The role and development of SMEs
– key issues and some Australian perspectives

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The Role of SMEs on Poor Power Empowerment:
Lesson Learned and Sharing Experiences

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Introduction

The role of small and medium sized enterprises (SMEs) in the national economies of developed and developing countries is an issue of considerable interest for policy makers. SMEs account for much of the private sector entrepreneurial activities in market based economies. They are an an important source of employment opportunities and are often the subject of special policy actions.

Government efforts to assist and encourage the growth of SMEs seem reasonable from an development perspective. If SMEs grow in size and number they will potentially generate jobs and incomes. But questions are often raised about the benefits of policy measures that favour SMEs over large scale enterprises. There is also the question of defining what constitutes an SME from a policy perspective.

Interest in the contribution of SMEs to economic growth has increased in recent times. Lower trade barriers, globalisation and new technologies have reduced the importance of economies of scale in many business activities. The potential contribution of smaller enterprises has been enhanced. More generally SME growth is important for managing adjustment pressures associated with structural change and economic development.

Development of the SME sector is an issue of interest for developing economies from a poverty r perspective. Population growth, structural change and a desire for higher living standards requires growth in non-farm jobs. SMEs are the primary source of new job opportunities and increased income. They play a vital role in farm level adjustment to policy reforms. For these reasons policies targeted at SMEs are advocated as a way to accelerate growth and reduce poverty.

This paper will discuss the role and development of SMEs. It focuses on issues affecting SME development in a general sense. Distinguishing between rural and urban SMEs is not especially important as most constraints are applicable to both locations. The issues are discussed from a policy perspective and illustrated by some Australian experiences on SME development:

- in Australia business support policies and the growth of small businesses are important matters of political debate;
- small businesses dominate entrepreneurial activity in the economy and continue to be a source of growth for non-farming occupations in rural and regional areas.

What's an SME and what's their role?

The importance of SMEs for economic development is evident in both developed and developing economies. In most countries they account for over 95% of business enterprises. But employment is probably the most relevant indicator of their contribution to an economy. SMEs account for 60-70% of employment in OECD countries (OECD 2000). In developing countries the contribution is often much larger.

There is no universal definition of an SME and data is often difficult to obtain. The measurement variable used by statistical agencies varies. There are different views on the threshold for distinguishing between SMEs and large scale enterprises. And there are measurement issues in the types of enterprises included in the definition:

- in developing economies the informal sector is often a major source of SMEs through occupations like street vendors or casual/seasonal work;
- sole operators can be a large part of the SMEs in particular industries and often use family labour and/or part-time labour for specific purposes; and
- in developed economies farmers are considered to be a small business as their economic activity is equivalent to a sole operator located in an urban area.

The definition matters from a policy perspective. Assistance to encourage the growth of SMEs needs an eligibility threshold to exclude larger enterprises. In some cases the SME definition is based on a financial variable such as sales or turn-over. But a more common definition is based on employment. The threshold issue raises questions about:

- what size enterprises need help and can they achieve the policy objectives; and
- economic performance – are firms below the threshold more efficient and sustainable than those above the threshold?

A typical definition might classify businesses with less than 10 employees as a micro-enterprise. Those with 10 to 100 employees may be classed as a small business and those with 100 to 500 employees a medium sized enterprise. Some international agencies use a lower threshold – a cut-off point of 250 or 300 employees is often used.

The threshold for a financial based definition would need to relate to the circumstances of the economy. For example, an annual turnover of less than A$50 million may seem a reasonable threshold in Australia but may not be for a developing economy. SME policy measures in Australia generally use financial thresholds for eligibility. It is preferred for assessment reasons – it is easier and more efficient to use tax records for verification.

In general the role of the SME sector is to generate job opportunities and income growth. SMEs are considered vital for a healthy private sector in all economies. In developing economies they are often the only realistic employment opportunity for millions of poor people in rural and urban areas. In particular they are the avenue for labour to make the transition from subsistence agriculture to non-farming occupations.

