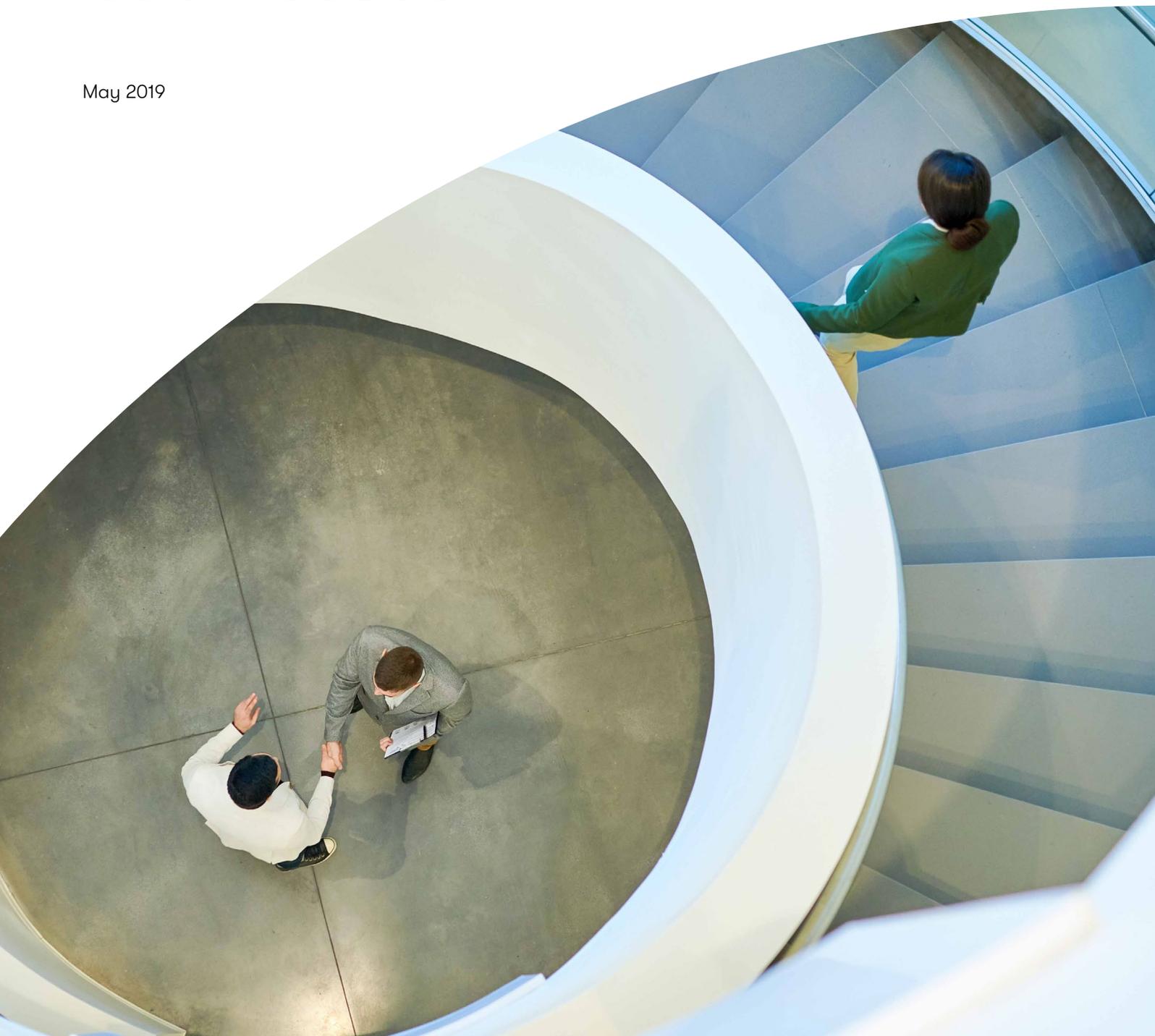


The overlooked opportunity in Australia's mid-sized businesses

May 2019



Welcome

There is an overlooked economic opportunity in Australia's mid-sized businesses – with the right incentives and tax policies in place, they can grow in size, scale and reach. They can employ more people, collaborate with other Australian businesses, and better contribute to Australia's bottom line.

Now is the time to look at different ways of incentivising Australian business. Our national economy is sluggish. We've had two successive quarters of negative growth per capita. Consumer spending is down. The housing market is trending down. The economy needs a kick-start.

Government is essential in setting the tone for business in Australia – and, bar some differences in application over the years and regardless of who is in power, we see that tax policy generally provides concessions and support to small business, while ensuring big business and multi-nationals are paying their 'fair share'.

Mid-sized business, defined in this paper as companies with revenue of \$50m - \$500m, belong in both and neither category. They can access some of the advantages for small businesses, but are also subject to much of the same bureaucracy as big business – but without the scale to absorb the time and costs as efficiently as the truly big end of town.

Would a boost to mid-sized business have an impact? We've asked Economist, Neville Norman, from the University of Melbourne and Cambridge to look at how a 10% increase in revenue would articulate itself in one and five years in terms of profit and tax revenue, particularly in lieu of the corporate tax cuts that failed to pass last year.

Short answer is yes – for our simulated mid-sized company with revenue of \$100m – a 10% boost would result in an increase of 35% in company cash flow over five full years, with \$26.7m (an increase of 25%) in company tax payable over the same period.



That additional cash flow could go towards R&D – a significant contributor to growth highlighted in our industry breakouts – investment in technology, jobs and expansion.

The additional tax revenue can go towards re-investment in corporate Australia to incentivise innovation, and back into our healthcare and education sectors for essential services.

Growth – sustainable growth – underpinned by a mix of government initiatives and business improvements by mid-sized business can have a positive impact on Australia's bottom line.

I strongly urge you to read the industry sections in this report as they reveal the specific drivers for growth based on our experience working with mid-sized clients.



Greg Keith
Chief Executive Officer
Grant Thornton Australia

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Key stats



0.5-1%
of businesses in
Australia are mid-sized



14%
share of sales
revenue



19%
share of company
tax

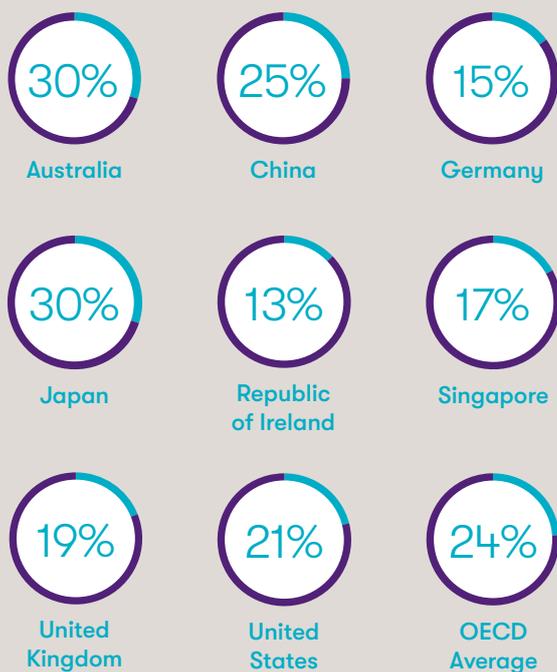
A **10%** boost in revenue for a \$100m business would produce a **35%** increase in cash flow over five years and a **25%** increase in tax payable based on the 28.5% corporate tax rate.

Current environment

Vince Tropiano
Partner – Tax
Grant Thornton Australia

Australia's current rate of 30% is uncompetitive when benchmarked against those of our trading partners and the OECD average of around 24%. The United States has a headline rate of 21%, and the United Kingdom is moving to a rate of 17%.

A sample of corporate tax rates around the world



There are a number of reasons why the corporate tax rate is important – obviously the lower the tax rate, the more attractive a destination Australia becomes for companies to either stay or set up. When globally mobile companies are looking for a home they will look at the whole suite of benefits a country can offer them – and the corporate tax rate can often be a deciding factor.

On top of this, companies make decisions based on the expected after-tax return on investment – such as how many people they can employ, investment in research and expansion, and activities like M&A. Of course, corporate tax rates are merely one part of the puzzle – but it does have a material impact on a company's ability to invest in themselves as well as attracting foreign investment.

Capital is highly mobile, and competition for investment is substantial. We are seeing significant investment from China and Japan into Education, Health & Aged Care, Agriculture, and Food & Beverage due to our excellent reputation for quality. But the 'Made in Australia' tag line only extends so far and doesn't hold the same cache for our more transportable industries, like Technology and Manufacturing.

Several countries have drastically reduced their rates to encourage foreign investment. Ireland, for example, has corporate tax rates as low as 12.5% and has remade itself as Europe's technology hub – creating new jobs and reinvigorating what was a sluggish economy less than a decade ago.

Reducing Australia's corporate tax rate to this level would not equip the nation to maintain a sustainable and appropriate tax and transfer system. However, a cut to somewhere between 20% – 25%, is certainly a step in the right direction and brings us in line with the OECD average.

As an advisor to mid-sized businesses, we see the challenges they face in competing with larger domestic and international companies while simultaneously looking to invest in new technology and products. We believe that reducing the corporate tax rate will help mid-sized businesses achieve their full potential.

Importantly, we are not necessarily advocating major new tax concessions – we simply believe that the Federal government should look at supporting mid-sized business with appropriate tax cuts. This will promote the growth of an important part of Australian business, one that is long overdue for appropriate recognition and support.

Our mid-sized businesses: Their impact and challenge

Prof. Neville Norman
Economist, University of Melbourne

Very large and small firms attract public and political interest, for different and obvious reasons. Mid-sized businesses (MSBs) attract neither the critical attention (often scorn and derision) directed to large size businesses, nor the persistent search for votes from smaller businesses and their employees. Nor are official statistical data readily or easily available for MSBs. They are the subject of this report.

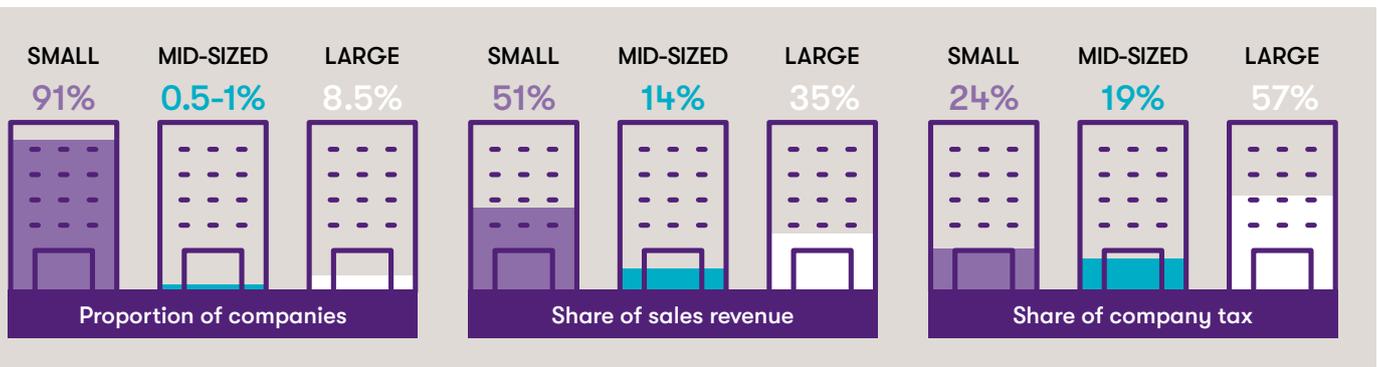
By mid-sized business we mean Australian businesses with annual sales revenues (turnover) in the range of \$50m - \$500m. Even the definition of size is controversial, as explained in our Technical Notes.

