiring personal guarantees from business owners, which undermines the scheme's fundamental purpose. It is difficult to see how even a reformed SME Loan Guarantee Scheme could overcome such issues — to succeed, the Government would need to lead a structural change in the way large financial institutions interact with small businesses, and this is unlikely to occur in the short term.

Finally, due to the above issues, it is worth underlining that a reformed SME Loan Guarantee Scheme is unlikely to increase the flow of capital to viable small businesses. Through our research and engagement with the small business sector, Blueprint has concluded that additional stimulus for small business will be required in the economic recovery. While HECS-style loans may have some difficulties in implementation and result in higher compliance costs (we will address this point later in this section), it will provide a simpler and more attractive avenue for small businesses to access capital to invest and grow. In turn, this could result in higher levels of productive economic activity. Moreover, with the Government already committing significant funds to maintaining jobs in small businesses through JobKeeper, improving access to flexible capital arrangements is also likely to improve the efficacy of this spending in saving viable businesses and helping them to grow. Shifting the method of delivery to a HECS-style scheme will simply allow funding, which the Government has already acknowledged the sector needs, to flow to small businesses in a more effective manner.

Selecting recipients:

It is important that any publicly-funded loan program should aim to recoup 80% of the program's cost, in line with similar outcomes in the HECS system. To reduce risk for taxpayers and increase the chance of loan repayments, it is imperative that access to HECS-style loans is only provided to viable small businesses. This



would involve determining which businesses were viable prior to COVID-19, and which were not.

It would be ideal if HECS-style loans could be provided to all businesses. However, there are currently a large number of 'zombie' companies that would have failed during normal economic times, but have been propped up by JobKeeper. While any business failure is regrettable, providing all companies with HECS-style loans would place an unreasonable burden on the taxpayer. As a result, these 'zombie' companies should be allowed to close down and not have access to HECS-style loans. For those companies that are deemed to have sound fundamentals, approvals should be granted promptly and efficiently, so that viable small businesses have access to the capital they need to grow their business and prosper.

The Government has already shown willingness to offer 100% publicly-funded loans

POLITICAL FEASIBILITY: The Government has already shown its willingness to offer publicly-funded loans to the arts sector. Given the critical role that small businesses play in the economy, Blueprint argues that they should be eligible for fully publicly-funded loans to invest and grow their business; in this fashion, small businesses can kickstart our economic recovery.

For example, the Government's Show Starter Loans, which are part of the COVID-19 Creative Economy Support Package, will provide $90 million in concessional loans to assist creative economy businesses to fund new productions and events that stimulate job creation and economic activity. These loans will be 100% government-backed and delivered through commercial banks.

RECOMMENDATION 1.2.

Vouchers for financial health checks to determine a business' suitability for the loans

To determine which small businesses are viable and which are not, the Government should provide vouchers worth $3,000 for small businesses to seek advice from licensed private practitioners to conduct financial health checks. This would cost the Government just over $4.4 billion[2,3] if two thirds of small businesses accepted the vouchers. A financial check could be offered to small businesses as a pre-condition of HECS-style loan approval, taking into account the business' financial position prior to COVID-19 to determine ongoing viability once JobKeeper ends. Where opportunities exist to improve business operations to achieve viability, recommendations could be made to the small business owner, with future approval for a HECS-style loan dependent on these changes.

Financial health checks could be funded through a voucher system, paid by the taxpayer, with proceeds going to a trusted small business advisor, such as an accountant, bookkeeper or other registered professional who understands the business in question. Applications for the financial health check could be managed by the ATO through their business portal, where small businesses in financial distress already interact with the ATO to receive JobKeeper. Upon completion of the financial health check, businesses could lodge the invoice of the check and a summary of its findings to the ATO (including a note as to whether they are viable and thus eligible for a HECS-style loan). We suggest this form could be lodged as part of putting in a claim for JobKeeper. For those businesses not claiming JobKeeper, the form could be lodged as part of standard reporting to the ATO. Additional conditions could be applied to reduce risk to taxpayer funds — for example, loans might only be available to businesses that have lodged 2 years of tax returns.

For those firms that are successful in gaining a revenue-contingent loan, the cost of this service could be incorporated into the loan itself. For those that are unsuccessful, and where the business is not viable, the Government should bear the cost of the financial health check. This will incentivise small businesses to apply in the knowledge that they will be no worse off if they are rejected for the loan. As we will discuss, owners of non-viable businesses would benefit from independent and transparent advice on how to wind up operations in a timely and dignified manner that suits them and their employees.

