

Policy and Guidelines Paper

Small business definition

Preface

Small businesses are a fundamental driver of employment and economic growth. They employ 43 per cent of the NSW workforce and generate over \$411 billion in annual sales and service income. They are a dynamic and innovative force – and most importantly, they are an engine of future growth, as big businesses start out as small ones.

But small businesses are also vulnerable. They lack the resources and balance sheets of larger firms and can be disproportionately affected by regulation. Governments sometimes seek to offset these disadvantages by framing policies to support small businesses or ease their compliance burden. Yet agencies have not been provided with clear guidance on what the Government considers to be a small business.

In January 2021, the report on the statutory review of the *Small Business Commissioner Act 2015* was tabled in Parliament (“the Report”). The Report included a recommendation that NSW Treasury work with the Small Business Commissioner to develop a standard definition of small business. This recommendation arose following feedback that multiple definitions used by government departments and agencies can be confusing for small business owners.

While not recommending a single definition, this guideline provides greater clarity by setting out two preferred definitions of small business: aggregated annual turnover less than \$10 million; or fewer than 20 full-time equivalent (FTE) employees.

A single definition of small business may not be feasible or appropriate in all circumstances. This paper, therefore, provides guidelines to help agencies choose the definition most appropriate for their policy objectives.

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Note

General inquiries concerning this document should be initially directed to:
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Executive Summary

- There are two preferred definitions of small business, and government agencies should aim to adopt one of them:
 - Aggregated annual turnover of less than \$10 million; or
 - Fewer than 20 full-time equivalent (FTE) employees.
- These guidelines outline the strengths and weaknesses of both definitions to help agencies choose the definition that is most appropriate for their policy objectives.
 - The turnover-based definition is better able to deal with complex group structures, is a better indicator of a business' ability to acquire goods and services for themselves (i.e. without government support), is better when targeting labour-intensive industries and is less distortionary to business decision-making. This definition also aligns with the definition of small business used by the Australian Taxation Office (ATO).
 - The employment-based definition is less commercially sensitive, is better when targeting high-turnover industries, and aligns with some past programs and legislation, as well as with the definition most commonly used by the Australian Bureau of Statistics (ABS) for data collection.
 - There are other small business definitions used across Government programs, however these are not preferred definitions because they are generally more burdensome to comply with, less familiar to small businesses or do not align well with existing data sources.

Defining ‘small business’: guidelines

Why do we define ‘small business’?

Given their comparative lack of scale, sophistication and resources, small businesses may face unique or specific challenges (for example, disproportionate regulatory burden or limited staff with expertise in key business functions). Policymakers attempting to address these issues may seek to define ‘small business’ to properly target their policy responses.

According to the Australian Bureau of Statistics (ABS), small businesses *‘are best defined in qualitative terms and share the following characteristics: they are independently owned and operated; they are closely controlled by the owner/manager who also contributes most if not all of the operating capital, and the principal decision-making functions rest with these owner/managers’*.

Since qualitative definitions are often not simple or practical to use when implementing government policy and programs, quantitative definitions that can act as a proxy for the above mentioned characteristics are required.

Purpose

Different definitions of small business are used across Government programs, legislation, and institutions in New South Wales. This can create confusion for small businesses and make it difficult for Government agencies to know which definition is appropriate for their program or policy.

These guidelines set out the two standard and preferred definitions of small business – 1) aggregated annual turnover less than \$10 million and 2) fewer than 20 full-time equivalent (FTE) employees. The Australian Bureau of Statistics (ABS) provides annual business counts for both definitions, making it easier to cost and more effectively target programs that adopt these definitions. The specific benefits of each definition are detailed in this document to help agencies choose the best definition for their circumstances.

What are the strengths of each definition?

Turnover-based definition

One of the preferred definitions of small business is based on turnover – aggregated annual turnover of less than \$10 million. Aggregated annual turnover is all income a business earns while running a business in a given year, plus the annual turnover of all entities the business is affiliated with. This definition aligns with the Australian Taxation Office’s (ATO) definition of a ‘small business entity’ for tax purposes. Visit the ATO website for more information on key technical definitions: <https://www.ato.gov.au/business/small-business-entity-concessions/eligibility/>.

A turnover-based definition has the following advantages over other definitions:

Better able to deal with complex group structures

When using employment-based definitions, businesses that are part of, and supported by, large complex multinational group structures may qualify and receive the benefits of programs targeted at small business. These businesses do not fit the description of a genuine small business but may satisfy an employment-based definition unless affiliated groups are specifically excluded. Excluding these businesses from employment-based definitions can be complex and no agreed definition currently exists.