The largest private company in our domain is Mackay Sugar, with just on \$500m of revenue, having 108 private companies ranked above it; the smallest in the list of "Top 500" (i.e. number 500) is Mett (motor vehicle parts and manufacture) with sales revenue of \$78m, so one can infer that about 600 private companies meet our size criteria to be MSBs.

At March 2019 there were 2,672,325 companies registered in Australia (ASIC data of registrations), of which 33% were registered in NSW and 32% of them in Victoria. This is more than double the 1.67m companies registered just 20 years before.

The statistical authority (ABS: Cat 8165.0) identifies 2,238,299 'Australian businesses' in the year 2017/2018. There are five categories of smallish firms, with sales revenue of under \$10m p.a., not even covering our own definition of 'small' (up to \$50m p.a.). Of these (very) 'small' firms, 59% by number have turnover under \$200k; 93.4% have turnover under \$2m and 98.5% have turnover under \$10m.

So, by number, MSBs with turnover \$50m - \$500m, together with even larger firms are plainly much less than 1% of all Australian firms, though they garner about 15% of business (sales/turnover) revenue and pay about 20% of company tax (our estimates from Tax Office Statistics, explained below and in the Technical Notes)



Of those firms identified by the Tax Office, the overall number is close to 970,000 (ATO Taxation Statistics, latest, for fiscal year 2016/17). We have analysed the ATO data. Our overall findings are in the diagram above and documented in the Technical Notes.

On any test, smaller companies are vastly more numerous, but large companies dominate the shares of profits and company-tax payments.



Would targeted support to boost revenue result in wider economic benefits?

Study

We take a model MSB with \$100m of annual sales revenue. Our Technical Notes support the following averaged experience for our example MSB-hypothetical company in the base year. All the data can be halved for the lower bound of our range and multiplied by up to five times for the upper end.

 **\$100m**
Sales revenue (turnover)
The base case

 **\$15m**
Profit

 **\$4.275m**
Company tax payable*

 **\$20m**
Cash flow
(profit, adding back depreciation)

* (28.5% of taxable profits. Note: this percentage coincides with, but is not taken because it is, the current statutory tax rate for small companies; it is the figure derived from ATO data explained in the Technical Notes.)

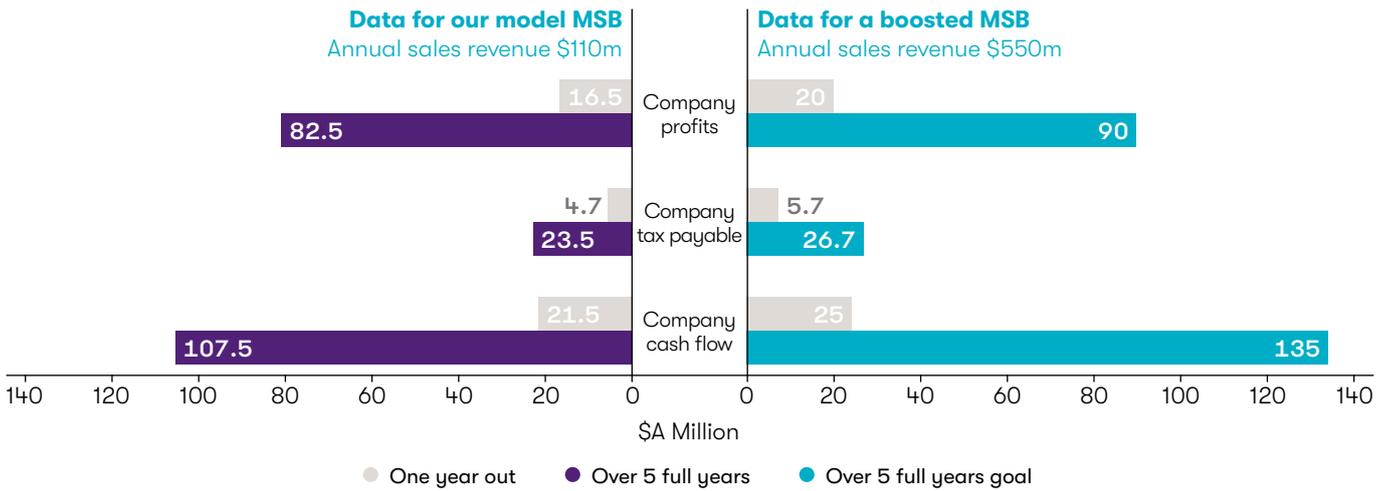
No two businesses are the same

The first point to carry into all the exercises like this is that the profit rate (to sales) varies significantly across all business in Australia from sharp negatives (through trading and carry-back losses) to high percentages to sales (commonly over 30% to sales in areas like antique dealing), where slow-turnover experiences can be consistent with the same rate of return (to capital/funds employed) as mid-sized high-turnover food and general retail operations achieve with 2-3% ratios of profits to sales.

The modelling

Our exercise is to contemplate the effects of a sustained one-off boost in business sales revenue for a 'typical' MSB operation from the averaged data. We do the numbers for one and five years ahead. The revenue boost takes place fully in the first year and is then calibrated over that year and the next four years. This time treatment allows for the economy-wide and business effects of what economists call "medium-to long-term impacts", which take us beyond simple numbers to more complex considerations.

On the simple numbers, before we address the economy-wide and industrial economic considerations, we have these data for a 10% revenue boost. Smaller or larger percentages can be computed easily by the reader. Note that sustained turnover boosts of much more than 20% from a base period are experienced by many firms in a growth phase, so this is NOT a fanciful exercise.



The chart¹ embodies the following strategy-success parameters, with realistic market and economist-sanctioned reactions: price uplifts and unit cost reductions, market reactions from competitors to follow product and productivity initiatives, which is why 5-year effects are not simple multiplications by five. The profit figure is trimmed for competitor response and new-product effects wearing off; cash flow is partly enriched by higher depreciation, as revenue-boosted firms tend, in time, to expand their capital expenditure, and thus depreciation charged.

We could paint many scenarios to achieve the results in the scenario above, based on the types of products, buyers, regulations applying, competitors (including offshore and on-line), market and public-policy reactions. But let's suppose the above data based on consultant inside experience of companies undergoing dynamic change is taken as granted.

To the extent that Australian Federal company tax revenue is boosted, the economic prospect is of the national budget deficit being reduced (or moved into Budget surplus), additional budget (e.g. welfare) spending without (any) tax (rate) increases. The other two outlets of additional profitability mean higher shareholder payouts and/or capital expenditure, boosting jobs and further enriching productivity, profitability and tax payments.

Our numerical exercise can be the springboard for further analysis of the national and corporate magnitudes that are possible. It is unrealistic to apply this data to all or most MSB firms in general: not all will be able to achieve such results and certainly not all of them seeking this at the same time period.

We have the following corporate and economic effects over the five year period in the exercise:

- 10%** Sales revenue up by 10%
- 20%** Profits up by 20%
- \$15m** Profits up by 20%
- 25%** Company tax payments increase of 25%
- \$5.3m** Company tax payments increase of 25%
- 35%** Cashflow of the revenue boosted company
- \$35m** Cashflow of the revenue boosted company

¹ See technical notes for data details.

How can our mid-sized businesses deliver such greater revenue?

Business revenue increases do not come from waving a magic wand. They arise, without any specific or further government support, from either:

- 1 the firms themselves, via better marketing decisions, products, advertising and pricing, efficiency improvements, perhaps with higher unit product prices;
- 2 in the market place, competitors falling over or losing favour with buyers, or swings in buyers sentiment towards the class of product our 'firms' are engaged in; or
- 3 financial support for these companies via government subsidies or tax breaks/better deductions/rate cuts.*

There is no claim here or evidence available anywhere to suggest that MSBs can provide any more beneficial effects on jobs, tax etc. than businesses in general. The claim and the spur to action is that MSBs have the scope, which is denied to most smaller businesses, of taking the price, product and productivity-enhancing decisions.

*Note, however, that such tax rate reductions affect cash-flow, not business revenues, and are usually deferred in its receipt, thus the time periods suggested above to capture them, and the inclusion of cash-flow data in our presentation.

The challenge

Mid-sized businesses are much less than 1% of Australian firms by number but they provide nearly 20% of Australian company tax receipts and have the capacity, unlike most smaller businesses, to earn greater profits and provide even greater tax revenues and associated national benefits.

So what are the 'levers' to achieve this providential outcome, for firms and society alike?



Certainly not operations on the company tax rate itself. Company tax rate rises for middle and larger company-tax payers would make Australian companies even less competitive and produce a string of corporate reactions to further denude the tax base.



Company tax rate reductions are costly (given the substantial tax collections taken already from MSBs, as shown herein) and they take much to give equivalent cash-flow effects, remembering that they are not, in any sense, revenue boosts. Given the relatively small number of MSB owners and employees (call them 'voters') and the large revenue at stake, election-driven company tax cuts are not likely to be advanced to MSBs.

That leaves the firms themselves, their markets and technology.

Have you researched or conducted price recoveries available in your marketplace, new and enriched product offerings, cost-reducing productivity improvements, and related strategies to boost your profits? These are amongst the relevant 'levers', and the story behind the providential numbers we have developed in this report.

A high-angle, vertical shot of a person climbing a large indoor rock climbing wall. The climber is positioned in the upper third of the frame, facing away from the camera. The wall is a vibrant orange color and is covered in numerous colorful climbing holds in various shapes and sizes, including red, blue, green, and white. The climber is wearing a black and red climbing harness and a backpack. The wall is supported by several vertical ropes. The background shows other sections of the climbing wall, including a white section and a purple section, all with colorful holds. The overall scene is brightly lit, suggesting an indoor climbing gym.

What levers can we pull?