From a technical perspective, the Government could work with the banks in a public-private partnership to develop their loan assessment platform, capitalising on private sector knowledge even if public funds underwrite the loans. We think the process could be conducted through Business.gov for simplicity, although this should remain flexible based on advice from industry experts and regulators.

Potential implementation issues and other considerations

Ensuring large-scale uptake

It is important that the Government carefully monitors how much funding is actually flowing to small businesses. The Australian Prudential Regulation Authority should conduct quarterly reviews to assess the flow of capital and whether it is reaching the businesses that need it.

Additionally, extensive public education campaigns should be conducted to inform small business owners about the HECS-style loan program. This would be absolutely fundamental to the program's success – as we outlined above, generous loan conditions following the bushfires were not embraced by many small businesses. Some may not have known about the loans, and others may have been unaware of the favourable conditions being offered.

Some businesses may fail, despite receiving revenue-contingent loans

In the end, despite the financial health check, some ventures that receive these loans may fail. This is the nature of small business. But this fact should not deter the Government from investing in the program.

We have suggested a number of measures to reduce risk for taxpayers, namely: reallocating funds from the SME Guarantee Scheme (so as to not increase the overall size of stimulus spending); rigorously vetting the viability of small business applicants through the financial health check; and conducting a review of the program to determine cost benefit at the end of 2021. These measures strike the balance between fiscal prudence in minimising our sizable public debt and maximising the opportunity for job creation and growth that small businesses represent.

We suggest that an 80% repayment target for the HECS-style loans is a sensible target. This is consistent with existing repayment rates of HECS loans amongst those who have completed a university degree. 80% repayment rates would mean the program is not revenue-neutral, and may cost the Government up to $4 billion; however, public subsidy of this loan scheme must be viewed in the context of the program's potential benefits in saving jobs and businesses, as well as overall stimulus spending during COVID-19. Furthermore, numerous experts with whom Blueprint Institute has consulted have argued that a HECS-style loan scheme is likely to reduce government spending on JobKeeper itself. Of course, JobKeeper is a sunk cost to taxpayers and the Government, while HECS-style loans present an opportunity to recoup investment once a business' revenue rebounds.

Risks of extra regulation or checks

During our consultation process, small business experts raised the concern that a revenue contingent HECS-style loan may lead to 'cash in hand' businesses artificially reducing their revenue to avoid repayments. To overcome these issues, our expert panelists suggested that new regulations could be introduced, with small businesses who receive a HECS-style loan being required to commit to more rigorous reporting standards to the ATO, with the potential for new rules targeted at minimising cash in hand payments.

However, this problem is not unique to HECS-style loans; rather it is an issue that the ATO faces every year. While this scheme could be 'gamed' by some businesses, we do not think this objection is sufficient to discount the benefits of the scheme for the majority of business owners who follow the rules. Further, any additional red tape would reduce uptake amongst small business owners and undermine the benefits of the HECS-style program.

If measures to solve the underlying problem of taxing cash businesses are too expensive or complex to address now, we argue that the overall benefits of a HECS-style program to the small business sector outweigh the potential costs and inefficiencies. That is, we accept there is some risk of fraud amongst cash in hand businesses. But the only approval process that small businesses should be asked to undertake is the financial health check, as outlined above.

Questions of implementation - administrative and compliance costs

Given the scope of this paper, Blueprint Institute has not examined in detail the various implementation issues and administrative costs that would arise from a HECS-style loan scheme. We acknowledge that it may be expensive to implement on account of higher administrative costs, with an additional compliance burden falling upon the ATO and related government departments.

Nonetheless, we argue that these challenges are not insurmountable. Higher administrative and compliance costs would be acceptable if a HECS-style loan improves the flow of capital to small businesses so that they can invest and grow. A HECS-style scheme requires no additional spending commitments (only a reallocation of the $20 billion committed to the SME Guarantee Scheme), and administrative and compliance costs are likely to be modest when compared to total stimulus spending during COVID-19. Indeed, it was only in March that the Government introduced JobKeeper, which required new administrative processes but also significantly increased public debt — to the tune of $10 billion per month until September 2020.

When considering a HECS-style loan scheme, compliance and administration costs should be factored into a broader costing undertaken by the Federal Government. Multiple options for delivery should be considered across the public and private sector. These are summarised below. While there may be some compliance and implementation issues with the design of the delivery mechanism, there are numerous options that the Government could consider to overcome these difficulties.

Implementation process

During consultation, we heard numerous stories of small businesses facing enormous amounts of paperwork before being approved for loans — this occurred not only during typical interactions with financial institutions (i.e. the banks), but also in the public service through the bushfire loans schemes.

