

Economic Openness and Small Business Employment in Australia, 1983-84 To 1994-95

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Abstract

This paper examines the impact of an increasingly open competitive economy on small business employment in Australia. During the period under study, small business employment grew by 2.5 per cent per annum which was marginally higher than that for both large and small firms together, indicating that small business employment grew at a faster rate than that of large firms. The relative increase in small business employment in Australia reflects not only the long term structural changes in a move towards the dominance of the economy by the services sector, but also the increasing openness of the economy resulting from economic reform measures that have been put in place since 1983.

Introduction

For most of this century Australia's industry policy could be described as interventionist and inward looking. For a long time, Australia has maintained very high tariff barriers to protect its domestic market resulting in a very slow pace of structural change of the economy. Since the early 1980s substantial progress has been made in tariff reductions to such an extent that most tariffs were reduced to 5 per cent by the end of 1996. The stated objective of successive tariff reductions is to make Australia internationally competitive and to remain so in the future. Industry policy emphasises globalisation, competitiveness and productivity for a durable industrial success. This is a complete turn around from a long standing government policy of undergirding the success of firms in exporting as well as import competing industries in Australia. Industry policy also recognises the interdependence between large and small firms and further states that strategic alliance between the two can be a successful tactic for breaking into export markets.

The economic reform measures that have been introduced in Australia since 1983 with a view to restructuring the Australian economy to make Australia internationally competitive, have had a profound impact on both small and large enterprises. In an increasingly open but small economy with falling tariff barriers, deregulated industry, financial and foreign exchange markets, the gradual privatisation of government business enterprises along with contracting out of many government activities all offer new opportunities as well as challenges for small firms in Australia. In the recent past considerable deregulation of the labour market has been introduced bringing in more flexibility in wage determination which has implications for employment growth. The paper intends to examine the employment implications in the small business sector in an increasingly open and competitive Australian economy during the period between 1983-84 and 1994-95 in a number of selected industries.

Small Business in the Australia Economy

The Australian Bureau of Statistics (ABS) defines small firms as those which employ less than 100 persons in manufacturing and less than 20 persons in non-manufacturing. There were around 850,000 small private sector businesses in Australia in 1993-94, employing some 2.9 million people. Small businesses account for approximately 97 per cent of all private sector business employment including self employment (ABS, 1996). In the early 1980s there were probably 660,000 small firms and they contributed in excess of 50 per cent of total employment in private enterprises (see BIE, 1985).

The relative importance of small business in the economy is determined not by its sheer numbers alone but also its share of employment and its contribution to economic growth. Any changes in small business's relative position in the economy over time should reflect changes in its relative importance in each industry vis a vis changes in the relative positioning of these industries over time in the economy.

TABLE 1
SHARE OF SMALL BUSINESS BY INDUSTRY, 1994-95
(Per cent)

| Industry | Businesses | Employment |
|--------------------------------------|-------------|-------------|
| Mining | 89.4 | 12.5 |
| Manufacturing | 97.9 | 46.9 |
| Construction | 98.8 | 80.2 |
| Wholesale trade | 92.8 | 47.1 |
| Retail trade | 97.1 | 48.8 |
| Accommodation, cafes and restaurants | 89.3 | 42.3 |
| Transport and storage | 96.9 | 50.8 |
| Finance & insurance | 95.2 | 20.3 |
| Property & business services | 97.1 | 56.9 |
| Education | 93.3 | 31.0 |
| Health & community services | 95.1 | 37.6 |
| Cultural and recreational services | 96.5 | 49.5 |
| Personal and other services | 98.5 | 68.6 |
| TOTAL | 96.7 | 49.1 |

Source: ABS (1996), Catalogue No.1321.0

Table-1 shows that small businesses accounted for 89 per cent or more of all businesses in each industry under study in 1994-95. However the small business share of employment across industries shows very wide differences ranging between 80.2 per cent in Construction and 12.5 per cent in Mining during the same year. Small firms provided a little less than half of all private sector employment excluding the agriculture sector in 1994-95.