Agribusiness, Food & Beverage

Tony Pititto

National Head of Agribusiness, Food & Beverage

324,500 employed in agriculture, forestry and fishing
(Nov-17 ABS Data)

\$102,869m in sales and service income for food and
beverage (2016-17 ABS Data)

Australia has a reputation for quality produce and products, so much so that our neighbours in Asia will pay a premium for the “Made in Australia” label. And rather than seeing the homogenisation of products or the dominance of big brands in Australia, we’re seeing a resurgence in artisan, ethically sourced, and innovative products.

There is always activity in this sector – M&A, inter-state and international expansion, as well as innovative funding models to take businesses to the next level. A great example is Endeavour Brewing Co. Launched in 2010, Endeavour Brewing achieved a major milestone in 2018 – becoming the first Australian brewery to offer shares direct to the public rather than through an ASX listing.

There are three clear ways government policy can support the Agribusiness, Food & Beverage sector to flourish – both here and overseas.



IMPROVED ROAD, RAIL AND PORT INFRASTRUCTURE

Our Agribusiness, Food & Beverage sector ships produce and livestock all around the country, and often to other parts of the world. But with our urban centres few and far between, and our specialised agricultural hubs clustered in rural locales, humane and speedy transport is essential – but not always accessible.

For instance, to ship bananas from Innisfail in Queensland to Melbourne by road, expect to be behind the wheel for approximately 32 hours non-stop.



[Watch Ben Kooyman, Founder and Executive Chair of Endeavour Brewing Co., talk about their future aspirations](#)

Better access to transport will open up new opportunities for mid-sized business in terms of where they can ship their produce, the premium they can command for quality and freshness, and the savings they can make through reduced fuel costs, smaller fleets, and less vehicle maintenance. Government continues to invest in essential infrastructure – both at a Federal and State level. However, even with funding, many infrastructure projects that will support the movement of goods aren’t prioritised. Inland Rail – Australia’s largest freight rail infrastructure project connecting Brisbane to Melbourne – is a terrific example of the kind of infrastructure the Agribusiness, Food & Beverage sector requires to not only keep up with demand, but grow their business.



With approximately 8.9m tonnes of agricultural freight diverted to Inland Rail, those bananas from Innisfail to Melbourne will cut 200km from their travel, at a more affordable rate per tonne. More projects like this – many already with funding attached to them – will help to open up Australia and the world to Australia’s Agribusiness, Food & Beverage sector.

2 MORE AFFORDABLE ENERGY

After labour and raw materials, energy is one of the sector’s largest costs. Machinery, production, climate control for livestock, water management and refrigeration all require energy. Turning the power off to avoid peak loads simply isn’t an option. While there are a number of ways that businesses can improve their energy efficiency, the fact remains that Australia – particularly Queensland, New South Wales, Victoria and South Australia – pays more for energy than most other countries. A multi-faceted approach to lowering costs – incentives to install solar panels and make energy efficient improvements are welcome, but an investment in new energy infrastructure (such as alternative energy sources and battery storage) is also needed to put downward pressure on business operating costs. The savings can be reinvested in improvements to the business, new product development, employment and new markets.

3 INCENTIVES FOR R&D

Innovation in the Agribusiness, Food & Beverage sector is important – not only to improve the quality and longevity of produce for local markets, but to meet demand for a growing world population. Recently we’ve seen innovations in the dairy sector, extending the shelf life of milk by up to 300% or nearly two months. This kind of innovation is typically driven by industry in collaboration with government and research bodies. In Australia the CSIRO regularly collaborates with the agricultural sector – helping to selectively breed the black tiger prawn, and hornless cattle, as well as developing new cotton breeds to help the Australian cotton industry remain sustainable and competitive. There is an appetite and opportunity for the mid-sized Agribusiness, Food & Beverage sector to invest more in research and development – many are already investing in new and niche produce and techniques, but lack the capital and research expertise to fully self-fund their own R&D programs. Australia’s R&D incentive program is clear and straightforward – but could be expanded to allow more activities to be eligible for a grant or rebate. Incentives to encourage collaboration between sectors, and with research bodies would also pay dividends, not only in new products and techniques, but in the potential for the innovations to be scaled up and new markets opened.



Consumer Products & Retail

Simon Trivett

National Head of Consumer Products & Retail

1,286,900 employed in retail (Nov 17 ABS Data)

\$417,587m in sales and services income for retail (2016-17 ABS Data)

376,700 employed in wholesale (Nov 17 ABS Data)

\$502,434m in sales and services income for wholesale (2016-17 ABS Data)

The Australian retail landscape is not only fascinating and dynamic, but highly prospective, with a significant growth in the size of market forecast over the next five years. Consumer Products & Retail turnover is strongly influenced by consumer demands, confidence and trends – not only in terms of what is fashionable, but also how people like to shop and receive their goods.

In many ways, mid-sized businesses in the Consumer Products & Retail sector are in a great position to compete with the big retailers in how they respond to customers – creating a consistent and responsive in-store shopping experience, and a seamless end-to-end online experience. Much of the magic in the retail sector is actually invisible to the customer. Supply chains, automation, robotics, merchandise strategies, consumer analytics – hidden in the back-end, but essential to delivering a great product alongside a great shopping experience.

And of course, the retail sector is a barometer for the overall economy – the more the consumer spends, the healthier the economy. While government policy and programs that put more money back into the pockets of individuals will usually trickle into the Retail sector, there are a range of ways that the mid-sized retailers can also take control of trends in the marketplace and punch above their weight in the retail world.



TAPPING INTO TECHNOLOGY

Mid-sized business are small enough to be nimble and large enough to benefit from scale – and the advent of Software as a Service (SaaS) has been a game changer for the Retail industry.

It's plug and play as opposed to hardwired technology infrastructure. It's a 12 month subscription rather than a three to five year investment.

Increasingly, the consumer journey starts online – researching a product, finding out where they can purchase it, comparing prices, and either completing the transaction online or in store. Having the right technology at the retailer's fingertips, connected to shopfronts, the warehouses, the delivery options and the consumer allows the retailer to match the consumer to their product at the best possible location, at the best possible price, with the best possible experience. Retailers can better understand what products do well and where, prioritising some of the key items for the shopfronts, while selling a broader range online only. Access to better data provides opportunities to match supply with demand – or sometimes even create the demand – essential in the Retail sector. The mid-sized retailers can innovate and adapt to consumers in this space in ways that the big retailers aren't able to and this is a real opportunity for mid-sized retailers.



2 A “DELIGHTFUL” CUSTOMER EXPERIENCE

A key differentiator, and a marker of success, is the customer experience. But here is the rub – the Retail sector is one of the country’s largest employers, but the workforce is largely casual and transient. Not many people choose to make retail their career. How then, do you create a delightful client experience? And maintain consistency of that experience if the experience from an online purchase exceeds an in-store one. There are great examples of Australian companies that deliver a great experience – Bunnings and JB HiFi are two specialist retailers where you know there will always be someone who will not only be happy to help you, but knows their product inside and out. This experience makes them a favourite amongst consumers. Much of this comes down to culture and training. Treating your employees like customers – showing them how something works, demonstrations, and incentives to support your employees to be your top advocates on the showroom floor – is essential to ensure a leading customer experience.

Treating your employees like customers – showing them how something works, demonstrations, and incentives to support your employees to be your top advocates on the showroom floor – is essential to ensure a leading customer experience.

3 PRODUCT INNOVATION AND R&D

Product development is something we see right across the Retail sector – for instance Coles and Woolworths now both produce an ever-growing range of private label products, from tinned tomatoes and frozen lasagne through to confectionary and personal care. While not ‘new’ innovations, we see refinement in processes, and improvements in existing products. This can reduce costs associated with sourcing products, leverage niche markets and trends, and automate processes that can be replicated to open up new markets. Australia’s R&D program is geared towards new innovations rather than refinements to existing products and technologies. So it doesn’t encourage businesses to invest in innovation – even though that innovation can lead to a number of opportunities for expansion, savings and efficiencies. Providing a wider definition of what is considered R&D to access government incentive programs would be supported by the sector.



Education

Stuart McDowall
National Head of Education

1,024,300 employed in education and training (Nov 17 ABS Data)

\$26,386m in sales and service income for private education and training (2016-17 ABS Data)

The education sector plays a vital role in our economic growth and productivity, as well as our social cohesion and quality of life. Investments made in this sector have a flow-on effect to all other sectors, which can be seen through measures such as workforce participation, labour productivity, the availability of necessary vocational and professional skills, and advances in research and innovation; all critical elements of our global attractiveness for investment.

As a nation, we have among the highest levels of education in the world – in the top 10 OECD countries for the number of 25 – 34 year-olds with tertiary education in 2017. But are they the right skills for the future workforce? Do we have our foundations right? According to the OECD we spend less on early childhood education as a proportion of GDP, but then the duration of early childhood education in Australia is shorter. Yet, research tells us that the first 1,000 days of a child's life are pivotal in their development – including how they perform socially and academically. Fostering the right environment for learning, collaboration and wellbeing for all ages sets the nation up for future success.

And depending on how you measure the academic performance of our school students, our progress in this area has not been as fast as many other OECD countries.

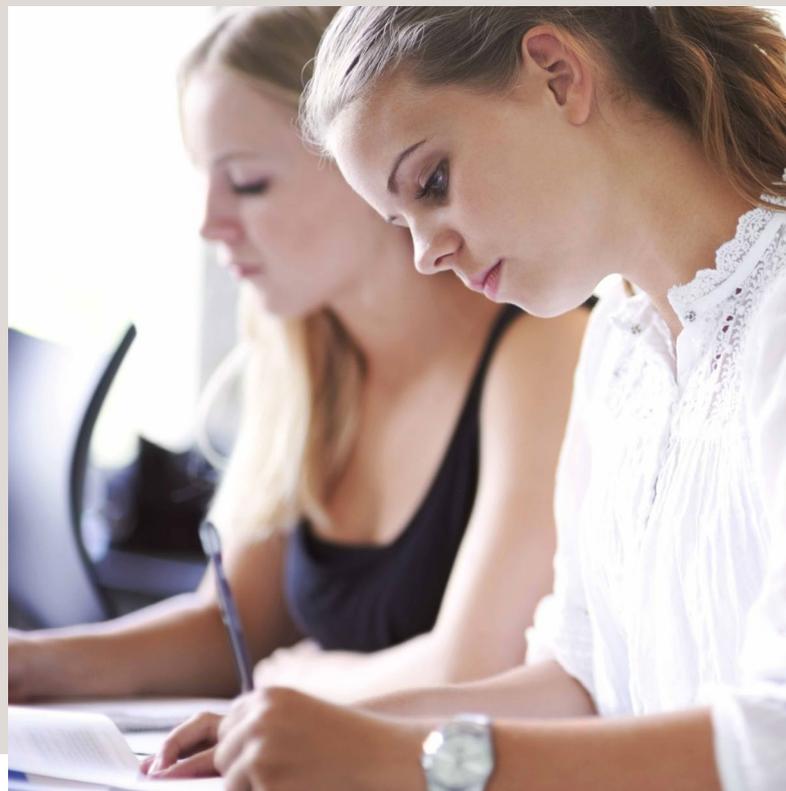
There are a number of key focus areas for encouraging short and long-term economic growth through the education sector.