Once a business has been approved for a HECS-style loan through the financial health check, it is important that capital be made available promptly and efficiently. Two potential pathways to facilitate the payment include:

1. A relevant public service department should make the payment upon submission of an approved financial health check. Our engagement with industry experts found that this would be the simplest pathway to win buy-in from the small business sector and get capital to those who need it quickly. Regardless of which Department takes ownership of payments, the ATO should be closely engaged in the process.
2. Once the health check is passed, the business could go to their private bank who would deposit the funds to their account, before applying to the Government for reimbursement. In this system, it would need to be clear that the financial health check is all that is required for eligibility, and no additional checks or stress testing should be done by the bank.

Implementing HECS-style loans will require consideration on the best method to facilitate repayments. In a similar fashion to the HECS student loan system, the ATO could have to levy an extra tax upon businesses until loans have been paid off. One option could be through an increase in GST payments by 1-2%. Blueprint Institute's conversations with small business operators indicate that many businesses would be willing to take on loans with such conditions during COVID-19. Another similar option could involve increasing the marginal tax rate via the Business Activity Statement (BAS) — for example, the rate could increase from 27.5% to 28.5% or 29.5%, and payments could increase proportionally as revenue increases.

Alternatively, private banks could administer loans and receive repayments, even if public finances fund the program. Of course, if such a system is adopted, close scrutiny would be required to ensure banks provide truly 'unsecured loans'. On balance, however, we suggest repayments should be administered by the ATO to reduce complexity.

Could financial health checks be voluntary for loan access?

The financial health check voucher that has been advocated for in this paper serves two purposes.

Firstly, it provides small businesses with the advice that they need to pivot and restructure in this turbulent economic environment. Small businesses will also gain advice about whether their business is viable, and if not, be offered a pathway for the business to be wound down in the most dignified and least harmful fashion possible. This would be invaluable in helping small business owners avoid taking on unnecessary debt, and ensure those within the small business community have the best chance of participating in the economic recovery.

Secondly, the financial health check offers a pathway for viable businesses to access the proposed HECS-style loans. As outlined, in order to avoid the Government offering loans to businesses that are not viable, we have advocated that small businesses should only gain access to these loans once a financial health check has been performed and the small business is deemed 'viable'.

Offering HECS-style loans to viable small businesses confers greater protection to taxpayer funds. However, we recognise that this must be balanced with other concerns. During our peer review process, for example, it was noted that if a financial health check is required to gain access to these loans, the feasibility of HECS-style loans would be contingent upon successfully rolling out financial health checks for large numbers of small businesses. Moreover, a business' ability to access capital could be delayed while they await the findings of their financial health check. Finally, the fundamental importance of financial health checks in determining a business' eligibility for HECS-style loans could incentivise corruption or fraud.

These factors suggest that there could be an argument for businesses to gain access to the HECS-style loans through different criteria without the need for a financial health check. This alternative implementation method could be based upon the business' pre-pandemic revenue and their current revenue as a measure of viability. Such simple inclusion criteria could hasten implementation, as these figures would be easily verifiable by the ATO, and reduce the chances of fraud. However, even if this implementation method was preferred by the Government, this should not take away from the importance of the financial health check for those business owners who are concerned about the long-term viability of their businesses and would benefit from advice to restructure or wind down. Many businesses applying for HECS-style loans may also benefit from a financial health check that provides advice on business strategy and restructuring plans, which in turn, could improve the effectiveness of HECS-style loans and the chance of a business succeeding (and thus repaying the loan). As a result, we argue that a financial health check should still be offered to small businesses as a condition of loan approval.

What rate of default is acceptable?

Analysis indicates that around 20%[55] of HECS student loan debt is 'doubtful'; that is, it is very unlikely to be repaid. This represents a pseudo-subsidy for higher education (in light of unregulated university places) and a cost to taxpayers in upskilling the Australian workforce. Few would argue that this figure is unacceptable given the broader social and economic benefits of university education.

As mentioned, the HECS-style loan scheme for small businesses should aim for a similar rate of repayments. We recognise that this could represent a significant increase in the risk profile when compared to normal loans. However, given the dire economic situation, and the need for further support for small businesses, aiming for an 80% rate of return is both reasonable and sensible as a stimulus measure. This would be consistent with the logic that underpins continued support for the HECS student loan scheme; it also represents a much less costly policy than JobKeeper, which results in a 0% return for tax payers.

Blueprint Institute has argued throughout this section that there is a clear need to make these loans as desirable as possible so as to ensure a high level of uptake — a key factor that will drive uptake is the interest-free nature of the loans. This is important, as high uptake would support business confidence and drive investment and job creation amongst a greater number of viable businesses. At the same time, a case can be made for examining whether a low interest rate should be charged for these loans (say 2-5% plus indexation).