Small Business Growth and Performance

Employment growth in the small business sector is directly related to the growth of the sector itself. Table 2 illustrates the growth of small businesses and employment within the small business sector during period from 1983-84 to 1994-95.

TABLE 2
AVERAGE ANNUAL RATE OF GROWTH IN SMALL BUSINESS
1983-84 To 1994-95
(per cent)

| Industry | Business | Employment |
|--------------------------------------|------------|------------|
| Mining | 4.8 | 4.6 |
| Manufacturing | 3.3 | 1.2 |
| Construction | 3.8 | 3.7 |
| Wholesale trade | 1.6 | 2.2 |
| Retail trade | -0.4 | 0.4 |
| Accommodation, cafes and restaurants | 2.5 | 2.4 |
| Transport and storage | 1.1 | 2.2 |
| Finance and insurance | 4.8 | 3.4 |
| Property and business services | 6.9 | 4.8 |
| Education | 7.0 | 5.8 |
| Health and community services | 7.7 | 5.5 |
| Culture and recreational services | 3.4 | 2.6 |
| Personnel & other services | 5.1 | 3.6 |
| TOTAL | 3.3 | 2.5 |

Source: ABS (1996) Catalogue No. 1321.0

Between 1983-84 and 1994-95, the number of small businesses increased by 3.3 per cent annually. This growth rate is identical to that for all businesses both large and small. Within the small business sector, Health and community services recorded the highest annual growth rate at 7.7 per cent while Retail trade recorded a negative growth rate at 0.4 per cent.

During the same period small business employment grew by 2.5 per cent per annum which was a touch higher than that for both small and large enterprises together where employment grew by 2.4 per cent per annum (see ABS, 1996). This indicates that overall small firm employment grew faster than that for large firms. Education recorded the highest annual average growth rate at 5.8 per cent and the Retail trade industry achieving the lowest annual average growth rate at 0.4 per cent. Small firms in service oriented industries, over all, appear to have exhibited stronger employment growth. Health and community services and Education showed the highest growth rate both in terms of the number of small businesses and employment in the small business sector. The two largest employing industries, Manufacturing and Retail trade recorded the lowest growth rates in employment with 1.2 and 0.4 per

cent respectively. In summary it can be said that small firms performed better than their larger counterparts in terms of employment generation during the period under study.

While industries in the services sector dominate Australian business in terms of numbers, the 3.2 per cent annual average increase in the number of these businesses since 1983-84 has not been as strong as in the goods producing sector where the average annual increase was 3.6 per cent. Small business employment in the goods producing sector grew at an average annual rate of 2.2 per cent between 1983-84 and 1994-95 compared with 2.7 per cent in the services sector (ABS,1996).

Small and medium enterprises contribution to overall profit levels increased from 34 per cent in 1990-91 to 39 per cent in 1993-94. The return on asset ratio (the indicator which shows how effectively the firm has used its assets to generate profit) for small and medium businesses has been consistently higher than it has been for large businesses. In 1993-94, the ratio was 7.7 per cent for smaller firms compared to 3.6 per cent for large firms (see ABS,1995).

Structural Change and Small Business Employment

The process of internationalising the Australian economy is increasing exposing Australian firms, including small firms, to the forces of overseas competition. All firms need to adjust their levels of labour in response to changes in market conditions.

Structural changes in the economy are quite often followed by high rates of unemployment. Small firms have been viewed as a cushion to moderate the impact of structural change on rising unemployment. There are other important roles small business also play in innovation and exports in which they make a smaller but a significant contribution to economic activity.

Small businesses do not dominate employment to the same extent they dominate the number of businesses in the economy. But small businesses appear to have contributed to employment growth at a faster rate than that for large businesses.