ADDITIONAL INVESTMENT IN CHILDCARE AND EARLY YEARS EDUCATION

Universal access to early childhood education is currently available for four year olds, but there is emerging interest in extending this to three year olds. This would be a welcome initiative which – should the newly returned Liberal Government choose to pursue – would assist to bring our expenditure on early childhood education more in line with many of our counterparts in developed countries.

Contemporary research demonstrates that investment in early years education delivers outsized returns, in terms of the future success of our citizens (economic, social and emotional). However, there is also a more immediate payoff available to Australia, by increasing the number of workers in the economy.



Australian women are under-represented in our workforce. Our workforce participation rate for those of working age is 74% for women and 83% for men. At the same time, women are over-represented in the ranks of our part-time workforce (40% of women work part-time, compared to 5% of men).

This uneven workforce participation is largely driven by the high number of Australian mothers who take on the role of primary carer for their children (31% of two-parent families have a stay-at-home mother, compared to 4% who have a stay-at-home father). In fact, Australian mothers with children under the age of five have one of the lowest rates of workforce participation in the developed world.

Additional investment in childcare and pre-school education would enable parents to re-enter the workforce sooner and on a more full-time basis. As with existing funding, this could potentially be delivered as a direct subsidy to eligible providers or as a means-tested payment through the family tax system. This investment would have a direct and almost-immediate impact on economic growth, while working towards greater gender parity in the workforce.

The benefit of increased and affordable early childhood education can be quantified. While there may be different approaches to quantifying the economic benefits of increased access to quality early childhood education, a Grattan Institute report from 2014 suggests that an additional 6% of women in the workforce would contribute an additional \$25b to Australia's GDP. Remove the barrier to early childhood education and there will be a positive impact on Australia's bottom line.

2 ENABLE A MORE RESPONSIVE VET SECTOR

The Vocational Education and Training (VET) sector is a key enabler of workforce productivity and social mobility, providing workforce skills to post-school students across Australia. Although there are many strengths in the current system, a common critique is that the national system of training package development and accreditation is slow to respond to changes in industry needs. This has negatively impacted the availability of relevant skills in areas which are subject to rapid change (particularly technological advances), also impacting on productivity.

An independent review of the VET sector, delivered in March 2019 included 71 recommendations across funding, policy and regulation – the key takeout being that businesses were losing confidence in VET and that class-room based learning alone does not adequately prepare vocational students to transition into the workforce.

A more responsive VET sector could be enabled through simplification of apprenticeship incentives, extension of work-based VET training into more fields, and streamlining the process for qualification development and accreditation.

3 CONTINUED SUPPORT FOR STEAM

Skills demanded by the labour market are changing. Technological change and global competition demand the mastery of new competencies and the acquisition of new skills for many. This can be seen in the increasing prevalence of robotics, automation and online service delivery in many sectors.

As our modern economy progresses, the importance of STEAM (Science, Technology, Engineering, Arts and Mathematics) as a focus area for our education system is widely acknowledged. As well as being key to modern work practices (e.g. digital, robotics) these subject areas also provide the foundation for much of the higher-order thinking skills (such as evaluating, analysing and designing) which are critical to the future of work.

Support for STEAM can be provided through targeted scholarships or subsidies, funding for specialist teacher training, research funding and other initiatives which encourage (or remove barriers to) participation in this field of education.





Energy & Resources

Jannaya James
National Head of Energy & Resources

136,700 employed in electricity, gas, water and waste services (Nov 17 ABS Data)

216,500 employed in mining (Nov 17 ABS Data)

\$126,254m in sales and services income for electricity, gas, water and waste services (2016-17 ABS Data)

\$214,984m in sales and services income for mining (2016-17 ABS Data)

There is particular opportunity in Australia for the Energy sector. The global trend towards renewable and alternative energy, aligned with local appetite for a better energy mix, is providing a ripe environment for project development and investment. According to our own research, Australia is an attractive destination for investment in the energy sector – this is compared to countries like Germany, which has an established and long standing renewable energy policy.

Australia is unique in a number of respects. While we are rich in resources and opportunities for energy generation, our population density is concentrated in small pockets along the coast and our energy infrastructure has further to travel to service those communities. Energy regulation is State-based – with a mix of private, public and private/public ownership of the energy value chain. As a country we’re still predominantly dependent on coal-fire, but we’re seeing the shift towards sustainable alternatives and this is where we’re seeing opportunity for mid-sized businesses in the sector.

There is an estimated 10.4GW of new solar and wind power to be brought online in 2018 and 2019 – that’s enough power to run 693,000 family homes for a year (based on a two parent, two child family). Not only are we on track to meet our Renewable Energy Target for 33,000GWh by 2020, but we’re also on track to reach 50% renewable energy by 2025. Other factors supporting growth in the sector are falling costs, rising electricity demand and the retirement of the existing coal plants.

1 FUNDING THE PIPELINE

The pipeline of renewable energy projects in Australia is at unprecedented levels and despite the attractiveness of Australia as an investment destination, some of the projects in the pipeline are under threat. Ageing infrastructure, access to finance and credit worthy off-takers of electricity are all barriers to enabling a sustainable and reliable energy mix in the future. At present we have a number of avenues for funding available for new projects through bodies like ARENA and the Clean Energy Finance Corporation.

From a State perspective, the Victorian Government recently introduced the Victorian Renewable Auction Scheme – holding its first auction in September 2018. The Scheme offered long term pricing arrangements for six renewable energy projects across Victoria, generating an additional 928.1Mw per year and an additional 903 jobs. Greater support such as this will assist companies to secure a credit worthy off-taker and give investors an opportunity to generate sufficient returns to make their project viable.

2 POLICY CERTAINTY

The Federal Government sets the tone for energy policy, but it is enacted at a State level. Better alignment would not only create consistency in the kinds of projects that are built and invested in, but also consistency in reliability, cost and customer experience. Mid-sized businesses in the energy market are seeking certainty in the future for renewable power to enable investment decisions and a streamlining of policy between Federal and State or Territory is a key part of gaining that certainty.



[Read our Renewable energy discount survey results – 2018](#)



3

BETTER INFRASTRUCTURE

The energy network we will have in the future will be very different to the one we had a decade ago – and yet the infrastructure that we use to distribute our energy is already 40 – 50 years old and designed to carry the regular energy loads from coal fire. Moving to renewable and alternative energies is essential for Australia – but we must respect that this different energy source comes with peaks and troughs in generation. Solar can only be generated when there is sun. Wind generation will be higher during a gale and gradually peter off during a mild breeze. Battery and other types of storage will be required to supplement the times when there isn't enough energy. Individual homes can help to generate and store their own energy. Community grids could be created to help support regional and rural communities.

We have projects and investors ready to build and invest in the range of energy projects of the future. But we must ensure that the infrastructure connecting these energy sources together, and to our communities, can cope with new energy loads, as well as increasing energy demand from a growing population. We would like to see incentives and funding also made available for projects to modernise ageing infrastructure, or create new infrastructure. The burden is typically on the private sector to ensure their poles and wires are up to scratch, but with approximately 877,500km of transmission and distribution lines across Australia, there needs to be support to tackle this major project. Smarter PPPs – which could be Public Private Partnerships or Public Public Partnerships is one way to achieve this.

The burden is typically on the private sector to ensure their poles and wires are up to scratch, but with approximately 877,500km of transmission and distribution lines across Australia, there needs to be support to tackle this major project.



Financial Services

Madeleine Mattera
National Head of Financial Services

420,700 employed in financial and insurance services

\$140b contribution to GDP in 2016 (The Treasury)

Many of us that work in the sector talk about the post-Royal Commission world. It's a pivotal moment that has shaken Australia's trust and confidence in our Financial Services sector. We have since seen a tightening in the lending environment, signs of consumers seeking to retreat from the big banks towards the mid-sized and more customer focused banks, and an unknown factor around potential new regulation, but certainly a more robust regulator with more powers than before. The sector will find it challenging in the short-term, but when we overcome the hurdles presented by the Royal Commission then we will likely see a significantly different sector in ten years' time.

Undoubtedly, the Royal Commission highlighted inconsistencies between consumer outcomes and the practices of big banks – but Australia's diverse Financial Services sector is made up of so much more than the Big 4. A strong customer focus and profit need not be contradictory. Many of Australia's best performing banks – both by profit and by customer satisfaction – are mid-sized. To support the growth of this sector there are a number of initiatives the Government and regulators can implement to ensure not only a level playing field, but to encourage the growth of diversity and competition in the sector.

Take Teachers Mutual Bank Limited, one of the largest mutual banks in Australia with over 198,000 members. Not only are they experiencing significant growth, they have also held their position as one of the world's most ethical companies for the last five years – demonstrating community good and growth aren't mutually exclusive.

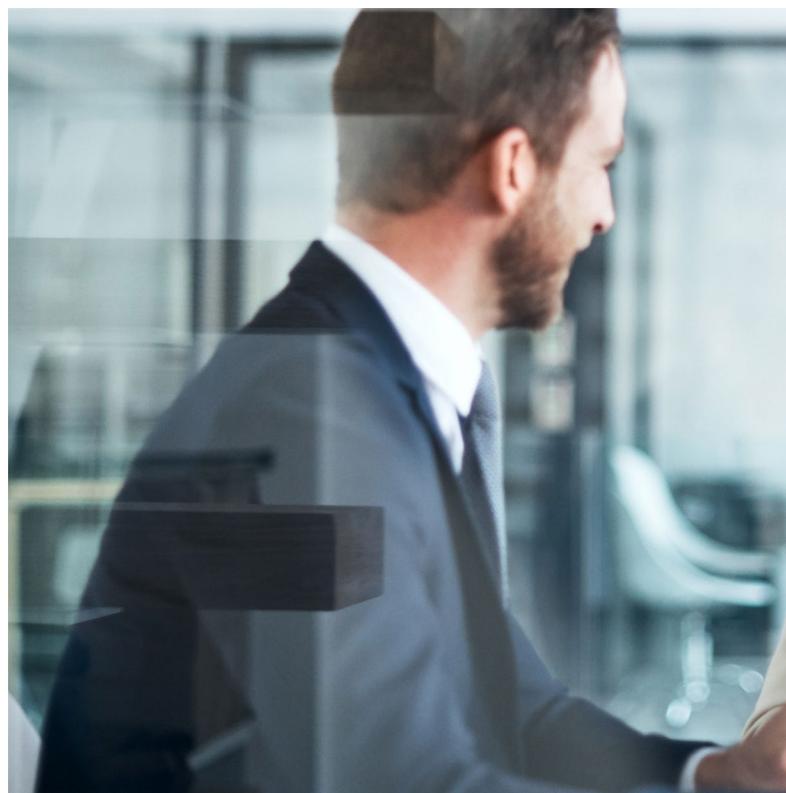
While not mid-sized, the start-ups of today are the mid-sized businesses of tomorrow. Providing robust but clear avenues of entry for disruptors, such as neobanks, ensures that the Financial Services sector can continue to evolve alongside consumer needs while providing the same safety and assurance Australians have come to expect from the Financial Services industry.



