NSW GOVERNMENT | Small Business Commissioner

Our reference: BN-07811-2022

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra, ACT 2600

To whom it may concern,

Thank you for the opportunity to provide a submission as part of the inquiry into the effectiveness of Australia's corporate insolvency laws in protecting and maximising value for the benefit of all interested parties and the economy.

The NSW Small Business Commissioner (the Commission) is an independent statutory office of the NSW Government. It provides strategic advice, advocacy and affordable dispute resolution services across NSW.

This inquiry provides a timely opportunity to consider whether the current corporate insolvency laws are appropriately supporting and maximising value for small businesses, and other interested parties and the economy more broadly.

Current economic conditions represent a challenging environment for many small businesses. Australia needs a set of arrangements that support small businesses to navigate and avert risks while protecting their legitimate interests.

Current economic conditions

The Commission regularly engages with small business across the State through the monthly Momentum Survey (survey) and through customer enquiries and engagement. This intelligence suggests many small businesses are facing new challenges, many of which are compounding the winding back of temporary COVID-19 financial relief measures.

The survey indicates that small business confidence levels have been somewhat subdued through the second half of 2022, coinciding with interest rate rises and persistent inflationary pressures. In the October survey, a minority of businesses (31 per cent) indicated they were confident about their individual business prospects, and a minority of business (21 per cent) indicated they were confident about their local economy.

Confidence, as per October 2022

	Confidence – in own business prospects#		Confidence – in local economy#	
	October 22	September 22	October 22	September 22
Extremely confident	6.7%	6.8%	1.7%	2.3%
Fairly confident	23.8%	22.9%	19.2%	17.1%
About the same	30.7%	30.6%	29.4%	34.5%
Fairly worried	27.9%	31.3%	39.3%	37.6%
Extremely worried	10.9%	8.4%	10.3%	8.4%
Extremely or fairly confident	**30.5%**	**29.8%**	**20.9%**	**19.5%**

Confidence figures weighted according to industry share of the small business population.

Throughout 2022 the Commission has consistently seen a range of customer enquires relating to business-to-business disputes and lease disputes, which can often indicate one party is unable to make payments. Between April 2022 and November 2022, the Commission has seen an monthly average of 102 leasing disputes and 198 business-to-business disputes. Recently payment disputes have ranged between $3,500 and $19,891.[1]

The survey also indicates broader business challenges. In the September survey, over a third (36.8 per cent) of businesses had noticed a change in payment times. Of these businesses, almost half (46 per cent) reported that it is taking their customers one month or more past the nominated due date to pay the invoice.

The October survey indicates that small businesses are concerned about the cost of business inputs, and that many are expecting revenue and profitability to decline. 83 per cent of businesses indicated that they were concerned about the costs of business inputs, 42 per cent of businesses expected a decline in profitability and 31 per cent expected a decline in revenue.

Factors influencing insolvency risks

The volume of business insolvencies has moderated since the onset of COVID-19 and the coinciding range of government support programs and initiatives. However, there are a range of factors that may mean insolvency rates for small businesses trend upwards over the coming years.

COVID-19 relief measures, in some cases, have resulted in more debts for businesses. For example, deferring of rent during COVID-19 lockdowns have increased debt, adding additional expenses for businesses that are now also experiencing inflation and interest rate increases. It is likely that COVID-19 relief measures contributed, to some extent, in the reduced number of insolvencies in 2020-21 and 2021-22.

Anecdotally, I have also heard of incidents of businesses becoming insolvent due to cash flow constraints related to delays in delivering goods and services, or supply chain challenges. While businesses have still been contractually guaranteed to receive income from delivering goods or services at a later date, they have been unable to meet their debts and have become insolvent prior to that date. For these firms, existing financial buffers have been insufficient and alternative financing options have been inaccessible or otherwise unsuited to their circumstances.

Small businesses are particularly vulnerable, as in some sectors they are often the last within a long chain of payment. For example, the risks of non-payment for small businesses and sole traders within the construction industry have been well publicised this year. As larger construction businesses become insolvent, small businesses are often owned income, and do not get paid, which in turn increases the risk of insolvency for these small businesses.

Insolvency processes

The current insolvency processes may not be providing maximum value for small businesses. Key factors are discussed below.

Lack of transparency within the existing legislation, common law, and regulatory arrangements

Currently, information advising how legislation, common law and regulatory arrangements operate and interact is unclear and difficult to navigate for many small businesses. As a result, small businesses are less likely to use government resources to understand the insolvency process and are instead more likely to rely on trusted business advisors when seeking information about their rights and obligations.

[1] Median dispute values per week, October and November 2022.

Small business would benefit from a clearer, user-focused explanation of the insolvency framework, the insolvency process, and the protections the existing legislation, common law and regulatory arrangements provide. Resources to support small businesses to proactively manage their risk of insolvency could also be considered.

Small business perceptions

There is often a perception that as insolvency practitioners are paid through the restructuring process, they are incentivised to close businesses to pay creditors as quickly as possible. This perception, whether real or perceived, means some small businesses fail to act early and engage professional advice prior to their situation worsening.

As the existing legislation, common law and regulatory arrangements are unclear, small businesses do not feel empowered to monitor the conduct of the insolvency practitioner or hold them accountable. I suggest considering measures that could instil greater confidence in the system, such as separating the diagnosis of a business' financial position from subsequent interventions (and in the event interventions are required, they can be performed by a separate insolvency practitioner).

This could include a two-step process for small businesses. An independent practitioner could first work with a small business to explain and identify appropriate alternative methods, such as mediation to address and work towards a resolution for their insolvency issues. If required, a restructuring practitioner could then undertake the restructuring process.

To support transparency and accountability, and ensure appropriate division between the two stages, mechanisms can be developed to ensure small businesses explore alternative methods, before moving to the restructuring process. For example, small businesses can formally sign to confirm that alternative methods have been discussed and explored with the independent practitioner, prior to transitioning to the restructuring practitioner.

Recent reforms

While initial uptake has been low, the recent reforms, including the small business restructuring reforms (2021) and the simplified liquidation reforms (2021) address some of the above issues, and have the potential to improve experiences for small businesses.

Positive elements of the reforms include 'debtor in possession' model, which allows the insolvent business owner to remain in charge of the business operations, while the creditors develop and vote on the restructuring plan. This supports small businesses to feel more empowered throughout the insolvency process.

Further actions should be taken to refine and improve this model so that it is optimised and fit for purpose.

Thank you for the opportunity to make a submission. If you require further information, please contact Megan Bennett, at either megan.bennett@smallbusiness.nsw.gov.au or (02) 9372 8767.

Yours sincerely

Chris Lamont
Commissioner
NSW Small Business Commission

Date: 30 November 2022