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Department of Education
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Discussion paper 'Boosting the Commercial Returns from Research' – submission by Michael Murray

I work and write in the insolvency and business reconstruction field.

The main purpose of my submission is to ensure that you are apprised of the various government, academic and other focuses on the issues your paper raises. These are the Financial System Inquiry (FSI) report, due on 8 December 2014; the government's proposed "second phase" of insolvency reform once the FSI report is released; your inquiry into promoting commercial returns from research; and the recent reference by the government to the Productivity Commission.

Background

I note from your paper that Australia has a large number of SMEs and a high proportion of firms in low to medium technology industries, such as services; that Australian business has a low incidence of new-to-market or radical innovation; and that access to finance is reported as a significant challenge for Australian innovation-active firms, in particular at the early start-up stage. You report that many Australian businesses, particularly SMEs, lag behind international best practice in several areas. You report a key message from industry is that greater regulatory and policy certainty would improve business confidence in innovation investment, and you include rules around directors' liability, crowd-sourced equity funding, bankruptcy, and taxation of employee share schemes, and early stage investments.

By bankruptcy I assume you mean insolvency ("bankruptcy" being a US term in the way you have used it); and by directors' liabilities, you may be referring to the on-going debate about directors' liability for insolvent trading.

The OECD paper - *Debtor-friendly bankruptcy laws can promote risk-taking but trade-offs emerge* – makes similar and worthwhile comments.

None of this seems controversial in terms explained by economics, or law, although the measuring of the benefit of greater regulatory and policy certainty in the areas of business rescue, by way of improving business confidence in innovation investment, would be hard to assess. There is a general perception that while our insolvency and reconstruction laws are good, the market and business has changed around them, and that Australia is lagging by international comparisons in insolvency law

reform. Certainly our knowledge of the way the system works, by way of good insolvency information and statistics, is low, and it is difficult to say with much certainty how any change to the system would impact or assist. Intuitively however, much academic and professional comment and legal analysis supports the need for a more efficient and effective regime, in particular that focuses more on business rescue than its failure. There is however only limited economic analysis or comment on the regime, in terms in which your paper explains, which would in my view be more beneficial.

In that respect, the government has now asked the Productivity Commission to examine the insolvency regime, and other issues, in order to suggest ways of "unleashing Australia's entrepreneurial endeavour" by way of removing "barriers to business entries and exits".

The government reference explains that the

"exit of inefficient firms can provide for greater allocative efficiency as their former resources can be put to higher value uses. … Cultural appetite for risk is also an important determinant of the level of business entry and exit in an economy. Business insolvency also results in losses to equity and debt holders, and to employees. Different approaches to managing insolvency can affect the efficient provision of finance and labour."

By way of brief comment on this, it was recently explained[1] how corporate insolvency law is currently dealing with inherent tensions between the need for accountability and transparency and the problems of cost and complexity and the commercial pressures to restructure businesses in financial distress in a manner that keeps costs down and produces better outcomes than liquidation or voluntary administration. However the current dialogue in Australia is an unhelpful one, based largely on themes of wrongdoing, inefficiency, cost and regulatory enforcement, rather than on a positive focus on future outcomes. In contrast, as the commentator suggests, while the insolvency profession is now more focused on helping companies turnaround and restructure rather than on cleaning up the financial mess when everything falls apart, the statutory and regulatory focus is still squarely on the diminishing number of formal insolvency appointments, a reality both in corporate and personal insolvency in Australia.

There is significant further literature and commentary along these lines if you require it.

Four inquiries

As I explained initially, there are now four inquiries into the promotion of entrepreneurial endeavour.

Firstly, the Financial System Inquiry (FSI) will be imminently reporting on this issue, on 8 December 2014 as we understand. Its August 2014 discussion paper raised a number of business rescue and insolvency related issues.

[1] Reference available.

At the same time, in releasing the ILRB 2014, the government said it was proposing a "second phase" of insolvency reform once the FSI report is released. That in itself may deal with issues like director liabilities and insolvent trading.

Then thirdly, there is your inquiry into promoting commercial returns from research, which, as I understand, is also examining our entrepreneurial approach to risk taking and business failure.

And fourthly, we now have the Productivity Commission conducting this current inquiry.

Other inquiries and reports

As well, the government has in its records many submissions made recently and over the years recommending change to the laws on insolvent trading, director conduct, tax issues, and on contractual and other moratoriums. These have been directed at improving our insolvency laws, including to promote business rescue.

In particular, the government has submissions and recommendations seeking more statistical and other analyses of insolvency and business failure in Australia. These have come in particular from academics and professional bodies, and the government's own parliamentary inquiries. At the Senate inquiry into ASIC in 2014, at the request of the inquiry for a statement of what statistical research data was needed in Australia, a number of insolvency academics put forward a detailed submission. Somewhat to our chagrin, the resulting Senate report made no comment on this submission, or otherwise.

Australia's lack of knowledge of business failure and how our insolvency laws operate contrasts with the US and the UK in particular. The former has a wealth of data on the operation of Ch 11 of the US Bankruptcy Code in corporate reconstructions, which is evident in the major review of Ch 11, the report from which is to be released on 6 December 2014.

As to the UK, in a recent inquiry into "pre-packaged" insolvency administrations, university research was commissioned "in order that [the] recommendations could be built on a solid foundation of hard evidence". The head of the inquiry noted that there was little published research available based on recent data to support (or undermine) certain preconceptions about pre-packs, and on that basis, she commissioned the university research.

Such an approach would be little known in Australia. Indeed, in Australia, I note that the FSI discussion paper of August 2014 had to rely on an earlier, year 2000, Productivity Commission report for information on business exits.

Conclusion

Apart from these background issues, I have no further comment. If you want to discuss further, please let me know. I will be interested to know the outcome of your inquiry.

Michael Murray