[Read our case for proportionate regulation](#)



[Watch Steve James, CEO of Teachers Mutual Bank Limited, talk about how they respond to changes in the market](#)



1 THE POST-ROYAL COMMISSION WORLD AND PROPORTIONATE REGULATION

The Financial Services sector – specifically the big banks – has taken a hit to its reputation throughout the Royal Commission process. Seventy-six recommendations have been made to improve the Financial Services sector – all of which will be acted upon in some way, shape or form. In addition to broader powers and additional support for the regulators – ASIC and APRA – there may well be additional regulation imposed on the sector.

This cost of regulation is easily absorbed by larger ADIs – the big banks – but can put undue pressure on the smaller ADIs – such as customer-owned institutions – that strive to compete in an environment where the cost of compliance is already burdensome, and the changing nature of technology continues to strain resources. Considering that the issues found in the Financial Services sector were largely contained to the big end of town, and our clients in the mid-sized sector have since seen an upswing in their customer base due to their operating structure and emphasis on customer service and community participation, it does seem disproportionate to have a ‘one size fits all’ regulatory environment to address the problems identified in one particular sub-section.

We’ve seen this done successfully in other parts of the world, using the Basel Framework to apply the principles of proportionality taking into account qualitative and quantitative criteria such as a bank’s size and risk profile, the complexity of its activities and its international presence.

2 USING DATA AND ANALYTICS TO BETTER ENGAGE WITH CUSTOMERS

In the aftermath of the Royal Commission we will see change – not only in the appetite for risk from the Financial Services sector, but in the products they offer and how they are offered. Technology is an enabler – and the Financial Services industry is better placed than most to understand its customers and respond to them intuitively based on their actions. According to the World Bank, a whopping 98.9% of Australians (based on our population) have a bank account – that’s an impressive data set.

We already see technology and analytics used to combat issues like credit card fraud – with either a text or a phone call when an unusual transaction is identified. But this can, and likely will, be expanded to help customers track their spending, schedule bills and even change banks. The emphasis will be on supporting the customer, and loyalty will be given based on the quality of the service and product, not on how difficult it is to change.

3 SUPPORT FOR DISRUPTORS AND R&D

Innovation in the Financial Services sector not only helps Australia stay ahead of the curve with new technological developments, it supports the local economy and helps to keep competition in the market. R&D incentives for the sector should support customer focussed innovation – empowering customers and encouraging transparent interactions.

Interestingly, we’re seeing a new breed of banking options on the horizon which encapsulate the way that customers want to bank. Fintechs and neobanks are disruptors in the Financial Services sector leveraging their ability for banking on demand, with a high level of service and with a real focus on going the extra mile for the customer. This is enabled by their systems – Software as a Service is considerably cheaper and more nimble than legacy systems – and they will be heavily reliant on technology and innovation to ensure they remain relevant, secure, and responsive to trends in customer needs and demands. Research and development will be an ongoing and constant requirement for these new entrants.

The new banking landscape will be fast paced, adaptable and agile – our regulation needs to match. The trick will be ensure we have the right regulatory settings to allow fintech and neobanks to establish, thrive, and continually innovate.





Health & Aged Care

Darrell Price

National Head of Health & Aged Care

1,663,900 people employed in health care and social assistance (Nov 17 ABS Data)

\$92,924m in sales and service income (2016-17 ABS Data)

The Health & Aged Care sector is one of the largest employers in Australia and is dominated by small and mid-sized enterprises. Unlike most of the sectors in this report, these enterprises deliver a community benefit in their work, and rely on government policy and funding models for their revenue. The enterprises and policy makers in this sector don't always apply a growth mindset to their business. However, to achieve their service and organisational goals, they should.

The two Royal Commissions that have been called in 2018 and 2019 – for the Aged Care sector and Disability Service sector – not only put a spotlight on the quality of care in the system, but also highlight areas where we can further support the Health and Aged Care sector to not only meet, and exceed, community expectations, but to also grow to become more sustainable. And sustainability is essential. Sustainability delivers better quality services, better quality outcomes, more people employed and more people having access to essential services. All positive benefits that our communities expect from the sector.

In 2016-17 Australia spent around 10% of GDP on health, in line with the world average. However, funding continues to be an ongoing challenge for the broader sector, with inconsistencies in where that funding comes from.

The Aged Care sector and Disabilities Services are primarily funded by the Commonwealth, while the Healthcare sector is funded by the States. The funding 'pie' typically doesn't get much larger, but the slices are reapportioned to try and accommodate population growth and new services. It's competitive to get your share.

What we fund is just as important as how much funding is available – with an emphasis on 'beds filled' or treatment types delivered rather than on the quality of the care or rewarding programs designed to reduce the prevalence of preventable disease. It is admirable that the Liberal and Labor parties want to invest in cancer research, however investments in prevention will eliminate the need for some of this research and allow vulnerable people to avoid disease in the first place. With the cost of running a community program to improve overall health outcomes much cheaper than the cost of treating disease, surely a re-think on what we fund in the system could achieve a better return on investment? The upshot: more essential funding is available for those who truly need it.

A potential barrier to this is patchy business maturity in the sector. Knowing what to invest in – the kinds of skills and roles that will boost outcomes as opposed to creating more bureaucracy – is a skill that many companies in the sector require but may not have.

In addition to access of funding being difficult, the availability of quality and qualified people to work in the industry continues to be a barrier – particularly in demanding roles (such as nurses in the Aged Care sector) and in regional areas.

Governments need to understand that certainty of funding allocations and models is required to stimulate long term investments in health service facilities, from built environment to specialist diagnostic equipment. Our industry requires long term commitments.

1 INDUSTRY SUPPORT PACKAGE

To improve the sector there must be public investment – to support the companies in the sector develop detailed and implementable strategies, improve the quality and rigour in their governance, and potentially to look at opportunities such as M&A to create larger entities with a greater ability to service the needs of their community. There is a precedent for this. We see similar packages offered to the agricultural sector during times of extreme drought, to the education sector to improve their facilities, and to families to invest in renewable energy like solar panels.

2 CHANGE HOW WE REMUNERATE OUR HEALTH & AGED CARE SECTOR

At present funding is allocated to the Health and Aged Care sector based on output – see a patient or client is Category A and receive a subsidy or payment of Y. The more patients or clients you see in a higher earning category, the more you receive from the government. This very quickly becomes a numbers game that focuses on the treatment of disease and not on the prevention of disease. Providing opportunities and funding for our Health and Aged Care specialists to work with communities on what a healthy lifestyle looks like, encouraging activity of all kinds, access to healthy foods and recipes will contribute to fewer incidences of illness and disease, less resource needed to treat illness, and fewer days off work. A number of countries have already made the switch to focus on the prevention of disease – including many of the Nordic countries and the UK. Invariably better health leads to increased productivity, happiness and wellbeing. That should be the goal of our Health & Aged Care sector.

3 SUPPORT THE UPSKILLING AND ATTRACTIVENESS OF THE SECTOR FOR WORKERS

There are over 1 million people working in the Health & Aged care sector in Australia – and this is just in the private sector. It's demanding work, with a number of people in the sector requiring a Certificate 3 minimum to enter the sector. While the Labor Party proposed policies to encourage more people into the sector – and proposed funding towards aged care placements at TAFE as part of their pre-election campaign, there needs to be more investment in the education, ongoing training, attraction and retention of skilled and suitable people to the sector. Understandably, the Royal Commission into both the Aged Care sector and the Disability Services sector will create the perception that the Health & Aged Care sector isn't a great place for a career. But with an ageing population, and a greater demand for a whole range of services, we must find a way to encourage the right people into the sector through means that aren't just related to remuneration.





Life Sciences

Michael Cunningham
National Head of Life Sciences

230,000 employed in life sciences (AusBiotech 2018 Data)

\$65b contribution to GDP in 2016 (Office of the Chief Scientist)

Australia has a reputation as one of the world's leading destinations for Life Sciences, developing life-changing innovations that have real social benefit – from the world's first anti-cancer vaccine to spray-on skin for burns victims. There is no shortage of examples of leading work by our researchers and medical professionals in Life Sciences, a sector that employs more than 230,000 people across 1,654 organisations (AusBiotech 2018) – the equivalent size of Mining's labour force. There are around 100 biotech companies listed on the ASX with a market capitalisation of around \$100b. It is the largest listed biotechnology sector as a proportion of GDP in the world.

While most people would know CSL and Cochlear, fewer still would know of Clinuvel Pharmaceuticals (a world leader taking an active role in photomedicine) and Avita Medical (with a focus on regenerative medicine, like spray-on skin cell therapy). In fact, companies that are, or are aspiring to be, mid-sized companies make up the bulk of the sector. The Life Sciences sector operates with a view to five – ten years in the future. This is how long it could take to bring a piece of research to clinical trial stage through to commercialisation. It's life saving work with a high risk profile for early stage product development and a high return when products do well – for both investors and the general public.

Programs, like our R&D incentives program, are essential to support small and mid-sized businesses to access the funding they need – particularly in the early stages of development. Much more can be done to support the sector.



SET THE NATIONAL R&D AGENDA

Set it – and then avoid tweaking it. The current R&D incentive rate is 43.5% or 38.5% (dependent on turnover) – this is a guaranteed rate of return on investment that meets the R&D program test and companies rely on this to plan for future research and employment. While comparing ourselves to our neighbours isn't apples for apples – New Zealand for instance has a credit rate of 15% but the wider program is different to ours – we must ensure that Australia remains a world class destination for R&D and Life Sciences, or risk losing both international and home grown companies to other jurisdictions.



ENCOURAGE INTER-SECTOR COLLABORATION

Not only does Australia have a world leading Life Sciences sector, we also have a world leading Education sector. Why don't they collaborate more? The tension between academic rigour and speed to market is one particular barrier – as has been the lack of incentive to collaborate. The Labor Party announced they would offer a 10% collaboration premium on top of current R&D incentives to support industry and academic or government (for example CSIRO) collaboration. While they were unsuccessful at the election booths, this would be a positive move which would provide industry (particularly those within the small to mid-sized sector) access to data, research equipment and depth of expertise.