Is a surcharge required?

During consultation, experts indicated that loans to eligible businesses could have a surcharge as an insurance policy to protect taxpayer funds against defaults. A sensitivity analysis could be conducted by the Treasury and ATO to consider what level of interest would be prudent to charge, and the likely effect on the program's cost to taxpayers. As we have made clear throughout this paper, we believe the significant benefits of high uptake for HECS-style loans outweigh the relatively low marginal costs in loan defaults (in the context of COVID-19 stimulus spending). However, this idea may warrant consideration if the Government was eager to adopt a highly conservative approach.

Taking stock

The design of the delivery mechanism and the exact implementation process of any HECS-style loan must skirt the line between ensuring high uptake, increasing certainty in the small business sector, providing timely and effective stimulus, and minimising costs to taxpayers. In balancing these factors, the Government should consider the impacts of an elongated economic crisis which may occur if a lack of support for small businesses leads to widespread business closures and losses of job-specific human capital. Policy decisions must take account not only of the cost of action but also the cost of inaction. At a time of record low borrowing costs, we argue that these considerations trump any marginal increase to the nation's fiscal deficit which could result from small businesses defaulting on their loans.

A generous HECS-style loan scheme that minimises barriers to entry and costs to small businesses would not only provide much-needed support to businesses and aid a smooth economic recovery, but also reduce unemployment (through increased business activity) and thus the Government's welfare spending.

RECOMMENDATION 2

New 'Insolvency Checkpoint' for small businesses

When JobKeeper is wound down, Australia needs a new, simpler road to recovery for businesses in financial distress to prevent a raft of insolvencies. Where restructuring is not possible, small business owners must have the right advice to wind up their businesses in an orderly fashion, so that workers entitlements are paid and the economic damage of insolvent businesses continuing to operate is minimised. Blueprint proposes that the Government implement two policies:

Recommendation 2.1.
Extend COVID Safe-Harbour provisions, currently set to expire in September, to March 2021.

Recommendation 2.2.
Offer vouchers for financial health checks to all small businesses, as outlined in Recommendation 1.

What is COVID Safe Harbour?

In March 2020, as the economic effects of the COVID-19 began to be felt, the Government introduced a temporary amendment to the Corporations Act. The Coronavirus Economic Response Package Omnibus Bill 2020[56] (the COVID Act) was passed by Federal Parliament on March 23 2020. The Act has two major provisions.

Firstly, the Act inserts a new section within the Corporations Act, 588GAAA, which outlines that a director will not be liable for insolvent trading in respect to debt incurred:

- In the ordinary course of the company's business; and
- During the six month period starting on the date the section commences (or any longer period prescribed by the regulations)

The section is not specific about what activities constitute an 'ordinary course of the company's business. Indeed, it provides examples such as: "A director taking out a loan to move some business operations online" and "debts incurred through continuing to pay employees during the coronavirus pandemic". But these are hardly classified as typical activities in normal times, which infers that the Act covers a variety of COVID-19-related business activities, including restructuring the business as a result of COVID-19 disruptions.

Despite a lack of clarity on its exact inclusion criteria, the effect of this change in the Corporation Act will be to protect directors from personal liability for 6 months. This will provide directors with the breathing room they need to make decisions in the interests of the business during a tumultuous period of economic disruption.

Secondly, the COVID Act has[57]:

- Increased the minimum debt which can form the basis for serving a statutory demand on a company from $2,000 to $20,000; and
- Increased the period within which a company must pay the amount demanded (or make an application to set aside the demand) from 21 days to 6 months.

The exact same changes apply to sole traders under bankruptcy law. This means that, until September 25th, companies and sole traders will have greater protection and flexibility to deal with financial issues without winding up procedures being commenced by creditors.

RECOMMENDATION 2.1

Extend 'COVID Safe Harbour' to the end of March 2021

The COVID Safe Harbour mechanism is welcome. However, many small businesses will find it difficult to achieve solvent trading by the end of September. To protect these business owners, Blueprint Institute proposes that COVID Safe Harbour provisions be extended to the end of March 2021.

Extending COVID Safe Harbour will protect directors against liability as they implement new strategies to adjust their business models. Further, by preventing unsecured creditors from initiating winding up procedures until March 2021, indebted small businesses owners will have greater breathing room. In this way, the extension of COVID Safe Harbour will provide more businesses with the time to recover revenue, consider restructuring and refinancing plans, service creditors, and save jobs. This extension will help to protect and maintain this productive and innovative engine of Australia's economy.