Employment in the small business sector grew from 2,032.6 million persons in 1983-84 to 2,676.3 million persons in 1994-95. This represents an increase of 31.7 per cent over these two points in time. Table 3 provides a comparative analysis of employment growth in the sector within the industries under review.

TABLE 3
Employment Growth in Small Businesses
1983-84 To 1994-95

| Industry | % – in Employment Level | – in Share of Employment |
|--------------------------------------|--|-------------------------------------|
| Mining | 3.8 | 5.1 |
| Manufacturing | 13.5 | 8.1 |
| Construction | 49.8 | 6.5 |
| Wholesale trade | 27.2 | 2 |
| Retail trade | 5.0 | -7.5 |
| Accommodation, cafes and restaurants | 30.4 | -6.4 |
| Transport and storage | 26.5 | -2.9 |
| Finance and insurance | 44.4 | -1.9 |
| Property and business services | 68.0 | 1.1 |
| Education | 86.3 | 0 |
| Health & community services | 80.6 | -1.5 |
| Cultural and recreational services | 32.7 | -6.3 |
| Personal and other services | 47.0 | -3.3 |
| TOTAL | 31.7 | 0.6 |

Source: ABS (1996), Catalogue No. 1321

A more detailed breakdown of employment by industry reveals that there was an increase in the employment level across all industries but such an across the division increase was far from uniform. Education and Health and community services recorded the highest growth in employment levels with 86.3 per cent and 80.6 per cent respectively; while Mining and Retail trade had the lowest growth rates in employment levels with 3.8 per cent and 5 per cent respectively. Education and Health, the two industries in the service sector have actively pursued internationalisation with significant successes since the mid 1980s. Very high small business employment growth in these industries reflects their success in the international market.

Changes in the levels of employment from 1983-84 to 1994-95 do not reveal the changing share of small business employment in each industry during the same period. Small firms in all industries except Wholesale and Property and business services in the services sector, recorded a decline in their share of total employment while the share of Education recorded no change. Small firms in Education and Health and community services achieved the highest growth in the level of employment. The former's share of total employment remained constant while the latter recorded a decline of 1.5 percentage points during the period under study. Manufacturing small firms with only a 13.5 rise in the employment level recorded the highest positive change in the share of employment with 8.1 percentage points. This increase in the small business share of employment occurred when the manufacturing industry experienced a decline in the level of employment by 6.1 per cent between 1983-84 and 1994-95. This is equivalent to an estimated annual decline in employment by -0.6 per cent. This

demonstrates that there have been shifts in activity in the manufacturing industry from large to small firms and these shifts are far more pronounced in Manufacturing than any other industries under investigation.

Over all, during the period under investigation there has been a remarkable shift in size distribution in terms of the share of total employment away from large to small firms in all industries in the goods producing sector (ie Mining, Manufacturing and Construction) while only two industries out of ten industries in the services sector recorded a shift away from large to small firms, one industry recording no change and the remaining seven industries experiencing shifts away from small to large firms. This shift away in the share of small business employment in the majority of service industries has occurred despite small firms recording growths in their employment levels in all service industries. Carlsson (1989) also found that declining plant and firm size in manufacturing occurred in several Western industrial countries since the early 1970s.

There are a number of factors that most likely contributed to such a remarkable shift in small business activities in the manufacturing industry. Small firms in the manufacturing industry have been undergoing significant structural changes due to economic reform measures that have been put in place since the early 1980s. These reform measures, together with the growing convergence of markets resulting from the globalisation process, are creating new opportunities and interesting challenges for manufacturing small firms in Australia.