Research takes time. University of Queensland researchers Prof Ian Frazer and Dr Jian Zhou were the minds behind the world's first HPV Vaccine (the leading cause of Cervical Cancer), Gardasil – manufactured by Merck & Co. Prof Frazer and Dr Zhou first started developing a vaccine for HPV in the 1990s – and it wasn't until 2006 that the Therapeutic Goods Association approved Gardasil, with Australia becoming the first country to roll out a national HPV vaccination program in 2007.

Collaboration then, is a long process – but an essential one as we both strive to better understand the human body, and to create medicines and products to improve quality of life, and prevent and treat disease.

3 SUPPORT COMMERCIALISATION

The ramp up towards commercialisation for mid-sized Life Sciences businesses is steep. So how can we support more of our Life Sciences companies to not only speed up the process to market, but to keep the companies and production in Australia?

The Medical Research Commercialisation Fund (MRCF), managed by Brandon Capital Partners, is a joint venture between a number of State Health Departments, with investment from AustralianSuper, Statewide Super, HESTA, HOSTPLUS and the Australian Government. Providing early stage funding to support the development and commercialisation of early-stage medical technologies – on the surface this seems to be the most significant avenue for commercialisation support in Australia. More is needed. We would like to see more investment from the Federal Government for commercialisation – the next phase from the R&D incentive program.

This could be done through rebates and incentives for companies taking the next step towards commercialisation, investment in the manufacturing infrastructure to make the transition to production in Australia more attractive (particularly for medical devices). Incentives for investors – like Australia's superannuation funds – to invest in the Life Sciences sector would also provide much needed funding in what remains a relatively high risk investment area. We are seeing some of our superannuation funds investing via the MRCF, but it's not as widespread – certainly not at the levels we see in investment in the Real Estate & Construction sector.

Greater support to the commercialisation process will help to grow the sector beyond research to the production line, creating opportunities in our Manufacturing sector, employing more people and keeping the profits and future development opportunities from the life sciences sector here in Australia.



Manufacturing

Michael Climpson
National Head of Manufacturing

885,500 employed in manufacturing (Nov 17 ABS Data)

\$253,255m in sales and service income for manufacturing (2016-17 ABS Data)

Although the knock-on effects of the Australian automotive industry exiting our country are yet to be fully understood, the industry is evolving, and manufacturing continues to be a major employer and critical to our overall economy. The pace of new technologies is accelerating, and manufacturers will require more investment in R&D than ever before to remain competitive in a global market. Our own research into mid-sized manufacturers demonstrates that the sector is resilient, and both sales and profitability are growing over recent years.

A good success story in this space is Redback Boots, an Australian footwear manufacturing company with its roots in the early 1900s. Specialising in work boots and army boots for domestic and international markets, Redback manufactures over 1 million boots a year. Key to their future success has been an investment in technology to better understand their customers and automate their operations.



[Watch Mark Cloros, Co-founder and Director of Redback Boots, talk about the influence of technology and customer expectations on their business](#)

There are a number of challenges facing the sector. Energy, for instance, is a major cost for manufacturers and has significantly risen over recent years. As local manufacturers are competing with global markets, a rise in Australian energy costs cannot simply be passed on, and margins are adversely impacted. Any government intervention that is effective in reducing energy costs would be welcomed by the industry.

There are many ways the government can support the manufacturing sector, and below we have highlighted some for consideration.



SUPPORTING MANUFACTURING R&D

The intersection between manufacturing and innovation can achieve great efficiencies, economies of scale and personalisation. Automation can refine and speed up production lines, 3D printing can create bespoke and complex components, Internet of Things (IoT) enabled systems and products feedback data about performance to support maintenance and improvements, and sense changes in the environment and usage.

There is a strong role for R&D in the Manufacturing sector – underpinned by the existing R&D incentive program, and other initiatives including the Cooperative Research Centres (CRC) program. Manufacturing punches above its weight in terms of investment in R&D – with one figure stating that \$4.8b was spent by the manufacturing industry in 2013-14 – as a proportion of GDP this is roughly four times the economy wide average. We would like to see more collaboration between industry and government and/or academia – and we were pleased to hear Labor announce that they would apply a 10% premium for collaboration with bodies like the CSIRO on top of the R&D incentives currently available. We hope this continues to be discussed under the returned Morrison Government.

2 FREE TRADE AGREEMENTS SHOULD COMPLEMENT LOCAL MANUFACTURING

Australia is a small market compared to many of our OECD counterparts – but we are an important trading partner for a number of countries including China, Japan and India. As a nation, we're buying more goods – and the free entry (zero tariff) of products from overseas provides a range of choice for the consumer and at considerably lower prices due to the lower cost of wages and materials in the products point of origin. The import tariff would typically be added to the cost of the product – passed on to the consumer – and helps to level the playing field with local manufacturers of similar products.

Our mid-sized manufacturers produce a wide range of products, almost anything you can get overseas, you can find a local counterpart. Australians like to buy locally – but if a competing product from overseas is available at a significantly reduced price (for instance 100% of China's exports to Australia are exempt from tariffs) then it becomes more difficult to compete. Of course, Australia receives benefits from some of our trading partners as well – with 98% of our exports to China now receiving zero or preferential tariffs. For our manufacturers that aren't yet of the scale to take advantage of these preferential arrangements, they are feeling the pinch the most.

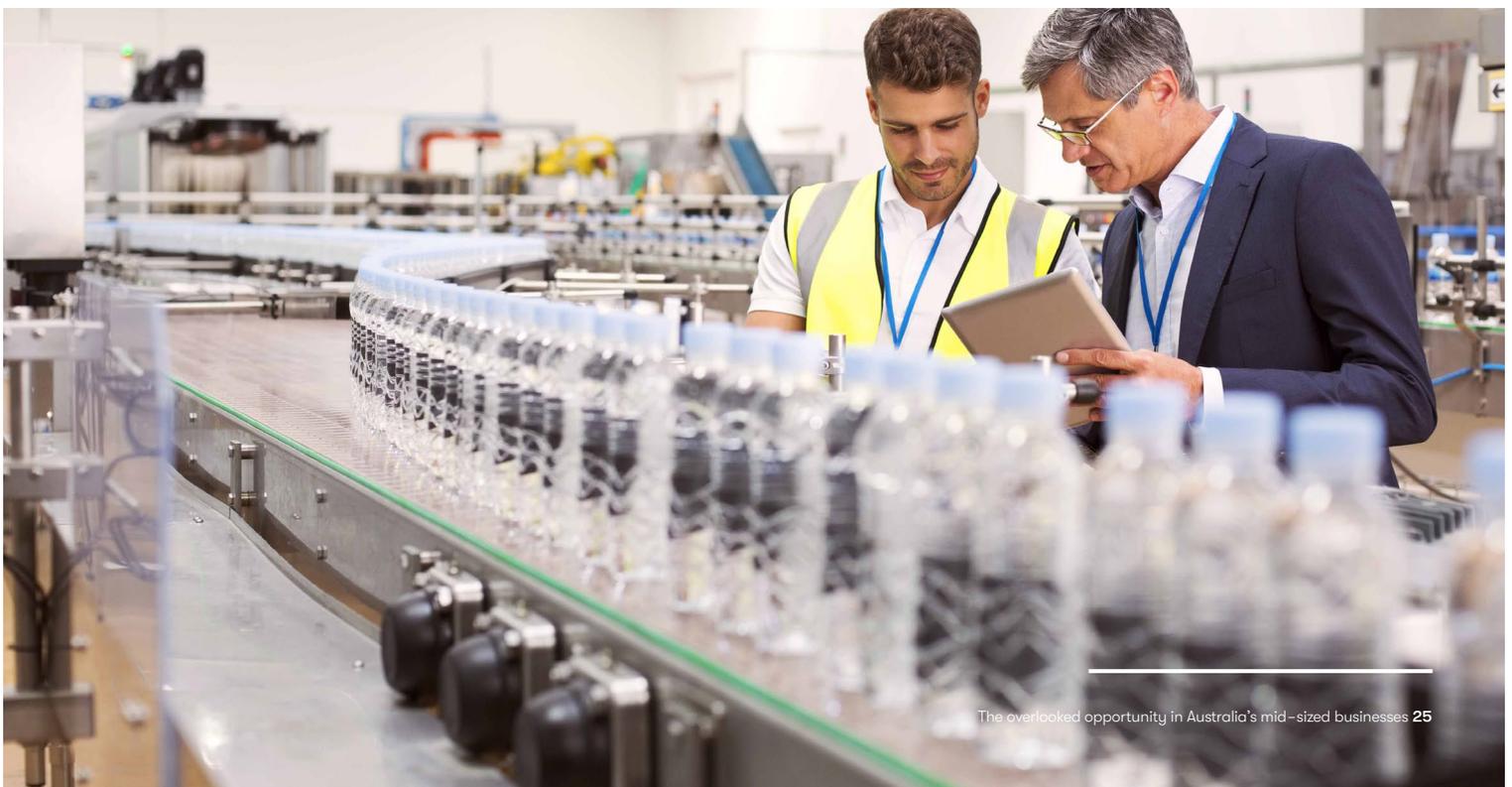
Free Trade Agreements and preferential tariff rates are important – but needs to be applied in a way that continues to provide support to local manufacturers. Would preferential tariffs be better than a flat zero tariff? Or should businesses that don't export be able to access some kind of support, rebate or incentive from the Government that can be passed on to the consumer or reinvested in their business to better compete with overseas products in the Australian market?

3 MANUFACTURING TO SUPPORT REGIONAL GROWTH AND PAYROLL TAX RELIEF

Most temporary and permanent immigrants take up residence in our cities (with 70 – 80% choosing to live in Sydney and Melbourne), and our cities are becoming congested and less liveable. At the same time, regional towns are often lacking the growth in activity they are seeking, often led by a lack of employment opportunities. The Government's 2019-2020 Budget announced 23,000 places set aside for two new regional visas for skilled workers requiring them to live in regional Australia for three years before being able to access permanent residence – a positive initiative that must be supported by investment in public infrastructure (with current commitments for highways and 'faster rail') and incentives for business to set up in regional areas.

Manufacturing is ideal for regional areas – with many businesses requiring a significant real estate footprint as well as providing employment for a range of skill sets and backgrounds.

One way the Federal government can do that is work with and compensate State governments for the removal of payroll tax altogether for businesses that offer employment in regional towns. Governments should not be afraid to contemplate fundamental changes to antiquated taxes.





Professional Services

Ben Matthews

National Head of Professional Services

1,033,000 employed in professional, scientific and technical services (2016-17 ABS Data)

\$162,368m in sales and service income for Professional Services (excluding computer system design) (2016-17 ABS Data)

For the Professional Services industry, it seems as though we are on a growth trajectory. Work resulting from the Royal Commissions is keeping law firms at all levels on their toes and the infrastructure boom means our architects and engineers are more than busy. In fact, the last industry report from IBIS suggests that we've seen a 1.6% growth rate for the Professional Services sector in the past five years and will continue to see a projected growth rate of 1.9% over the next five years.

