

Does evaluation practice in New Zealand sufficiently take into account the perspective of small business?

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Abstract

There is a significant body of evidence in the international literature, which suggests that regulations and changes in legislation can be major impediments to small businesses' abilities to grow and flourish. There is also evidence that regulations and well-intentioned social policies can have negative impacts on small businesses' hiring practices and the culture within workplaces.

Despite one international study by the World Bank (2008), which suggests that New Zealand fares relatively well when compared to other countries in relation to regulatory burden on businesses in general, this paper questions whether sufficient emphasis is being placed on determining the impacts of social policies and government regulations on small businesses in New Zealand; and it proposes areas of enquiry that evaluators and social researchers should consider when designing the frameworks of their evaluations.

Introduction

As noted in the publication *Behavioural analysis for policy: New lessons from economics, philosophy, psychology, cognitive science and sociology* (Ministry for Economic Development, 2006), one of the flaws of the neoclassical economic model is that it assumes that all individuals have complete information about goods, services or states of the world, and will therefore always be able to make decisions appropriately. Another flaw in the model is the assumption that all individuals act completely rationally or in a logical and consistent manner (e.g. they make decisions based upon a careful assessment of the facts at hand, rather than based upon emotions or other subjective criteria).

In reality, people can (and often do) misjudge the costs and benefits of their actions, for better and for worse. Economic behaviour theory posits that this can be the result of a combination of issues including poorly thought out logic (sometimes due to variability in the cognitive abilities of some members of society), that some individuals will always react impulsively and/or respond based upon their feelings and emotions, while others make judgements based upon their personal beliefs and morality systems, regardless of the evidence that is presented.

As such, there will always be a need for governments to develop policy, enact legislation and put regulations and guidelines in place to:

- ◆ Protect individuals and vulnerable groups from exploitation and risks to their health.
- ◆ Promote fairness and ensure public safety.

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- ◆ Correct for market failures (a prime example being the recent issues facing parts of the New Zealand financial services sector).
- ◆ Stimulate innovation and investment (e.g. patent regulations and guidelines regarding intellectual property). An example of such initiatives is the recent funding announcement to stimulate research and development in the agriculture sector.
- ◆ Boost productivity by promoting healthy competition.
- ◆ Promote employee welfare.

In the context of businesses and the economy, decision makers within New Zealand enterprises need to be knowledgeable and navigate through myriad regulations and guidelines² that touch on areas such as:

- ◆ Tax compliance, and accounting practices.
- ◆ Environmental legislation and the Resource Management Act (1991).
- ◆ Operating licensing requirements.
- ◆ Import and export trading requirements and tariffs.
- ◆ Intellectual property.
- ◆ Guidelines for quality of goods and services.
- ◆ Working conditions, including health and safety.
- ◆ Employment contracts, employee participation and dismissal regulations.
- ◆ Equality legislation, to promote equitable, safe and peaceful working environments.

However, there is a significant international research evidence-base that suggests regulations and government policies can stifle businesses by removing incentives and imposing costs (i.e. the time and dollars associated with compliance), creating implementation delays (as a result of licensing practices, resource consent application processes, etc.) and instilling uncertainties about the future business environment.

There is also evidence to suggest that the nature of regulations can create disincentives for new businesses to start-up, discourage existing businesses from expanding, growing their customer base or moving into new markets (Small Business Service, 2004).

² The New Zealand Small Business Advisors Group in its annual reports to Government has raised many of these issues (2004, 2006, 2008).



Similarly, it is known that in some countries, regulations and social welfare policies can have negative flow-on effects on participation in the labour force, and workplace cultures and hiring practices. For example, a World Bank study of 130 countries in 2003 found that higher degrees of regulation are associated with higher rates of unemployment, and lower rates of entrepreneurship among women and minority groups (Small Business Service, 2004).

How New Zealand compares internationally

One international study suggests that New Zealand appears to fare well in relation to the number of regulations that its businesses face. In the most recent release of the World Bank's study *Doing Business 2008 - Comparing Regulations in 178 Economies* New Zealand was ranked number two (behind Singapore) on the "ease of doing business index", which looks at the number of regulatory hoops that businesses must go through to launch, operate, and/or wind-up a business enterprise.