The relative decline in the share of large firm employment in the manufacturing industry is largely due to restructuring necessitated by the increasing openness of the economy to stay internationally competitive. Carlsson (1996) indicated that increased global competition has resulted in reduced diversification and smaller firm size in manufacturing. Large firms faced with readjustment to stay competitive in the changing economic environment have started to decentralise or sub-contract specific tasks to smaller, more specialised firms. To reduce cost, there has been an increasing trend towards the maintenance of a very low level of inventory by large firms, and this has led large firms to develop long-term supply relationships with small firms. In some cases restructuring has also led to take-overs and mergers affecting the number of large firms in manufacturing in the late 1980s. (Howard,1990), further argues that the key unit of production is no longer the individual company but a decentralised net-work of companies. Sometimes these net-works consist of vertical links tying small suppliers to final a assembler. In other cases, the links are horizontal - binding together a number of more or less equal companies. In both cases, these networks make possible continual innovation through a delicate balance of competition and cooperation, demand and support. In Australia, there is evidence that the growth in small business activity in many service industries has largely come from the increased tendency for large firms to contract out such services as accounting, recruitment, printing, transport and delivery services, catering, design and advertising, cleaning, and certain areas of training activities.

A large proportion of world trade now involves countries exporting and importing similar types of goods, known as intra-industry trade. Much of this trade is conducted among industrialised countries and involves manufactured goods. It offers opportunities for small firms with a niche product to expand their market horizon into other countries with consumers having similar tastes and income

levels. Small firms with competitive advantage arising from their product quality and product differentiation are better positioned than others in the world market. In 1992-93, 13.3 per cent of all manufacturing firms in Australia exported but of which 83.7 per cent were small firms.

Increased competition from imports due to tariff reductions, deregulation of financial and foreign exchange markets and industry, competition policies and new technology reducing production costs for small firms, may have contributed to small business employment growth in manufacturing.

Technological changes in some cases have eroded economies of scale, making it more economical for small firms to undertake short production runs and causing large firms to reduce labour inputs. Also small firms in recent years have exhibited increased capacity in developing and introducing new technologies.

In a period of rapid structural changes forced by economic reform measures and long term underlying economic factors and rapid technological changes, it was likely that some small firms increased their share of total employment while that of other small firms declined substantially resulting in small firms in a number of service industries experiencing decline or a stagnant share of employment.

Small firms in Retail trade, Accommodation, cafes and restaurants and Cultural and recreational services recorded a much higher levels of employment share loss to large firms than other industries in the services sector. All these three industries are marked by a very high proportion of part-time workers. Retail trade and Cultural and recreational services also appear to have relatively high concentration ratios while Accommodation, cafes and restaurants has a very low concentration ratio. This indicates that these industries' loss of employment share to large enterprises is not simply due to the relative dominance by large firms alone in those industries.

Small firms in many service industries in Australia increasingly respond to changing technological and market conditions in a way that appears to have resulted in shrinking of the share of stable or core workers while the share of more mobile or contingent workers is increasing. The largest segment of these mobile workers is found at the upper and the lower end of occupational and skill levels. Such organisational changes may have also impacted on the small business share of total employment in many service industries.

One way to respond to increased competitive pressure by small firms could be to reduce wage costs to stay competitive. Occasionally this could have been achieved by using the underground economy to recruit workers. If this method was used, then the real employment level would not be reflected in the published data.

Small Business and Part-time and Self Employment

Adjustments to the changing economic environment can take place through changes in hours of work and work effort or it can take place through part-time, casual or self employment. Another way of looking at employment is by types of employment. The proportion of employed persons who are part-time workers has shown an increasing trend over the last two decades in Australia. For the economy as a whole part-time employment rose from 15 per cent in 1978-79 to 24 per cent in 1994-95 (ABS, 1995a). The rate of increase in part-time employment accelerated from the middle of 1986. Small firms are usually regarded as the principal employer of part-time workers. Self employment also constitutes a reasonable proportion of total employment in Australia. BIE (1992) considers that Australia seems to have a particularly high share of employment in the employer and self employed categories. Table 4 illustrates the situation in regard to part-time and self employment in Australia in the industries under review in May 1995.