Growth doesn't come without its challenges. Conversations we're having with our clients across the legal, engineering and architectural sectors reveal similar issues – talent management, risk and regulation, and stakeholder engagement continue to come up as the immediate barriers to meet current demands, let alone to support projected growth.

This industry, similar to so many, also faces major disruption and change, with an increase in regulatory changes, industry consolidation and new technologies coming to the fore. Overlay this with the cyclic nature of work – the current infrastructure boom can't last forever – and navigating the market as a mid-sized Professional Services firm can be complex. We've identified some key considerations for the Professional Services sector below.



PEOPLE AND SKILLS

As revenue has increased in the Professional Services industry, we have seen both staff and skills shortages. This is partly due to a disconnect between universities and Professional Services firms – we're not seeing job ready graduates enter the workforce in the areas of most need. In addition, changes made to the 457 work visa in May 2017 have made it more difficult to sponsor talent from overseas.

During his Budget Reply speech, Bill Shorten proposed a SMART Australia – targeting “world leaders” in Science, Medicine, Academia, Research and Technology to come and work in Australia as well as ensuring a focus in Australian schools on STEM subjects (Science, Technology, Engineering



and Maths). This focus would be positive for the engineering industry, ensuring better access to engineers fresh out of university, or overseas, with the right skills.

However for legal and accounting firms, the problem remains. Part of Labor's pre-election pledge on education included support for apprenticeships – with a focus on trades and the Aged Care sector. But could there also be a place for cadetships and internships in these less hands-on industries – and what support can be provided to encourage future pathways into the Professional Services sector beyond a university degree? This is a key question for mid-sized businesses in the sector that have to compete with the large firms for quality graduates and experienced hires. A strong value proposition and innovative entryways could prove the deciding factor for a potential hire.

2 COMPETITION AND CHOICE

We've seen a trend over the past five years of industry consolidation, where the top firms across all Professional Services sectors are expanding their service areas by purchasing small and mid-market firms to incorporate that knowledge into their offerings. Grant Thornton has also been active in this space, acquiring GNC Group in 2017 to greatly enhance our retail and operational improvement capabilities.

But is the tide about to turn? More recently we have seen the Competition and Markets Authority (CMA) in the UK recommend to the Government that the Big Four accounting firms divide their audit offering from their other professional-services offerings. This recommendation is in response to the consolidation trend, as well as the Big Four's expansion into legal and consulting services, resulting in serious issues around independence, preferential cross-selling and lack of competition in the marketplace.

The question is, if the UK government takes this recommendation on board, what will the flow-on effect be in Australia? These changes could have a significant impact in the Australian market, and could lead to huge opportunities for mid-sized firms to capitalise and differentiate themselves in the market.

Alongside this, there appears to be a growing trend away from big business. Organisations seeking accounting, legal, engineering or architectural services increasingly want advisors who will partner with them – understand their unique needs and challenges, and without having to compete for attention with larger companies for the best service.

3 MANAGING THE PEAKS AND TROUGHS OF GROWTH

The Professional Services sector is experiencing growth now – and is already experiencing shortages of skilled workers – but what will happen when the work for the Royal Commissions dries up and the infrastructure boom is quelled to business as usual. The sector relies on people and knowledge, and with some forethought to the future (which could be 20 years away from now) companies can plan to capitalise on their size and reach to re-deploy their people into new areas of opportunities rather than reducing headcount.

Australia is in a unique position – we're an established, geo-politically safe country located in the midst of rapidly growing Asia Pacific region. The ASEAN nations – comprising Indonesia, Malaysia, Singapore, Philippines, Thailand, Vietnam, Myanmar, Cambodia, Lao PDR and Brunei – had a combined GDP of US\$2.5tn in 2017 and is on track to be the fourth largest economy by 2030. Once the work slows down in Australia, can our Professional Services sector support the growth of economies all around us?

Much of the growth we will see in the ASEAN region will include attracting international business, economy stimulants like international sporting competitions, and concessions and incentives to help their local economies produce more for the domestic and international markets. There are a number of opportunities for Professional Services to support both Australian interests in these countries, but to also increase their presence and advice to those countries.

It will be easier to enter some markets than others – based on existing political and economic relationships in place. Any support the government can offer in terms of introductions and agreements between nations to offer Professional Services in other jurisdictions would be greatly welcomed. Engineering and architecture is an easily translatable service – with Australia in a position to offer world-leading design and consulting services to support major city and region shaping developments.





Real Estate & Construction

Sian Sinclair

National Head of Real Estate & Construction

1,167,200 employed in construction (Nov 17 ABS Data)

218,700 employed in rental, hiring and real estate services (Nov 17 ABS Data)

\$378,306m in sales and service income for construction (2016-17 ABS Data)

\$130,513m in sales and service income for rental, hiring and real estate services (2016-17 ABS Data)

There is a lot of noise around the property sector at the moment – and not all positive. Prices are down – but this shouldn't be a surprise when some markets (namely Sydney & Melbourne) saw unprecedented hikes in recent years. The cooling activity put in place by the regulators to combat these hikes coincided with a number of other factors. A drop in foreign investor numbers due to targeted taxing of these buyers and China's currency controls, along with a banking Royal Commission, which has wiped out any of the brashness that banks may have regained since the GFC have helped bring things back into line – perhaps at a quicker rate than expected.

Despite assurances from the bank that they have funding available, the current lending rates have been falling and the pre – election tax policies directly impacting property investors have seen a significant drop in investor activity.

If Government doesn't support the industry while it is not at its strongest this will have flow on effects to employment and residential rents. On the up side we're seeing significant commitment for State and Federal investment in city and region shaping infrastructure. While this should buoy confidence and employment opportunities, it hasn't yet rebalanced negative market sentiment. With the election result out the way and the threat of big changes in this sector now deferred, hopefully we'll see a lift in confidence and some fresh activity.

This sector is multifaceted in terms of policy – requiring cooperation between Federal, State and Local governments to achieve the right conditions for both investors and customers and to meet social needs.

I don't believe anyone would say we have found the right balance yet, but the sector is resilient and continues to work with governments to innovate and adopt new ways to stimulate the market.

Mid-sized companies in this space have an important role to play, particularly in creating hubs and unlocking housing opportunities outside of the major cities where the big companies tend to dominate. Take one of our clients, Springfield City Group – they have successfully created an award winning master-planned community with its own CBD,

Greater Springfield in South East Queensland with a planned population of 138,000 by 2030 and a target of 52,000 new jobs by that date. This project would never have been undertaken by a large multi-national, and this is why our mid-sized clients should be encouraged to thrive and innovate.

Three ways in which we can incentivise mid-sized businesses in the real estate and construction sector which will support business growth as well as community outcomes, centre around collaboration, planning and certainty.



Watch Raynuha Sinnathamby, Managing Director of Springfield City Group talk about customer-centricity as a key driver of growth



1

BETTER PLANNING AND COLLABORATION BETWEEN THE TIERS OF GOVERNMENT

The availability of land, coupled with the correct planning platform and infrastructure creates a fertile environment for investment in housing and productive communities. City Deals is a great example of what that collaboration can look like – with an emphasis on creating hubs for homes, work and employment outside of our major cities and giving a kick start to regions. Mid-sized business are nimble and entrepreneurial, many with bases in the locations that governments see opportunity to expand.

2

PUT BROADER TAX REFORM BACK ON THE TABLE

As a sector the property industry bears a hefty share of the tax burden both directly and indirectly. It's time we saw some political courage to tackle this issue and bring Australia's tax system more in line with OECD averages. For instance, in 2016 the OECD average for tax revenue from property as a percentage of GDP was 5.7%. In Australia this was 10.8%. Tax reform would allow us to redistribute where we generate tax revenue – releasing the tax burden on property and income, and ensuring we are generating the appropriate levels of tax from our goods and services (including digital goods and services).

3

PROVIDING BETTER CERTAINTY

Investment decisions around property are significant longer term decisions. From finding the right location and securing the land or existing property, designing and testing the concept through to development approvals, construction, marketing and ongoing management – the process can take many years. Industry participants need to feel confident that the economic factors such as taxes, environmental protection and planning laws that have been built into feasibility assessment will remain certain, giving them the confidence to make business decisions and progress projects. In 2012 the Brisbane City Council announced a 3-year moratorium on infrastructure charges for new four and five star hotels. Twelve projects with 963 rooms benefitted from the initiative, providing a huge boost to tourism investment. This demonstrates that when governments can provide certainty, developers are encouraged to act and provide outcomes that benefit the wider community.



Technology & Media

Simon Coulton
Partner, Technology & Media

215,000 employed in information media and telecommunications (Nov 17 ABS Data)

\$79,575m in sales and service income (2016-17 ABS Data)

Innovate or perish – if not the motto for the Technology & Media sector, it is at least the theme song to which most businesses in this space dance to. The sector is dynamic and fiercely competitive – and having a great product doesn't guarantee success.

In Australia we have a wide range of businesses in the sector – from the large and established telcos through to digital start-ups. And of course, technology is pervasive. Think about your own company – even if you don't work in the sector, you are using technology to perform better, connect and manage your processes or provide a better client experience. Think about your home and social life – how you share and connect with friends and family, how you find that perfect recipe, research a fun family holiday. All powered by technology – and refined by algorithms that learn from your online behaviour to surface information and search results most relevant to you.

More than any other sector, Technology is global – but locally we are fostering our own Technology & Media sector. It's a relatively small sector, made smaller due to our sparse population and fewer incentives to innovate and commercialise than other jurisdictions. Yet Australians are early adopters of technology and some successful technology start-ups originated on our shores, like Atlassian, Afterpay, Nearnmap and Canva.

There are some unique challenges in this sector – particularly for start-ups and the mid-sized tech companies. The ability to invest in research and development, as well as a tax system that hasn't kept up with advancements in the sector can stymie companies in this space from getting to market first, and then scaling up.



1 ACCESS TO R&D INCENTIVES AND COLLABORATION

In the tech world you must always stay just in front of the trends – and 12 months is more than enough time for a new, better, augmented product to overtake an incumbent. Innovation in the Tech sector is not a one-off project. It is continuous and it is constant. In the US, the top 15 companies for R&D spending were mostly from the Technology sector – the top spot going to Amazon which spent US\$22.6b in 2017. Many of these large companies – both abroad and locally – are largely able to self-fund their R&D and then commercialise their innovations.

For many Australian small and mid-sized technology companies looking to scale up, it's a much harder feat to achieve without government support. Australia's R&D program is a straightforward one – no tiers or preferential treatment – but could be more clear in what companies need to do, and the kinds of activities the government would like to see to be eligible for the program.