However, examination of the methodology of the *Doing Business 2008* survey found that it was completed by local lawyers and public officials (not business owners themselves) and to make the data comparable across other countries (in particular with the super-economies of the US, Japan, and Western Europe) the survey is based upon a hypothetical case study wherein regulations and compliance issues are assessed for a business that:

- ◆ Is a limited liability company.
- ◆ Operates in the country's most populated city.
- ◆ Operates in the manufacturing sector.
- ◆ Has more than 200 employees.
- ◆ Is subject to collective bargaining agreements, wherein more than half of the manufacturing sector is covered, and all other firms not party to the agreements still apply their terms.
- ◆ Abides by every law and regulation, but does not grant workers more benefits than mandated by law, regulation, or its collective bargaining agreement.

But to further put the results from the *Doing Business 2008* into context, based upon Statistics New Zealand's estimates there are only 381 manufacturing businesses in New Zealand with greater than 100 employees. Additional inquiry found, however, that it was not possible to discern how many manufacturing businesses in New Zealand have more than 200 employees (covered by a collective bargaining agreement), are based in Auckland, are both knowledgeable of, and abide by, every law and regulation, but do not grant workers more benefits than mandated. Therefore, New Zealand's ranking as being the "second most easy country to do business in" could be viewed with a fair degree of scepticism.



The importance of small businesses and their role in the New Zealand economy

The international literature points to a significant research evidence base that the impact of legislation and government regulation on small businesses can be particularly onerous.

Research in the United Kingdom has estimated that compliance costs for businesses employing fewer than 20 people are at the very least 35 percent higher per employee than for larger businesses (Small Business Service, 2004). Separately, the OECD (2003) has estimated that the regulatory burden on businesses with fewer than 20 staff is five times greater than that on businesses with more than 50 staff, and one of the reasons for this is that in small businesses, and particularly those with fewer than ten staff, regulatory responsibilities are dealt with primarily by the owners of the business.

Putting this further into a New Zealand context, most New Zealand businesses are small businesses (96 percent of all businesses in New Zealand have fewer than 19 employees), and more than one third of all New Zealanders (37 percent) who are currently employed work for a small business with fewer than 19 employees (Table 1 below).

Table 1: New Zealand Enterprise Demographics

Employer Size (based on employee numbers)	Enterprises	Employee counts	Percentage of employed New Zealanders
0	219,964	-	11.1%
1 to 5	80,607	189,810	20.6%
6 to 9	18,015	130,040	27.2%
10 to 19	15,090	202,350	37.4%
20 to 49	8,172	241,160	49.5%
50 to 99	2,309	158,830	57.5%
100+	1,934	843,250	100.0%
Total	346,091	1,765,440	

Source: Statistics New Zealand 2007.

Small businesses, also contribute significantly to the New Zealand economy, and in particular to provincial economies by creating and maintaining employment in smaller non-urban centres through the production of goods and services that are used by the local community, as well as supporting families and stimulating further economic activity through their payrolls.



Some evidence of the scale of the issue for small businesses in New Zealand

Recent research completed by Research New Zealand³ with small businesses found that:

- ◆ Fifty-five percent of small businesses reported that dealing with compliance issues, business regulations and government departments was difficult for them, and 21 percent reported that compliance was the most difficult issue and at times made them consider “throwing in the towel”.
- ◆ Thirty-three percent of small businesses that employ between two and 19 staff found it difficult to set up appropriate health and safety systems to meet their obligations.
- ◆ Relatedly, 11 percent found registering with ACC was difficult, while six percent had difficulties registering for GST with the IRD.
- ◆ One quarter of businesses (24 percent) reported that dealing with government departments (other than ACC and IRD) was difficult.

These results are similar to those found by a UK study (Small Business Research Trust, 2001), where one in five small business owners reported that regulations for businesses were the most significant problem facing their enterprise (particularly in the areas of tax compliance, employment law and licensing arrangements), and one in three said that regulations and red tape were such significant barriers to them that they seriously considered not continuing with the business.