TABLE 4
PART-TIME AND SELF EMPLOYMENT IN AUSTRALIA, May 1995

| Industry | Part-time as % of Total Employment | Self- employed as % of Total Employment |
|--------------------------------------|--|---|
| Mining | 4.4 | 5.0 |
| Manufacturing | 9.6 | 4.1 |
| Construction | 15.4 | 28.2 |
| Wholesale trade | 14.4 | 5.0 |
| Retail Trade | 43.0 | 9.3 |
| Accommodation, cafes and restaurants | 43.9 | 2.7 |
| Transport and storage | 13.2 | 13.0 |
| Finance and insurance | 15.9 | 2.4 |
| Property and business services | 23.6 | 10.7 |
| Education | 31.5 | 3.0 |
| Health and community services | 38.2 | 3.8 |
| Cultural and recreational services | 41.2 | 14.4 |
| Personal and other services | 26.6 | 15.1 |
| Total | 26.1 | 8.7 |

Source: ABS (1996), Catalogue No. 6203.0

Small firms in many service industries such as Retail trade, Accommodation cafes and restaurants, Cultural and recreational services and Health and community services are characterised by a high proportion of part-time and casual workers, all recording more than 40 per cent of total employment in small businesses. These three industries are where small firms experienced the highest, (above 6 percentage points) decline in the share of total employment over the period 1983-84 to 1994-95. Table 4 further indicates that self employment as a proportion of total employment among the

industries differs considerably with Construction recording the highest and Finance and insurance the lowest share of total employment within the industry, but overall it constitutes 8.7 per cent of total employment in May, 1995.

It is interesting to note that the incidence of part-time employment is generally much higher across all industries in the services sector. Construction is the only industry in the goods producing sector which has a relatively high proportion of part-time workers. This is also an industry dominated by a very large proportion of self employed persons. The construction industry is marked by very low barriers to entry and that possibly explains a high proportions of self employment in the industry.

Self employment and self employment generated small firms seemed to a certain extent to have worked as a counter cyclical force to create new jobs during the 1990-91 recession in Australia. During the recessionary phase it is quite understandable that some unemployed persons will try to solve their unemployment problem through self employment and as well, a self employed person under the right circumstances can be a potential employer.

It must be recognised that the composition of the labour force has been undergoing change which also favours small business employment growth. An increasingly flexible labour force, including a preference for self employment and increased participation of women in the work force, all have changed the labour supply conditions. A significant number of labour force participants are looking for part-time, casual or self employment, thus providing the types of labour many small firms need under the changing labour market conditions.

Small Business and Employee Earnings

The discussions surrounding employment are, of course, a part of a much wider and important issue of earnings and the quality of job. It is usually suggested that most self employed persons work part-time and are the only employees of their firms. They also seem to earn much less than their comparable wage and salary earning counterparts. It is further suggested that jobs in small firms (in Australia) are often characterised as being low paid and given the high failure rate of small firms, short term (BIE, 1992). 72.2 per cent of all small businesses were in the services sector employing 72.9 of all workers in the industries under review in 1994-95 compared to 73.3 per cent of businesses employing 66.2 per cent of the same in 1983-84. Despite a decline of 1.1 percentage point in the number of small businesses, their share of employment went up by 6.7 percentage points. As firms in service industries tend to be smaller, and, increasing shifts toward services will naturally lead to an increase in the share of small business employment, the debate on earnings needs a closer examination in service industries in particular. Table 5 provides information on earnings by industry and firm size.

TABLE 5
Earnings by Industry and Firm Size, 1993-94
(in A\$ Per employee)

| Industry | < 20 Employees | 20-99 Employees | > 100 Employees |
|--------------------------------------|-------------------|--------------------|--------------------|
| Mining | 32,422 | 48,311* | 61,981 |
| Manufacturing | 23,458 | 29,366 | 36,071 |
| Construction | 24,620 | 40,935 | 42,737 |
| Wholesale trade | 29,464 | 34,395 | 37,924 |
| Retail trade | 16,422 | 19,747 | 17,790 |
| Accommodation, cafes and restaurants | 14,566 | 17,396 | 19,052 |
| Transport and storage | 21,285 | 29,569 | 42,746 |
| Finance and insurance | 33,869 | 51,412* | 39,094 |
| Property and business services | 26,517 | 26,070* | 36,350 |
| Education | 14,734 | 28,813* | 24,085 |
| Health and community services | 25,032 | 19,794 | 21,082 |
| Cultural and recreational services | 15,704* | 6,633* | 27,765 |
| Personal and other services | 21,792 | 24,908* | 29,539 |
| TOTAL | 22,790 | 25,439 | 30,700 |