Encouragingly, the Labor Party introduced a policy designed to encourage collaboration between industry and academia – with a 10% premium available on top of the existing incentives available. We would encourage this initiative to be picked up by the returned Liberal Government. As Australia has one of the lowest levels of collaboration between industry and academia in the OECD, anything that can further this agenda is welcomed.

There is an appetite for collaboration – and some additional challenges to overcome. Academia have the research capabilities and data sets at their fingertips, and industry has the market knowledge and ability to commercialise – but the speed at which both operate can leave the tech sector chomping at the bit to beat the competition to market while researchers further refine their research. Ownership of IP is another issue that needs to be resolved when entering into formal collaborative arrangements.

2 GLOBAL COMPETITIVENESS AND A LAGGING TAX SYSTEM

Put plainly, many tech companies move overseas because they can access more funding, better incentives, and a larger market in another jurisdiction. The UK is a great example of a jurisdiction that is not only attractive to tech companies, but regularly runs programs in places like Australia to entice tech companies to move their base or list on the AIM (formerly the Alternative Investment Market).

The main corporate tax rate in the UK is 19% – reducing to 17% in 2020. Compare this to Australia's 30% – with a reduction to 27.5% for small companies. While the corporate tax rate doesn't increase company revenue – it is an incentive, alongside our stable economy and R&D program, for companies to stay and invest in Australia for the long term.

On top of that, tax legislation hasn't kept pace with technology changes. A mid-sized company (reminder we mean a company with revenue between \$50m – \$500m) can access tax deductibility on intangibles like technology over 25 years. But software doesn't last that long and could be obsolete in three years. This isn't an issue just for the Tech sector, but for any company that relies on technology. Tax reform is needed to keep pace with change.

3 MARRYING A GREAT PRODUCT WITH GREAT MARKETING

You have a great product. It fills a niche that no one else has cornered yet. It's clever and intuitive. But no one knows about it – no one is using it. This is a common occurrence in the sector – and in a noisy marketplace where there is always a new product being launched it is essential that a business is underpinned by a strong sales and marketing strategy. The experience of the product, and the client experience for issue resolution, technology updates and training can all influence whether or not a product will stand the test of time.



Its time to leverage mid-sized business

It's fair to say that we underestimate the contribution mid-sized business makes to the Australian economy. They are small in number – but are big engines for productivity, employment and tax contribution. They are the small businesses of yesterday, and the big businesses of tomorrow.

Why then, do they not receive more support to grow? A reduction in regulation complexity would help businesses to access the right concessions at the right time. Clarity around the R&D incentive program – or lifting the investment to 3% of GDP as proposed by Labor – would greatly increase businesses capacity to invest in themselves across so many industries. Investment in our Education and Health & Aged Care sectors – provides opportunities for more people to enter or re-enter the workforce. Productivity is up because people are generally healthier in body and mind.

While the election on the weekend provides us with certainty and an element of safety around what business can expect from the next three years – there is always room for progress. Some of the initiatives and concepts put forward by the Labor Party in the lead up to the election have real merit and warrant further investigation.

We would encourage the newly confirmed Government to look at how they increase access to incentives and reduce the regulatory burden on this burgeoning segment of the economy. Lowering the corporate tax rate to between 20% - 25% would make Australia significantly more competitive on a global scale. As we saw in Professor Norman's modelling – an achievable 10% boost in revenue would result in a 25% increase in company tax revenue after five years. Supporting mid-sized business would not be a hand-out.

And of course, mid-sized businesses are used to doing things for themselves – and we encourage businesses to not wait on policymakers but to chart their own path. Many of the recommendations made by our Industry Leaders can be acted upon now – look at how you can take advantage of technology to create that seamless client experience, invest where you can in R&D and look at the efficiencies that can be made in your supply chains and processes. Mid-sized business isn't burdened by legacy like many big businesses and can take advantage of scale better than small businesses. Opportunities for growth are there for the taking.



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MSB Technical Notes

Prepared by Prof Neville R Norman, Universities of Melbourne and Cambridge

Number of Mid-sized firms, by ABS Data

The statistical authority (ABS: Cat 8165.0) identifies 2,238,299 'Australian businesses' in the fiscal year 2017/2018. There are five categories of smallish firms with sales revenue of under \$10m p.a., not even covering our own definition of 'small' (up to \$50m p.a.). Of these 'small' firms, 59% by number have turnover under \$200k; 93.4% have turnover under \$2m and 98.5% have turnover under \$10m. So, by number, MSBs with turnover \$50m to \$500m, together with even larger firms are much less than 1% of all Australian firms, though they gain about 15% of business revenue and pay 19% of company tax (our estimates, explained below).

Of those identified by the Tax Office, the number is close to 950,000 (ATO Taxation Statistics, latest at 2014/15).

Technical Note on their meaning of Mid-sized Australian Businesses

By mid-sized business we mean Australian businesses with annual sales revenues (turnover) in the range of \$50m to \$500m. Even the definition of size is controversial. Some commentators, and public inquiries, such as the recent (Hayne) Royal Commission into Banking and our Financial System, definition 'large' and 'small' by employment numbers. We say that is misleading, because some huge companies have small (or middling) employment bases, and their sales, even more paid-up capital betrays large size in a more meaningful and commercial manner.

We thus reject the size definition in Small_Business_Statistical_Report-Final.pdf released by the Federal Government, (www.gov.au) based on employment. No equivalent medium-sized business report is available.

This Report is focussed on MSBs on the sales definition. Even to identify and study the features of such firms is a research exercise in itself. The Tax Office gives a number of grades of their tax and other financial or employment data but then lumps mid-sized and large firms together. The ABS figures are even more consolidated. We need technical and estimation measures to unscramble our target businesses. We have done that for this Report, making plain our methods at every stage.

Tax and Commercial Characteristics Derived from ATO data

Tax data are very detailed, a little delayed (understandably) and do not exactly match or capture the firms the subject of our investigation. Nevertheless, some very plausible inferences and estimates can be made by take the cross-corrected data collected, analysed and reported by the ATO for tax-processed companies in the annual sales ranges closest to our companies.

Using the very detailed spreadsheet data in ATO's Company Tax 2 from the latest **2016-7 Taxation Statistics**, we find for **mid-sized Australian companies** that they comprise:

- 0.46% of all ATO-processed companies [(4176+319/969,518)
- 14% of all sales [\$306.8bn/\$2,209bn = 13.9%]
- 19% of all company tax paid [\$14.1bn/\$75.5bn= 18.7%] with implied Company Tax Rate 28.6%
- 16% profit-to-sales rate [\$49.5bn/\$306.8bn]

- 18.4% ratio of cash flow to sales [\$56.4bn after adding back \$16.9bn depreciation/\$306.8bn]
- 3.4% company tax to sales ratio [data above]

By contrast, **small(er) companies** were (or contributed):

- 91% of all ATO-processed companies by number [883k/970k], and paid
- 24% of all company tax [\$18.1bn/\$75.7bn]
- 51% of all sales [\$1170bn/\$2209bn]

The data for **larger companies** processed by the ATO were:

- 8.5% of companies by number [data above by residual]
- 57% of company tax
- 35% of all sales [\$763bn/\$2209bn = 34.5%]

These findings can be summarised in the table below which is embedded in our main text.

Company size	Proportion of Companies	Share of Sales Revenue	Share of Company Tax
Small companies	91%	51%	24%
Mid-sized Companies	0.5 of 1%	14%	19%
Large companies	8.5%	35%	57%

The modelling

We take a model MSB with \$100m of annual sales revenue. All the data can be halved for the lower bound of our range and multiplied by up to five times for the upper end.

Sales revenue (turnover): \$100, the base case.

Profit: \$15m

Cash Flow (Profit, adding back depreciation): \$20m

Company tax payable: \$4.275m (28.5% of taxable profits. Note: this percentage coincides with, but is not taken because it is, the current statutory tax rate for small companies; it is the figure derived from ATO data explained in the Technical Notes.)

Our exercise is to contemplate the effects of a sustained one-off boost in business sales revenue for a 'typical' MSB operation from the averaged data. We do the numbers for one and five years ahead. The revenue boost takes place fully in the first year and is then calibrated over that year and the next four years. This time treatment allows for the economy-wide and business effects of what economists call "medium-to long-term impacts", which take us beyond simple numbers to more complex considerations.

On the simple numbers, before we address the economy-wide and industrial economics considerations, we have these data for a 10% revenue boost. Smaller or larger percentages can be computed easily by the reader. Note that sustained turnover boosts of much more than 20% from a base period are experienced by many firms in a growth phase, so this is NOT a fanciful exercise.

Data for our model MSB	One-year out (crude uplift)	Over Five Full Years (Crude)
Annual Sales Revenue	\$110m (10% boost)	\$550m (c.f. \$500m base)
Company Profits	\$16.5m (same ratio to sales)	\$82.5m (c.f. \$75m base)
Company Tax Payable	\$4.7m (28.5% net rate)	\$23.5m (c.f. \$21.4m base)
Company Cash Flow	\$21.5m (\$5m depreciation)	\$107.5m (c.f. \$100m base)

Data for a boosted MSB	One-year out	Over Five Full Years
Annual Sales Revenue	\$110m (10% boost)	\$550m
Company Profits	\$20m (profit rate boosted)	\$90m (see note below)
Company Tax Payable	\$5.7m (28.5% net rate)	\$26.7m (same tax rate)
Company Cash Flow	\$25m (\$5m depreciation)	\$135m (see note below)

We have the following corporate and economic effects over the five year period in the exercise:

Sales revenue up by 10%

Profits up by \$15m or 20%

Company tax payments increase of \$5.3m or 25%

Cash-flow of the revenue-boosted company by \$35m or 35%.

Some industrial economics

Smaller firms, called 'perfect competitors' (sic!) in basic economics, have no say in product types, prices or market quantities. Even with best cost control, market entry and exit offer no better than a basic rate of (profit) return to these firms. Most businesses in modern economies are not like this, though economics taught in most basic economics courses seldom gets much or seriously away from perfect competition.

The writer's base for analysis in this report is long consulting experience with larger companies and detailed teaching in management and graduate economics courses in five continents (both Americas, Europe, Asia and Australasia) where all relevant firms exhibit substantial market power. They can shift demand and cost curves, bring in radically-new products, make markets and usually attract corporate regulators with their market power, even MSBs.

Productivity increases manifested in unit cost reductions of over 20% pa (seldom sustained for more than a few years) have been observed in mining operations, robotic assembly operations (vehicles and other machinery) and chemicals, for instance. Profit-to-sales increases from near zero to 30% are frequent, though seldom sustained.

In addition to observing these far-from-theoretical shifts the writer has mathematically modelled them and taught them in graduate courses (alas, the details are proprietary to Universities involved.)

The data in the report are not fanciful, though they are far from generic.

(N R Norman, dated 5/5/2019)

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