Many New Zealand small business owners and operators also feel that they receive poor service from the government agencies and local authorities that they are required to deal with in the course of running a business. To further highlight this issue, when queried about the service they received from specific government agencies that they had to deal with, the Research New Zealand study found that:

- ◆ Twenty-seven percent of small businesses rated their interactions with ACC as being poor (i.e. between zero and four on an 11 point scale where ten equals excellent).
- ◆ Fifteen percent rated the IRD poorly.
- ◆ Thirty-four percent rated the service they received from their local council poorly.

While it is not known whether small business people perceive that the difficulties they encounter when dealing with government agencies are better or worse than what they have been in the past, it should be noted that the perceptions among small business owners of poor service levels in government departments is not just a case of them being a bunch of ‘haters’, as just nine percent rated the bank they regularly deal with poorly.

³ *Shattering the SME Myth* (to be published in 2008).



Areas where evaluation activities could add significantly towards developing a thriving and healthy business environment in New Zealand

While the New Zealand Government has sought to reduce compliance costs for New Zealand⁴, the potential impact of government regulation goes beyond the burden of compliance for the business sector.

For example, many recent policy and legislative changes have been put into place over the past several years to protect workers' rights and improve their work-life balance, such as changes to the Paid Parental Leave Scheme (under the Parental Leave and Employment Protection Act 1987), the implementation of the Holidays Act 2003, and legislative changes to the Employment Act, which came into effect this month, wherein employers must consider carers' requests for flexible working arrangements, regardless of industry type or workplace size.

Other areas where government legislation and initiatives can have an impact on businesses include New Zealand's taxation scheme, the Resource Management Act (1991) and health and safety regulations (i.e. the ACC scheme and the Health and Safety in Employment Act 1992)⁵.

While it is likely that many government regulations and initiatives result in positive impacts and outcomes for New Zealand workers, their families and the communities they live in, one question is whether sufficient effort is being placed on also identifying the impact of such legislation on businesses, and in particular workplace practices and culture.

This is not to say that work is not being done in this area. One notable example, is the three-staged evaluation conducted by the Department of Labour regarding the Paid Parental Leave Scheme. As part of its activities, it sought to assess employers' attitudes towards the scheme and their perceptions of workers who availed themselves of it.

Similar work is planned in relation to the Employment Relations (Flexible Working Arrangements) Amendment Act (2007) to assess the impact of requiring employers to consider caregivers' requests for flexible working arrangements such as being able to regularly vary their start and finish times at work.

The argument can be made, however, that in some cases our evaluations of initiatives such as these are not going 'deep enough' in assessing their impacts on workplace productivity and workplace culture.

⁴ For example, in 2005 Government made changes to the Financial Reporting Act 1993, wherein the *exempt companies system*, which allows certain small to medium sized enterprises (SMEs) to produce financial statements in a simple format, was extended to a "two out of three" test for companies with annual turnovers of either less than \$2 million, less than \$1 million in assets and/or five or fewer full-time equivalent employees.

⁵ A working paper by the Kauffman-Rand Centre for the Study of Small Business and Regulation suggests that there is evidence that some workplaces in the United States avoid adding permanent employees when they are close to an employment threshold for particular health and safety regulations.



For example, to what degree has work been done to establish whether initiatives such as the Paid Parental Leave Scheme, or Flexible Working Arrangements lead to an increase in 'subjective' hiring decisions by employers (i.e. discriminatory hiring practices, wherein women of childbearing age or those with carer responsibilities are disadvantaged), or resentment among co-workers who either cannot or choose to not avail themselves of such schemes?

A study completed for the Department of Labour (Fursman, 2006) found that 31 percent of New Zealand workers believed that some people experience negative impacts in the workplace for taking-up flexible working arrangements including: being resented by other workers (noted by 44 percent of the sub-sample), having difficulties in advancing their careers (noted by 38 percent of the sub-sample), finding their pay rates do not go up as quickly as those who do not use flexible working arrangements (noted by 32 percent of the sub-sample). Similarly, almost 60 percent of all workers surveyed reported that there were significant aspects of their workplace culture that made work-life balance harder to achieve, particularly the expectations of colleagues, workmates, managers and supervisors.