We recognise that many creditors of small businesses are small businesses themselves. As a result, this recommendation could serve to disadvantage small business creditors; for this reason, COVID Safe Harbour should not be extended past March 2021. The HECS-style loan will offer a valuable means for those small businesses acting as creditors to continue to run their business during this period. We note that some businesses may be worse off under this arrangement. But on balance, we argue this set of policies is the best opportunity to save the largest number of small businesses.

At the same time, enacting this recommendation will only be beneficial if small business owners are provided with high-quality financial advice to understand their options early, and act accordingly. As such, an extension of COVID Safe Harbour provisions must be enacted in line with Recommendation 2.2, which is described below.

RECOMMENDATION 2.2

A COVID-19 'Insolvency Checkpoint' – financial health check vouchers for small businesses

Extension of COVID Safe Harbour will provide company directors with the time they need to raise capital, restructure their business and implement new revenue streams. In making this change, the Government will ensure that insolvency processes during the COVID-19 recovery focus on giving businesses every chance to succeed.

High-quality financial advice will be essential to this vision. To achieve this, the Government should offer the same voucher-based system proposed in Recommendation 1.2. Businesses could use their voucher to undertake a financial health check from a trusted financial advisor who can provide advice about the business' viability. These vouchers would be publicly funded at a cost of $3,000 per voucher.

As described in a ASBFEO discussion paper[58] on insolvency laws:

"Small businesses… [could] access advice from an expert to review the business operations. The review would identify activities that are causing financial stress and make recommendations to improve operations. Where the review concludes the business is not viable, it would recommend the optimal external administration process. Benefits include time to review and correct, potential to maximise value if the business should be sold without the impact of the appointment of a registered liquidator, and preservation of the value of assets as well as the business' 'brand' (no bad publicity etc.)."

The directors of many small businesses are typically the same people who work in the business, and they may not be aware of the COVID Safe Harbour provisions, or the ability of small businesses to embark on a new course of action without directors incurring liability. Further, many small business owners are, understandably, emotionally invested in their business, and may only seek help when it is too late for them to restructure. Enlisting help from a trusted financial advisor who is familiar with the business, such as a bookkeeper, accountant or other qualified professional, would help small business operators bridge this knowledge gap and better understand their options.

Following this advice, those businesses that restructure successfully could go on to play a productive role in Australia's economic recovery.

A high-profile public awareness program should aim to educate small businesses about their legal rights under COVID Safe Harbour and the benefits of undertaking a complimentary financial health check voucher. Together, these measures would place small businesses owners in the best position to make sound decisions about the viability of their business and potential restructuring plans.

Justifying the cost; consider the benefits

While these vouchers may seem interventionist, we must remember that the Government is currently providing significant wage supports to Australian businesses — totalling more than $10 billion per month for JobKeeper until September. Even with the upcoming reduction in JobKeeper, government spending will still be around $3.5 billion per month in the December quarter and $2 billion a month in the March quarter of 2021. If these vouchers increase the likelihood of more small businesses surviving this crisis by improving their viability, this would complement existing public spending and increase its effectiveness. The stated goal of these wage support programs has been to save jobs and businesses. Providing small businesses access to advice from accredited financial advisors and legal practitioners is likely to do just that.

Providing these vouchers should not be seen as only beneficial to small business owners, but rather to the economy as a whole. By improving the viability of small businesses and helping them avoid insolvency, we will be protecting jobs and livelihoods now, while laying strong foundations that will pay dividends in the years to come.

On a broader level, Blueprint Institute holds that the Government's role in the market should be to create the foundations so that innovation and entrepreneurship can flourish. In this instance, the Government has a duty to protect those areas of the economy which will spur growth in the recovery stage. Without action, many small businesses may become insolvent unnecessarily when another course of action could have saved the business and the jobs it supports. Allowing such developments could lead to unnecessary financial hardship, result in stress for many small businesses owners, and slow the nation's economic recovery.

What happens when insolvency processes are unavoidable?

The great promise of liberal democracy is to reward hard work and aspiration; this should form the foundation of insolvency laws. Yet the current insolvency process is brutal for small business owners who report[59] going through a process in which their expertise is discounted, their desired goals are ignored, and decisions are taken out of their hands. Without action, we risk small business owners and their staff getting crushed by the combined impacts of forced lockdowns and the insolvency process. This could stifle the entrepreneurial spirit on which our national productivity, innovation and economic growth rely.