The question of excluding or including sole operators such as farmers or street vendors is important for policy development. Sole operators may not be willing or have the capacity to create jobs, undertake R&D projects or participate in export markets. These are often the objectives of targeted SME assistance measures:

- in Australia farmers are considered a small business but they are unable to access SME programs as they fail the eligibility criteria on employment or turn-over.

In assessing the role of SMEs in an economy the geographical location or type of activity is not especially important. SMEs are often described as the engine of economic growth as they are the biggest source of job creation, income growth and innovation across the economy. Therefore they should be viewed in an economy wide perspective rather than distinguishing between rural and urban based businesses.

Creating the conditions for SMEs to flourish is a critical policy issue for all economies. Governments typically have a range of policy measures to encourage the development of SMEs. The effectiveness of these measures depends on correctly identifying the growth impediments and assessing the role for government interventions.

Access to investment finance and credit, gathering market intelligence, difficulties in adopting new technology, access to markets, limited management capabilities, low productivity growth and regulatory burdens are some of the major issues affecting the growth of SMEs in developing economies. Many of the impediments are also evident in the developed economies although the scale of the constraints may be less acute.

In some areas there is a clear role for governments to intervene. In other areas the role for targeted SME actions are harder to justify on efficiency grounds. Judgements are needed on the type and timing of assistance if it is to be provided. Subsiding SME development at the expense of large enterprises may not be best use of public resources.

An effective strategy for encouraging the growth of competitive SMEs should focus on issues of market failure. SMEs need to be efficient and profitable to be economically sustainable. Subsidising inefficient SMEs can slow the rate of development and they need to be allowed to succeed or fail. This is a natural aspect of economic growth and policy measures that unduly distort market signals should be avoided.

Issues in the development of SMEs

There is a widespread view that policies to encourage growth in SMEs can accelerate economic development and poverty reductions. Evidence to support this view is difficult to obtain because of data limitations (Beck et al 2004). Comparable cross country data is not readily available because of definition differences and there is a lack of data on the informal sector which is a large part of the SME sector in developing economies.

Despite the lack of evidence some policy officials advocate the use of targeted assistance to SMEs. The support is justified on the basis that an expanding SME sector will increase competition which is the key to efficiency gains, innovation, adoption of new technology and productivity growth.

SMEs are considered to be more productive than large scale enterprises and more labour intensive. Therefore policies that encourage SME growth will create more employment opportunities. In particular direct assistance is needed to off-set one of the key constraints to SME growth in developing economies – access to credit and investment capital.

There is a perceived market failure in the way financial institutions treat small businesses in developing economies. But it is not clear if the circumstances reflect a market failure or a more risk averse culture to lending due to a lack of asset backing for loans. Other factors may be involved such as insufficient competition in the financial sector or regulatory requirements to maintain confidence in the financial system.

Subsidised loans and/or government guarantees have been a common way to address this constraint. This can be expensive if targeting conditions are not tightly defined and the level of assistance is un-capped. There is also the issue of using an economy wide or sector/industry approach. The key considerations are to establish if:

- the constraint should be addressed through other mechanisms – for example, regulatory reform or increased competition in the financial sector;
- SMEs are stronger performers in creating jobs than large businesses;
- there are industry/regional differences in enterprise performance that suggest a targeted program would be more beneficial than a non-discriminatory approach.

The circumstances can vary and there is a role for governments to fund research to establish the facts. Good policy development requires rigorous analysis to verify the current situation. It also requires considered reflection of the need for a policy response and the likely outcomes of the alternative policy actions.

If a political decision is made to provide business assistance the distortion effects of the program should be given careful consideration. It needs to be recognised that large scale businesses may be stronger performers than SMEs in job creation and productivity gains. Economies of scale allows fixed costs to be spread over a larger output. Large enterprises are also likely to be faster adopters of new technology and R&D results.

The available evidence does not provide much support for the view that targeted SME assistance is the best policy response (Beck et al 2003). Much of the firm level evidence does not support the view that SMEs are more effective job creators and foster innovation. Some studies find that SMEs intensify competition but evidence on productivity growth is weak.