Another example of a very well-intentioned government initiative that could have unintended negative impacts on the viability of some small businesses was extending the Free Early Child Education (ECE) Policy to provide up to 20 hours per week of free education to three and four year old children in teacher-led ECE services. In 2007, the Ministry of Education commissioned a study into the early effects of the implementation of the Free ECE policy, wherein evidence was to be sought about the effects of Free ECE on participating services' practices, policies, costs and revenues.

Again, an argument could be made that the scope of the study was not sufficiently broad. For while it was clearly stipulated in the Request for Proposal for this work that evidence should be sought regarding *whether, how and why revenue and costs have changed for services as a result of implementing the policy*, it was not specified that the study should also assess the degree to which increased costs exceeded businesses' abilities to increase their revenue. Nor did it seek any evidence of whether it had negatively affected teachers' workloads, or whether some business owners were considering 'opting' out of the scheme. Therefore, an opportunity to ascertain early evidence of the policy's likely impacts on the mid-term viability of some businesses in the sector (and hence its abilities to meet levels of demand in the market) was lost.

One particular area of enquiry where one might hope that significant work will be done in the future is the impact of compulsory employer contributions to the KiwiSaver scheme, as the Government has found that in some workplaces, employees who participate in the scheme are at a disadvantage, when compared with employees who do not participate in it, when their employers consider pay rises for staff.

So, a well-intentioned policy that was intended to ensure people have greater levels of savings to draw on in the future may actually be resulting in some people being paid less than they would be, if the policy had never been put in place.



Similarly, as government policies and regulations around carbon emissions and emissions trading schemes take shape, these should include plans to evaluate whether too onerous a burden is being placed on different sub-sectors of industry as to affect the long-term viability and competitiveness (both domestic and international) of New Zealand businesses. For example there is a risk that regulatory pressures to limit carbon emissions in the Primary Production Sector could inhibit growth in certain types of agriculture and horticulture businesses, which could have long-term repercussions for the viability and diversity of small-towns and rural areas New Zealand, particularly given their historically reliance on the agriculture sector contributing disproportionately toward their local economies.

What is happening in this space internationally?

Despite the fact that some work is being done by government regarding the impact of regulations and government policy on the business sector, there are several governments in the OECD that have embraced the concept of assessing regulatory impacts on businesses (and in particular small businesses) to a greater degree than has occurred in New Zealand to date.

For example, in recognition of the fact that compliance with business regulations and policy changes often burdens smaller firms disproportionately, the New South Wales Government (Department of State and Regional Development, 2008) has set up a taskforce to undertake a review on a sector-by-sector basis to examine:

- ◆ Regulatory controls that impose administrative burdens on small businesses and create unintended consequences (particularly for businesses starting-up or trying to expand).
- ◆ Opportunities for agencies and businesses to apply technology to reduce the administrative burden of regulations on small businesses.
- ◆ Identify overlapping, duplicative or inconsistent regulatory requirements created by various pieces of active legislation.
- ◆ Identify domestic and international best-practice approaches that could be applied in New South Wales.

In 2004, the Government of Ireland commenced a pilot of the Regulatory Impact Analysis tool (RIA) to assess the likely effects of proposed legislation, new regulations or regulatory changes⁶. The tool was subsequently used to assess the impact of proposed pieces of legislation and changes to regulation by a number of government departments including the:

- ◆ Department of Health and Children.
- ◆ Department of Justice, Equality and Law Reform.

⁶ As of July 2005, the conducting of RIAs was compulsory for policymaking and regulatory agencies in twelve of the twenty-five Member States of the European Union (Department of the Taoiseach, 2005).



- ◆ Department of Enterprise, Trade and Employment.
- ◆ Office of the Revenue Commissioners.
- ◆ Department of the Environment, Heritage and Local Government.