Where insolvency proceedings are already underway, or the business is not in a position to restructure, the aim of the policy process should be to rehabilitate the business. This could involve allowing parts of the business and assets to be sold, to give stronger parts of the business a chance to recover, or for debt or capital to be raised where appropriate — as advised by the financial health check. Business owners who falter should be encouraged to try again.

Blueprint Institute supports the findings of the recent ASBFEO report[60] on the issue, although we appreciate the complexity of this policy area and the diverse array of interests involved. Key findings of the report are included below. We expect a large number of businesses will become insolvent whichever course of action the Government undertakes; as a result, the recommendations in ASBFEO's paper should therefore be dealt with as a matter of urgency.

ASBFEO's Insolvency Report - Key Recommendations

- Often professional advice can be hard to find and difficult to fund for small businesses. Vouchers should be distributed up to the value of $3000 as part of a Small Business Viability Review program.
- Systematic shocks have shown that a Small Business Debt Hibernation instrument is needed when a systematic shock has occurred (such as the pandemic).
- There is a concern that the cost of winding up a business is too expensive, even where liabilities are small and a business structure is minimal. The Government should establish a Directors' Insolvency Agreement instrument where owners of a business can advise a registered liquidator on the best way to manage the business.
- For small businesses where the deficit is less than $50,000, a simplified liquidation process should be undertaken. Here, the process would take no more than 30 days, with cost capped at $10,500.
- Registered liquidators may only pursue recoveries that are proportionate, where the expected net financial benefit to creditors is estimated to be at least 10% greater than the cost.

RECOMMENDATION 3

Fast-tracking skilled migration – open the border for small business to recruit global talent

With unemployment on the rise, the Government has announced a number of measures to get unemployed Australians into apprenticeships and training courses. We welcome these programs as a means to increase the depth and complexity of our labour market at a time of high unemployment. Examining high-quality training and micro-credentialing programs will be a strong theme of Blueprint's research on industry policy, to be released in 2021. However, we think it is unlikely that new training programs will fill structural skill shortages[61] in the economy in the short term.

For many years Australia has relied on immigration to fill such shortages. With COVID-19 border closures, migrant numbers have plummeted, and there is little sign of borders opening any time soon. With no guarantee that an effective vaccine for COVID-19 will be developed, Australian governments should give serious thought to the question - what is Plan B?

Blueprint Institute argues it may be necessary to introduce a sensible system of immigration to provide our small business community with access to temporary and permanent skilled labour — both during and immediately after COVID-19. Given the economic benefits of such a move, this program could be modelled after similar efforts during COVID-19 to return international students to Australia to attend university; however, we note it will require careful planning and consultation. In this section, we outline broad principles for the Government to consider, and argue strongly that these programs should prioritise the interests of small business owners.

We recommend:

Recommendation 3.1.
Prioritise visa renewals for skilled migrants in Australia

Recommendation 3.2.
Skilled migration target and fee waivers for small business

Acute skills shortages amongst small businesses

The Former Department of Employment, Skills, Small and Family Business released a list of occupations that have skills shortages in 2018-19. Many of these occupations require years of training; while a greater emphasis on skill development is welcome, these skill shortages will not be solved in the short term through increased spending on training programs.

Many areas of the economy, in which small businesses play a large role, experience skill shortages. Construction and healthcare are highlighted below due to their particular importance during COVID-19, and in the economic recovery to come.

Construction

The following occupations[62] are in shortage in the construction industry in Australia:

- Construction Project Managers
- Surveyors
- Bricklayers
- Stonemasons
- Carpenters and Joiners
- Electrical Engineers
- Mining Engineers

Skill shortages in the construction industry significantly impact small businesses. The most recent data[63] available from NSW shows that just 38% of vacancies were filled, with only 0.5 suitable applicants per vacancy. The picture was similar in Victoria[64], with just 36% of vacancies filled and only 0.6 suitable applicants per vacancy.

If Australia is to spur a swift economic recovery, these skills shortages may create difficulties for Australian small businesses who account for 71.1%[65] of employment in the sector. These businesses may find it increasingly difficult to fill vacancies even as the economy recovers — high unemployment may lead to greater numbers of labourers in the short term. But it does little to fill shortages in highly-skilled personnel such as engineers and surveyors. Skills shortages in this sector may hold back the growth of Australian small businesses, delay critical infrastructure projects, and increase construction costs due to a limited supply of labour.

Healthcare

Importantly, given the unfolding health crisis, there is a shortage of certain healthcare workers in Australia, such as:

- Medical Diagnostic Radiographers
- Hospital/Retail Pharmacists
- Sonographers
- Dentists
- Occupational Therapists
- Physiotherapists
- Midwives

Healthcare workers are of particular importance for obvious reasons during a global pandemic. Less obviously, these workers are also more likely, because of occupational risks, to develop

COVID-19 and fall ill or have to quarantine, thus potentially leading to more shortages of these skilled workers. The impact of skill shortages in healthcare also falls disproportionately on regional and remote areas[66].