This suggests the case for subsidising SMEs through direct and indirect measures is not especially strong. There is some evidence from developed and developing economies that suggests large firms may offer more stable employment and higher wages than SMEs. Generally available business assistance programs may be more appropriate. In addition, measures that aim to reduce the commercial costs of particular business activities should be one-off and capped:

- if there is a lack of supporting evidence programs should be designed to act as a catalyst for business development in general rather than targeting SMEs;
- assistance should require complimentary contributions by the business applicant.

If SMEs are no better at creating jobs and no more labour intensive than large businesses then targeted assistance could have the perverse effect of slowing business development.

Institutional constraints in financial services, a weak legal system and poorly enforced property rights (eg IP, trademarks) affects the development of businesses of all sizes. For these sorts of issues targeting interventions does not seem appropriate.

It also needs to be recognised that the capacity for targeted assistance to exogenously generate growth is limited. Factors such as macro economic conditions, infrastructure constraints, trade policy developments and access to markets will also play a role in SME growth. To some extent the growth of the SME sector is itself an endogenous component of economic development.

Strong growth rates in particular industries will often be the catalyst for an expansion in the number and size of the SMEs. Increased private sector investment or an expansion in market demand can be a trigger for SME growth. For this reason a moderate approach to the provision of direct business assistance is the best strategy. Attention should focus on regulatory reforms and the elimination of institutional constraints.

SME assistance is often provided in the form of advisory services. This is aimed at the labour and skill deficiencies that limit the business development capacity of SMEs with small management teams. The pay-offs from this form of support are not clear but they are widely used. In some cases there is a charge for the services and in other cases the services are free.

In general it is common for these advisory services to focus on:

- capacity building to improve management skills;
- improving access to credit with advice on loan applications and financial management;
- research services to collect market information and business intelligence;
- advice on the availability and adoption of new technologies;
- access to internet services and e-commerce infrastructure; and
- advice on issues that affect the business operating environment including taxation, regulations, legal requirements and opinions, dispute settlement mechanisms, etc.

Australian experiences with the development of SMEs

Data on Australian SME developments is limited. The Australian Bureau of Statistics (ABS) has conducted surveys on the small business sector which is defined as enterprises with less than 20 employees – the definition excludes farmers. These surveys have been discontinued. But the most recent data suggests there has been strong growth in this sector of the economy:

- in June 2007 there were 1,927,590 active small business operators (DIISR 2009);
- this represents an increase of more than 50% since 2004;
- small businesses account for 96% of all businesses.

Survey results for 2006 indicate most small business managers (67%) were aged less than 50 years old (ABS 2008). It suggests small business is a valuable source of occupations for young and middle aged people. Total employment was estimated at 9,857,000 in 2006 so these business operators accounted for about 17% of total employment (ABARE 2008). If the employees and operators of farm business were included the share of employment would be much higher.

Most businesses operators (92%) were managing one business and two thirds worked full-time hours. Survey results for 2004 indicate more than half (56%) of the small businesses had no employees. A further 33% employed just 1 to 4 people. These shares have not changed much in recent times. This has implications for policies to support small business growth. A business with less than five labour units will have a limited capacity to invest time and money in:

- research to collect market information and find buyers in overseas markets;
- skills development and keeping up-to-date on new technologies; and
- monitoring changes in government policies and regulations.

The use of computers and internet access has been a key factor in the development of small businesses in Australia. Apart from the productivity gains in business management it has been critical for communications and accessing information. An estimated 93% of small businesses had internet access in 2008 and 54% had a website (DIISR 2009).

Another feature of the small business sector is the growth in home-based operations. In 2004 an estimated 68% of small businesses were home based – in 1997 the share was around 58%. Most were owner-operators or employed less than 5 people. It indicates micro-enterprises are widely dispersed and not clustered in the CBD or designated business zones like larger scale firms:

- these two issues – IT infrastructure and business location – may have implications for SME support policies in developing economies.