In addition to using the tool to ascertain whether or not a new regulation will have the desired impact, the Irish Government sought to identify any possible side effects or hidden costs associated with regulation, quantify the likely compliance costs for businesses and individual citizens, and clarify the costs of their enforcement to the State. As a result of the pilot, the Department of the Taoiseach (the Prime Ministry of Ireland) recommended that a full RIA be conducted by all government departments and regulatory agencies whenever there are questions around proposed regulations and/or legislative changes that could:

- ◆ Involve a significant policy change in an economic market.
- ◆ Have significant negative impacts on national competitiveness.
- ◆ Disproportionately impinge on the rights of citizens.
- ◆ Have significant negative impacts on the socially excluded or other vulnerable groups.
- ◆ Impose a disproportionate compliance burden on businesses (and/or individual citizens).

In British Columbia, Canada, the regional government has also done significant work to assess the impact of regulatory compliance on local business, and small businesses in particular. As a result, they have implemented a programme of regulatory reform and simplification (Ministry of Small Business and Revenue, 2007).

Summary and conclusion

Most people understand that the intentions of governments' regulations and social initiatives are to address market failures, promote fairness, and ensure public safety.

It is, however, to everyone's benefit that it become common practice to give greater consideration to whether well-intentioned regulations or initiatives act as barriers to the start-up and growth of businesses, impede productivity and/or competition, contribute towards accelerating business failure rates. As any such impacts will likely have negative flow-on effects on our national competitiveness, as well as limiting the viability, diversity and choices that are available to New Zealand citizens and residents.

Given the growing body of international evidence that small businesses are impacted to a greater degree by legislative and regulatory change, and the importance of small businesses in contributing to the wealth and health of the New Zealand economy and New Zealanders, it is hoped that in the coming years government will provide greater opportunities for evaluators and their work to contribute towards this issue and assist New Zealand in:



- ◆ Developing better regulations and policies that minimise burden and compliance on businesses, but still deliver positive economic and social outcomes.
- ◆ Building an enterprise culture and knowledge economy.
- ◆ Encouraging more enterprise in disadvantaged communities and under-represented groups such as women, Māori and Pacific peoples.
- ◆ Improving small businesses' experiences of government services.

As for our role in the process, as researchers and evaluators we should be asking ourselves a few simple questions when in the scoping and design stage of an evaluation⁷.

1. Does the regulation, initiative or policy apply to businesses or affect the business environment in which they operate?
 - a. If yes, than an assumption should be made that any compliance costs in this area may fall disproportionately upon small businesses.
2. Are the levels of up-take of an initiative or compliance levels with new or changed requirements unlikely to be high unless the practicalities confronted by small business people are fully taken into account?
3. Will the regulation/initiative/policy change lead to an increase in small firms' overheads, that is likely to result in significant price rises for customers and consumers, or other unintended flow-on effects such as limiting consumer choice or limiting New Zealand's international competitiveness?
4. Does this policy/initiative/regulation involve an issue that is driven by peoples' behaviour in the workplace (either business owners and/or their employees)?
5. Relatedly, is it likely that some business owners or their employees will respond to the policy/initiative/regulation in an undesirable manner, which will either defeat the intentions of the intervention, and/or result in some other negative impact to workplace practices and/or culture?

If the answer to any of these questions is yes, consideration should be given to whether the evaluation needs to factor in the impacts of the intervention on business productivity, practices and the workplace culture as part of its framework.

⁷ The proposed questions for evaluators and researchers have been derived and adapted from a number of sources: Department for Business Enterprise & Regulatory Reform. (2007, September). *Small firms impact test: Guidance for policy makers*. The Author; Department of the Taoiseach. (2005, July). *Report on the introduction of regulatory impact analysis*; Small Business Service. (2004, January). *A government action plan for small business: Making the UK the best place in the world to start and grow a business: The evidence base*; Report on the introduction of regulatory impact analysis. Victorian Government. (2007?). *Small business: Regulatory impact assessment manual*.



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