A definition based on aggregated annual turnover is better able to deal with and exclude these non-genuine small businesses, as there are existing ATO 'grouping rules' that aggregate turnover across the business and all entities the business is affiliated with.

Better indicator of a business' ability to acquire goods and services for themselves

A key reason government defines and targets small businesses for support is due to their more limited resources, which are needed to acquire the services and expertise to grow and become more productive.

Turnover is a better measure than employment (albeit still an imperfect proxy) of a business' ability to acquire these services and expertise. It is therefore a better indication of which businesses may need support.

Aligns with the Australian Taxation Office's definition of small business

A definition based on aggregated annual turnover will already be familiar to many small businesses as it is the definition used by the ATO for small business tax concessions.

The ATO definition allows several modifications to their measure of aggregated annual turnover (e.g. grouping rules, carve-outs for particular industries with high turnover and low profit margins) to ensure that, as much as possible, genuine small businesses are able to access support. One of the major advantages of adopting this definition is that policymakers can leverage this work and adopt these integrity measures.

Validating a business's claim to be a small business is also likely to be simpler, as businesses are required to declare if they satisfy the 'small business entity' definition in their annual company tax return.

Better when targeting labour-intensive industries

Certain industries are particularly labour intensive. In these industries, some genuine small businesses may exceed typical employment-based thresholds. If the program or policy is attempting to target industries that are particularly labour-intensive, a turnover-based definition may be appropriate.

Less distortionary to business decision-making

Where there is significant financial support or concessional treatment at stake, a small business definition based on employment could create disincentives to employ labour. A definition based on turnover avoids distorting business decisions about employing labour, leading to a more efficient allocation of resources and ultimately higher productivity.

Employment-based definition

A turnover-based definition may not always be appropriate. An employment-based definition – fewer than 20 full-time equivalent employees (FTE) – may be more suitable.

An employment-based definition has the following advantages:

Less commercially sensitive

In some circumstances, there may be commercial sensitivities associated with businesses reporting their turnover. In these circumstances, a definition based on a less commercially sensitive metric such as employment may be more suitable.

Better when targeting high turnover industries

Certain industries have particularly high turnover and low profit margins, meaning some genuine small businesses may exceed typical turnover-based thresholds. If the program or policy is attempting to target industries with above average turnover levels, an employment-based definition may be more appropriate.

Past precedents and legacy programs

Numerous programs and policies across NSW Government agencies have utilised the fewer than 20 FTE employee definition. This definition has also been commonly used by the ABS for their data collection. As a result, both policy owners and targeted businesses are likely to be familiar with this definition. Where limited benefits to switching to the turnover based definition exist, it may be more appropriate to maintain continuity by retaining the existing employment-based definition.

Other definitions

There are several other small business definitions used across different policies or programs including:

- Total/net asset value (e.g. less than \$50 million in assets for Australian Prudential Regulation Authority prudential supervision)
- Total wages (e.g. less than \$1.2 million to fall beneath the 2020-21 NSW payroll tax threshold)
- Other turnover-based definitions (e.g. \$2 million for access to the small business capital gains tax concessions)
- Other employment-based definitions (e.g. fewer than 15 employees for the *Fair Work Act 2009*, fewer than 100 employees for the *Workplace Gender Equality Act 2012*).

These definitions are not preferred because they are either less familiar to small business, more burdensome to comply with or do not align well with existing data sources. However, if alignment with legislation, or consistency with similar previous programs is the most important consideration, it may be appropriate to use one of these alternative definitions.

If the primary objective of a program or policy is to capture as many small businesses as possible, and the integrity and fraud risks of the program are low, agencies may wish to consider a two-pronged definition where a business is considered to be a small business if they satisfy either the turnover or employment criteria.

Agencies may also wish to refine or add secondary conditions to their definition to better suit the objectives of their program. Notable examples of this include 'actively trading' conditions or excluding certain types of businesses (e.g. farm enterprises, sole traders).

Verification

Where Government agencies need to verify that a business satisfies the small business definition selected, consideration should be given to the evidence available to test eligibility.

For example, businesses could provide:

- A copy of their income tax return: checking the box that they are a small business entity provides evidence aggregated turnover is less than \$10 million
- Extracts from a payroll system to support claims that a business has fewer than 20 FTE employees.

Further information and contacts

For further information or clarification on issues raised in these guidelines, please contact:

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This publication can be accessed from the Treasury's website <https://www.treasury.nsw.gov.au>.