1. Employment & wages in Australia's food industries

Year ended June 30		**1999-00**	**2004-05**	**2005-06**	**2006-07**
Food production employment					
*All agriculture **	*'000*	314	312	304	309
Food processing sector employment					
Meat & dairy	*'000*	64	74	76	78
*Flour & bakery ***	*'000*	33	32	31	33
*Other food ****	*'000*	37	58	59	56
*Beverages *****	*'000*	18	27	29	31
Total	*'000*	152	191	195	198
Food processing sector wages					
Meat & dairy	*A$m*	2 385	3 071	3 320	3 688
*Flour & bakery ***	*A$m*	1 065	1 382	1 364	1 399
*Other food ****	*A$m*	1 917	2 679	2 831	2 859
*Beverages *****	*A$m*	735	1 404	1 509	1 528
Total	*A$m*	6 102	8 536	9 024	9 474

* Includes owner-operators, partners & employees working for farm businesses. Source: DAFF 2009a.
** Includes flour milling, cereal & factory based bakery products.
*** Includes sugar, oils & fats, fruits & vegetables, confectionary, seafood, animal feeds etc.
**** Includes soft drinks, beer & wine.

Data on the development of SMEs in rural and regional Australia is limited. Structural adjustment pressures in agriculture has seen an on-going decline in the number of farmers. Some retire but many younger people shift from farming to non-farm occupations in their local area.

There is no shortage of job opportunities in rural and regional areas especially in food processing and mining (Bryant & King 2007). But issues with skill shortages and retraining are affecting SME development. This highlights one of the barriers to SME development in all economies – the skill level of employees. Despite this constraint there has been significant employment and wage growth in the food processing industries which is dominated by SMEs (table 1).

In Australia the development of small businesses is a major area of public policy. The Department of Innovation, Industry, Science and Research (DIISR) is the focal point for small business policy issues. It manages a range of business support programs – rural and urban based enterprises are eligible to participate in these programs. Most programs are designed to address specific issues but some are used to fund advisory services.

DIISR has a separate agency – AusIndustry – as the contact point for small business information, assistance and referral services. It manages over 30 business support programs worth A$2 billion a year. They include innovation grants, tax concessions and business development programs. Each year more than 10,000 businesses and 80,000 individuals access these programs (DIISR 2009). The programs are delivered through a national network of 22 regional offices.

The assistance programs have a variety of objectives and some are targeted at small businesses. Several aim to encourage innovation, research and the commercialisation of new technologies. Others facilitate structural adjustment in specific industries such as the motor vehicle and TCF industries. There are also programs to encourage the development of the small businesses. Program users range from large multi-nationals companies through to micro enterprises and individual owner-operators (AusIndustry 2009).

Most of the business assistance programs are entitlement or grant programs. The grant programs require applicants to compete for a limited pool of funds and selection is based on the merit of the application. Entitlement programs involve claims for assistance such as R&D tax concessions. Currently there are 11 programs targeted at SMEs:

- the *Pooled Development Funds* program establishes private sector investment companies to raise equity capital from investors to invest in SMEs;
- the *Small Business Advisory Services* program provides competitive grants to enhance access to information and advice on issues related to the growth and sustainability of SMEs – it was a response to the global financial crisis;
- the *Innovation Investment Fund* program invests in private sector venture capital funds that assist small companies to commercialise R&D outcomes;
- the *Commercial Ready* program offers competitive, merit-based project grants to commercialise R&D that leads to innovation and productivity growth;
- the *Renewable Energy Equity Fund* program provides venture capital to assist small companies to commercialise R&D in renewable energy technologies;
- the *Re-Tooling for Climate Change* program offers grants of between A$10,000 and A$500,000 to manufacturing SMEs for investing in initiatives that improve their production processes, reduce energy use and cut carbon emissions;
- the *Building Entrepreneurship in Small Business* program is for capacity building initiatives such as training, mentoring and succession planning;
- the *Intermediary Access* program assists SMEs to engage with R&D organisations and other entities to develop research project on new commercial opportunities;
- the *Small Business Online* program assist small businesses to improve their web facilities and engage in e-business;
- the *Small Business Support Line* program is a referral service to help cope with the global recession by providing counselling and advice on business issues;
- the *Textile, Clothing and Footwear Small Business* (TCFSB) program provides merit-based grants to improve the enterprise culture of small TCF businesses.