Many occupational therapists, physiotherapists, dentists and pharmacists work in small businesses that provide crucial health services to their community. In private health care and social assistance, 30% of employment[67] is in small businesses, and this accounts for nearly 40% of total Industry Value Added (IVA) — a measure which demonstrates small businesses in private healthcare deliver more output at a lower cost when compared with larger enterprises.

Australian trainees are unlikely to meet these shortages in the next few years

In the dynamic post-COVID economic environment, there will be rich opportunities for businesses to create new goods and services, both for the domestic market and to drive exports. It may be difficult to predict what skills are required for these new industries to flourish; and once shortages have been identified, a long lead time in training Australian workers for the roles could reduce economic efficiency and productivity.

The economy will likely change significantly post-COVID, with related shifts in the need for certain skills. Furthermore, a new generation of Australians could be trained to fill some of the skill shortages as the Government expands the number of places available for apprenticeships and training courses. However, in the short- to medium-term, skill shortages could create significant barriers, not only to the health of the nation, but also to our economic recovery.

As mentioned, Blueprint Institute views a rejuvenated and invigorated training sector as a key determinant of Australia's prosperity in the mid- to long-term. It is imperative, particularly at this time of enormous change, that Australian workers have access to the skills that they, and the business community, require to drive productivity and lift national economic output. This topic will be examined and addressed in our future research on industry policy.

RECOMMENDATION 3.1

Streamlining visa applications for those already in Australia

Many migrant workers have already left the country on account of reduced hours or lost jobs and a lack of support from the Australian Government. Blueprint Institute deems this as an unfortunate but necessary consequence of the pandemic. Little can be done to retain skilled workers who have already left Australia to return to their country of origin.

However, visa extensions should be offered to those workers who remain and have skills that small businesses need. Businesses that have retained their migrant workers, or would like to rehire them once revenue allows, should be able to do so through existing but streamlined government processes for issuing skilled work visas. It would be remiss for the Government to insist that visa holders must leave the country while small businesses may require their labour during the economic recovery. These migrant workers have already been trained in the skills and processes that a business requires; it is much more efficient for a business to rehire workers that were previously employed. This logic has been used to justify the JobKeeper program — it should be expanded to all skilled foreign visa holders.

RECOMMENDATION 3.2

Skilled migration target and fee waivers for small business

Where important skill shortages remain, the Government should consider introducing a scheme of immigration that targets a certain number of skilled foreign workers to enter the country, even while borders are closed. The exact details of this scheme would need to be carefully constructed to minimise the risk of COVID-19 cases being imported into Australia — one can envisage a limited number of skilled migrants with specific skills that are in high demand, with careful protections such as hotel quarantine to minimise risk. Key industries and skill sets that could be considered include: cybersecurity, advanced manufacturing, construction/engineering, mining, and healthcare. Indeed this process is already available for those who have received a travel exemption to join Australian family members and/or fill critical skill shortages.

Travel exemptions are available, but they do not go far enough in encouraging skilled workers to come to Australia

We note that the Department of Home Affairs currently considers travel exemptions[68] for critical sectors or critical skills, such as those in medical services, infrastructure, engineering and mining, agricultural technology, manufacturing and financial technology, amongst others.

However, under this arrangement, it is unclear if the Government is encouraging skilled migrants to come to Australia. For instance, under the 'I want to apply for a visa'[69] tab, the Home Affairs website states that "you should reconsider your need to apply for an Australian visa at this time." No guarantees are provided as to whether applications for a travel exemption will be confirmed for critical skills and shortages, with applications taking 4-12 weeks. And many of the necessary requirements for visa applications, such as visa medical appointments, have been disrupted by COVID-19, which Home Affairs notes may delay and disrupt visa applications. While understandable, long application times and disrupted application processes reduce confidence for businesses looking to bring skilled migrants to Australia.

In a Senate Committee submission[70] on the matter, the consultancy Ernst and Young criticised "inconsistent decision making" on travel exemptions from the Department of Home Affairs. Ernst and Young's Global Immigration Leader, Wayne Parcell, wrote:

"The assessment process needs to be refined and the assessment criteria need to be made transparent and applied consistently… Business cannot determine which circumstances will carry more weight and which cases will be considered compelling or compassionate… As Australia begins to restart the economy, businesses will need greater certainty that they can access the skilled workforce required to contribute to the country's economic recovery."