Source ABS (1996), Cat No.1321

* subject to high sampling variability.

The table clearly indicates that in general earnings per employee increase with the size of the business across almost all industries. There is no evidence that the services sector in general and small firms within the sector in particular provide low pay jobs. Only four industries in the services sector; Retail trade, Accommodation, cafes and restaurants, Education and Cultural and recreational services have average earnings significantly lower than in other industries within the sector (these four industries accounted for 28.8 per cent of total small business employment in the services sector in 1994-95). These industries are marked by a very high proportion of part-time employees. Health and Community services also has a very high proportion of part-time employees but it appears that this industry is also distinguished by a very high professional entry barrier compared to other industries. On average earnings are fairly comparable among all industries between the goods producing and services industries except those four industries. Earning differentials among industries and among firms within an industry, may arise from a variety of reasons such as skills required, structure of industry, professional entry barriers, productivity, profitability, work experience etc. These factors equally influence earnings outcome in both the goods producing and services industries for both large and small firms.

Firms with less than 20 employees on average worked 39.7 hours a week, employees in business with less than 100 worked 42 hours a week and businesses with more than 100 employees worked 40.8 hours a week in May 1994 (see ABS, 1996). More aggregated data reveal that employees in the goods producing sector work longer hours a week and also work more overtime hours than employees in the services sector (see ABS,1996a). There has also been an upward trend in the number

of hours employees worked a week since the early 1990s for all sizes of firms in all industries. The combined impact of increased competition in the market place and an increasingly deregulated labour market is likely to have caused this upward trend in the number of hours employees work.

Conclusions

The economic reform measures to transform Australia into a more open economy beginning in 1983 have considerably impacted upon the small business sector in Australia. The increasing openness of the economy forced both small and large firms to respond to increased competition from both inside and outside. Such competitive pressure created both challenges and opportunities for small businesses. The growth in small business employment under such a rapidly changing economic environment is directly related to the growth and performance of small business under such circumstances.

Between 1983-84 and 1994-95, the number of small businesses increased by 3.3 per cent annually. This growth rate is identical to that for all businesses both large and small. During the same period small business employment grew by 2.5 per cent per annum which was marginally higher than that for both large and small enterprises together where employment grew by 2.4 per cent per annum implying that small business employment grew at a faster rate than that for large enterprises. Small firms in the services sector appear to have exhibited stronger employment growth. Despite impressive employment growth in the services sector, small firms in seven out of ten industries, lost their share of total employment to large firms while small firms in all the three industries in the goods producing sector gained the increased share of total employment in each industry. The study also found that there have been shifts in activity in the manufacturing industry away from large to small firms and that is where increased employment opportunities lie in the industry.

The employment growth in the small business sector during the period under study reflects not only the long term underlying structural change in a move towards the dominance of the service sector but also the increased openness of the economy resulting from economic measures and competition policies generating pressures for firms to improve their competitiveness. Furthermore an increasingly flexible labour force, including a greater preference for self employment and increased participation of women in the workforce, are also contributing to increased employment in the small business sector.

There was no evidence that industries in the services sector in general and small firms in those industries in particular offer low pay jobs compared to industries in the goods producing sector. However it must be mentioned that there was a tendency in general for earnings to rise with firm size across all industries under review. There has also been an upward trend in the number of hours employees worked since the early 1990s for all sizes of firms in all industries.

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