The TCFSB program is an example of targeted assistance to facilitate structural changes in an industry. It is part of a larger assistance package of A$747 million for the TCF industry. It will run for 10 years and provide A$2.5 million of grants each year through competitive selection rounds. Eligibility is restricted to TCF small businesses with less than 20 employees.

The aim of the program is to improve the 'entrepreneurial behaviour' of TCF small businesses (AusIndustry 2008). It funds projects that enhance the decision-making and production processes of a business. A maximum grant of A$50,000 is available regardless of the project cost or the cash contribution by the applicant. Eligibility conditions focus the assistance on domestic output. For example, a business that only imports TCF products or only undertakes retail activities is not eligible. Applications that meet the eligibility criteria are assessed against a merit criteria and compete against the other applications in the round.

The Department of Agriculture Forestry and Fisheries (DAFF) has a limited involvement in the development of rural based SMEs. Some industry adjustment programs have included measures to encourage jobs growth or business investment in regions where the industry is located. Recent examples include structural adjustment programs for the dairy, sugar and pig meat industries:

- in general these programs were time limited and involved grants for projects with employment, innovation and investment benefits;
- eligibility conditions exclude farmers but businesses of any size can apply.

DAFF has 3 programs that assist rural businesses. The A$35 million *Regional Food Producers Innovation and Productivity* program enhances food and seafood business competitiveness through innovation and technology improvements (DAFF 2009b). It has a 4 year lifespan and offers grants of between A$50,000 and A$2 million on a matching fund basis for projects on:

- the design and adoption of new technologies, production or processing techniques;
- the adoption of production or processing technologies developed overseas; and
- the redesign of existing production and processing processes.

The *Promoting Australian Produce* program assists food organisations to more effectively promote and market their produce in domestic and export markets. It is a 3 year program offering grants of between A$50,000 and A$750,000 on a matching fund basis for projects that develop marketing strategies and enhance marketing and promotion capabilities (DAFF 2009c).

A related program – *Promoting Australian Produce: Major Events* – supports major national events that bring together food industry businesses to exchange information on production, manufacturing, marketing and distribution across the supply chain. Grants are available on a discretionary basis for a limited pool of funds (DAFF 2009d).

SME access to markets

Access to markets is a key factor for the development of SMEs. Extensive market access does not guarantee the expansion or the survival of an SME – enterprise competitiveness and profitability are the essential ingredients. But opportunities for SMEs to extend their market penetration offers the potential for sales growth and increased employment.

Market access constraints for SMEs in particular locations or more generally is a focus of policy actions in most economies. The constraints will vary with the circumstances of each SME but there are often some common issues. An investigation of the constraints on market access has to first consider the existing market reach of SMEs. Conceptually market access could be viewed as:

- the regional area surrounding the SME;
- some wider combination of provincial, state or district areas;
- the entire national market; or
- overseas markets.

Extending the market penetration of SMEs could involve moving from a local or regional focus to a Provincial or National trading environment. Infrastructure, market information and regulatory requirements are some of the issues that may warrant government action. The capacity for SMEs to participate in the world market through export sales or imports can raise additional issues.

There is a widespread belief that SMEs find it more difficult to participate in overseas markets in comparison to large scale enterprises. However, many of the barriers to international trade are common to enterprises of all sizes. From an export perspective there is a role for government to facilitate trade by addressing issues such as:

- market access barriers (eg tariffs, tariff-quotas, NTBs); and
- differences in standards, regulations and product approval requirements.

The added difficulties for SMEs arise in their human, technical and financial capacity to establish a viable export trade (WB 2005). For many SMEs these transaction costs are too high and there is reluctance to enter overseas markets. The financial risks associated with exports are perceived to be higher than dealing with domestic customers. For a business with limited turn-over and a low capital base this is often a significant deterrent.