Blueprint Institute agrees. The travel exemption for critical skills and sectors may help to attract some skilled migrants to Australia. However, this is very different from a proactive immigration 'target' for skilled workers. The Government should be planning to meet skill shortages through skilled migration, as well as advertising this fact to skilled workers overseas and Australian businesses, so they are aware of the pathway.

The Government could take three steps to address these issues and incentivise skilled migrants to come to Australia

First, specific targets for skilled migration should be set, with plans put in place to meet these targets. At the moment, Australia has clear skills shortages that are likely to be accentuated the longer immigration numbers remain low. We should be proactive in considering where skill shortages are likely to exist, and set targets for attracting skilled migrants in advance — this will avoid reactive policy and inefficiency in the labour market. To help reduce barriers to skilled migration, the National Cabinet will likely need to examine caps on international entrants into Australian airports, which currently limit flight numbers and thus increase the price of travel. It may also be worth considering whether skilled migrants should be provided with hotel quarantine at no or low cost.

Second, visa costs should be re-examined. Attracting more engineers, medical service providers, and other highly-skilled workers to Australia during and after COVID-19 is likely to yield rich economic benefits. Yet, at present, employer-nominated skilled visa applications have flat rate fees[71] which exceed $4,000 for the business in question. Individual skilled visas[72] start at $1,200 for a 4 year Temporary Skilled Shortage visa, and increase to more than $4,000 for skilled workers who wish to move to regional Australia with their family. The rationale for these fees should be examined in light of the significant skill shortages faced by the economy, and the devastating toll of COVID-19 on small businesses in regional and rural communities.

Finally, any visa scheme for skilled workers should prioritise the needs of small businesses by reducing application costs and streamlining the application process. The Government could consider creating a tiered system for visa applications in which small businesses are offered a lower application rate than large businesses. This would provide a fair playing field for all Australian businesses in attracting skilled labour; in turn, this would aid the recovery of the small business sector and drive innovative activity in the economy.

What about unskilled migrant workers?

Australia is also dependent on unskilled migrant workers to fill critical workforce shortfalls in a range of industries. Working holiday makers, who are permitted to undertake 3 months work in areas of regional Australia, accounted for more than 134,000[73] visa holders in June 2018.

One industry particularly dependent on these workers is plant and animal agriculture, where unskilled temporary migrants play a critical role in conducting seasonal work during periods of high demand — such as fruit picking. With the Government ceasing all tourist intake (many unskilled workers are backpackers), Blueprint Institute has heard that many farmers are faced with the real possibility of fruit being left to 'rot on trees'.

An initial response might be that, during a period of high unemployment, Australian workers should be able to fill these roles; however, with many farms located in regional and rural Australia, it is not a foregone conclusion that this seasonal need for unskilled workers to complete hard manual labour will be met by Australians. Where employers are unable to find Australian workers to fill these roles, they should be able to hire foreign unskilled workers. The Government should work to identify where gaps in unskilled labour exist, and consult with business stakeholders in these sectors on an appropriate plan for bringing unskilled migrant workers into the country.

Conclusion

This Blueprint provides a framework for the Australian Government to better deliver on one of the great promises of our liberal democracy — to reward the entrepreneurship, hard work and aspiration of small businesses.

The JobKeeper program has been a vital mechanism to prop up the Australian economy — and small businesses in particular — at a time of unprecedented uncertainty and forced standstill due to the coronavirus pandemic. But it is also an enormous drain on the public purse, increasing Australia's already sizable debt and deficit. Towards the end of 2020 and beginning of 2021, as this program is rolled back, we will likely see a second spike in unemployment with many small businesses becoming insolvent.

At such a time, opportunities to improve business confidence and create jobs are extremely important. Offering access to a HECS-style, revenue-contingent loan system could provide viable small businesses with the confidence to invest and grow, drive innovative activity, create jobs for those in need, and provide valuable services to the economy.

For those businesses that are struggling, a voucher for a financial health check can help business owners understand their options, and where possible, save their businesses and the jobs they support.

Finally, it is important to understand that some skills shortages are likely to remain, whatever the strengths of training/internship programs implemented by the Government. Where this is the case, the Government should examine opportunities for targeted immigration to address skill shortages, with a view to prioritise the interests of small businesses. This could involve setting targets for skilled migration, reducing the cost of visa applications, and streamlining approvals for small businesses.

Together, these measures will help support Australian small businesses during the economic recovery, help to put people back to work, and generate economic activity. In turn, this would decrease unemployment and increase public revenue. This would be a win for both the Australian Government and for small businesses.

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