A number of other technical and financial issues can be impediments to gaining access to export markets (Table 2). Many of these barriers are commercial constraints that relate to the size of the enterprise. Government programs to encourage SME participation in world trade often involve subsidies to partially offset the cost of some of these issues. But the justification for excludes large enterprises from this sort of assistance is debateable.

Australian experiences with SME access to foreign markets

Australian experiences with SME participation in world trade are worth considering. Official statistics indicate around 90% of Australian exporters are SMEs (ATC 2007a). But the number of SMEs involved in exporting is only 15%. In recent years participation rates have been relatively stable at around 12-16%.

Survey results show Australian SME exporters are likely to be a medium sized enterprise, located in a metropolitan area and have an aggressive expansion strategy in comparison to other SMEs. In general exporting SMEs are more profitable, more productive and pay higher wages than their non-exporting counterparts (ATC 2007b).

2. Some common barriers to SME participation in world trade

1. Lack of management and marketing skills
2. Insufficient knowledge of business environment in target markets - laws, taxation, corruption
3. Lack of knowledge on trading conditions in target markets - consumer preferences, competition
3. Differences in standards and regulations on product/service requirements
4. Financial risks of market participation - payment defaults, marketing expenses
5. Difficulties in accessing credit, investment capital
6. Compliance costs of customs declarations, product approvals & registration, labelling, accreditation
7. Inadequate protection of intellectual property rights
8. Difficulties in accessing new technology, equipment, IT capabilities
9. Language barriers and cultural differences

Sources: WB 2005; ATC 2007b, 2007c.

Despite the pay-offs there is still a low 'intention to export' amongst SMEs. The major impediment cited by SMEs is their inability to attract well trained, experienced export managers. It suggests that government funded training programs have a role to play in facilitating SME participation in world markets.

While there are constraints on the capabilities of SME to expand into export sales there is a recognition that overseas sales are important for future growth and viability. Increased competition from foreign enterprises in the domestic market is encouraging SMEs to consider export opportunities. The difficulty is converting this into active participation.

SMEs participating in overseas markets are increasingly looking to extend their involvement from export sales to a more active engagement (ATC 2007c). Recent survey results show that 70% of the SME exporters are conducting their business through some form of foreign direct investment or a partnership arrangement. In some cases this has been necessary to gain access to the market or to establish an effective sales presence. In other cases it is due to financial and tax incentives or other strategic objectives.

The agency that supports overseas trade by SMEs is the Australian Trade Commission (ATC). It operates a network of offices in more than 60 countries. Their activities focus on SMEs but large enterprises also use their services. The ATC has 18 offices in Australia to provide information, advice and practical support to companies that wish to access overseas markets.

General information is provided free of charge but there is a charge for specific tailored advice. These services help SMEs to identify trading partners, understand foreign regulations and business practices, gather market intelligence and organise in-country visits to meet potential buyers. Austrade also manages an assistance program called the Export Market Development Grants (EMDG) scheme.

The EMDG provides cash rebates to Australian based SMEs that promote their output in foreign markets. Businesses are reimbursed for up to 50% of their marketing expenses over a A$15,000 threshold (ATC 2009). Claimable expenses include overseas marketing visits, promotional brochures and providing free samples to potential buyers. State governments also provide financial assistance, often on a dollar-for-dollar basis.

The EMDG is designed to encourage Australian SMEs to develop export markets. Eligibility is open to individuals, companies, associations, co-operatives and statutory corporation. However, eligibility is limited to businesses with an annual income of less than A$50 million. It is targeted assistance with a definition based on the value of sales rather than employment.

The primary impediment for SMEs is the high level of financial risk associated with exports. The ATC helps businesses develop a risk management plan. The aim is to develop strategies to cope with issues such as foreign exchange exposures, political risks, shipping disruptions, difficulties with customs clearances, quarantine requirements and standards regulations.

Financial services for SME exporters are provided by the commercial banking sector. Insurance is a key issue because of the higher risk of payment default. The commercial banking sector is often unwilling to manage this issue without charging a substantial premium. The Export Finance and Insurance Corporation (EFIC) was established to address this market failure (EFIC 2009). It provides credit insurance to SMEs and large scale enterprises on a commercial basis.

The turnover in SMEs

An issue often raised about the development of SMEs is the failure rate. There is a perception that SMEs have a high failure rate and only survive for a short time. If this perception is accurate it raises questions about the provision of assistance. It also has implications for the sustainability of employment and perceptions of the risk in SME investment.

In reality the loss of an SME is part of the business turnover that is a natural phenomenon in all market based economies. New SMEs are continually emerging to replace business that are 'lost' to the economy. In Australia thousands of SMEs go out of business each year. They are replaced by thousands of new SMEs that start up each year (Bickerdyke et al 2000).

The rise and fall of new business enterprises is a desirable outcome for the economy. It enables resources (ie land, labour, capital) to shift into more productive uses that earn a higher return which is the basis of wealth creation. It also a catalyst for innovation and productivity gains through the emergence of more efficient production processes. The loss of SMEs is not a cause for concern unless the exit rate is exceptionally high.

It is important to recognise that business losses are not necessarily failures in the classical sense of insolvency from costs exceeding income. A more appropriate term is business exits. In general there are two types of business exits:

- changes in ownership when businesses are sold, merged or taken over – they may change operationally but will re-emerge under a new name or in a new form; and
- business cessations which are those that go bankrupt – business failures – and those that close for other non-financial reasons;

Australia's experiences with business exits are a useful illustration of developments in market based economies. The most recent study of business exits show on average 7.5% of businesses exit each year (Bickerdyke et al 2000). This equates to an economy wide loss of 55,000 to 65,000 businesses and most of these will be SMEs. It suggests that in the case of Australia, concerns about rate of SME failures may be an over-reaction.

In reality most Australian businesses survive for a considerable period of time. Two-thirds of businesses are still operating after 5 years and almost half are remain operating after 10 years. The perception that most exits are failures is not supported by the data:

- changes in ownership accounted for about 20% of exits;
- business cessations accounted for the remaining 80% of exits;
- each year only 2.5% of businesses 'fail' for financial reasons;
- direct job losses from business cessations account for 9-10% of total job losses.

Most of the cessations are solvent businesses closing for other reasons. Furthermore these losses are more than offset by new business start-ups and the growth of existing businesses. In recent times the entry of new businesses has been more than 60% above the exit rate. A number of factors can influence the prospects a business will exit. Location, the industry sector, access to markets, competition and management ability. Evidence in Australia and overseas also indicates that the age and size of business are relevant factors. New businesses are more likely to exit than older businesses and small businesses are more likely to exit than larger ones.

There is a role for government in correcting perceptions about the failure rate for SMEs. Collecting statistics and funding studies on the rate of SME exits and the reasons for the exits is important. Incorrect perceptions can lead to exaggerated concerns about the risk of starting or investing in an SME. The potential for job creation will be curtailed if there is less willingness to take a risk and become involved in an SME.

SME exits are a natural outcome of the dynamic behaviour in market based economies and have some positive effects. Productivity is enhanced as less efficient and unprofitable SMEs are replaced by more efficient, profitable businesses. The exits contribute to the adjustment process of structural change by allowing resources to be used in other ways.

Governments also have a role to play in facilitating SME exits. This may seem counter-intuitive to the wider policy goal of encouraging SME growth. Supporting unprofitable or poorly performing SME is not conducive to economic development. Regulations to minimise the time and cost of completing a business exit allows the departing resources to rapidly shift into more productive uses.

Effective insolvency policies and regulations are an important issue for all market based economies. They set the ground rules for SME investors, owners and operators. Rules are required to facilitate a rapid resolution in the reorganisation or sale of SMEs. Insolvency regulations are also required for an orderly exit of failed SMEs:

- they provide signals for appropriate attitudes to risk by investors and managers;
- they ensure debts and borrowings guaranteed by assets are honoured; and
- they contribute to improved efficiency and resource allocation by encouraging the closure of non-viable businesses and the survival of efficient ones.

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