Bridge the Gap

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REST Industry Super

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Foreword

What defines an entrepreneur in the 21st Century? Is it someone who works on disruptive technology from their basement, or someone who is breaking the mold in an established industry, starting out on their own because they believe they can do something faster, smarter, or with more skill independently than they could as part of a company?

Because while many Australians may regard an entrepreneur as the former, our experience does not hold true with this stereotypical image of the entrepreneur.

Every day at REST we work with entrepreneurs from all walks of life, and the defining factor between them is the ambition, courage and willingness to take on challenges to deliver on what is important for them. This entrepreneurial mindset is incredibly critical for the future economic success of our country, so we set out to see if our experience was reflected across the country, and to find out what drives and motivates these entrepreneurs.

Our research bore true to our daily experience of working with entrepreneurs – less than 1% of respondents to our research fit the stereotypical 'entrepreneur' working in a disruptive technology industry. Because in truth, it is the 99% of entrepreneurs who sit outside this stereotypical description who are driving Australia's economic growth, representing the lion's share of total employment in Australia. Using small and medium enterprises (SMEs) as a rough proxy for entrepreneurs, these innovators account for 68% of employment in Australia, with large, established, businesses accounting for 31%.

According to the Department of Industry and Science, these young SMEs generate the largest share of total job creation in the economy, producing 40% of new jobs in Australia between 2001-2011.

This means that entrepreneurs are responsible for helping to ensure the livelihood and income of millions of Australians, but are they looking after their own financial wellbeing? Do they have adequate insurance cover should they be injured and unable to work? Is their comfortable retirement entirely dependent on finding a buyer for their business, or are they saving towards their retirement as well?

We also know that concerns about attracting and retaining the right staff are keeping SME owners and managers up at night, so we set out to identify how superannuation can be leveraged to help increase the employer value proposition.

The findings from this aspect of the research are compelling – SME employees are conscious of the need to save for retirement, and see their employer going above and beyond the Superannuation Guarantee as a valuable addition to the employer value proposition.

I hope that you find this research insightful and valuable in shaping how you think about and frame both your own retirement, and the critical role you play in helping your employees on their life journey.

Damian Hill
Chief Executive Officer
REST Industry Super

1. Parliament of Australia – Statistical Snapshot: small business employment contribution and workplace arrangements – 2 December 2015
2. Office of the Chief Economist - The employment dynamics of Australian entrepreneurship – September 2015

Key Findings

One in five SME owners believe their business could not survive for a week in the event of their unplanned absence

Only 32% of SME owners consider superannuation to be critical in their retirement

55% of SME owners consider the sale of their business important in funding their retirement

82% of SME owners believe it is the responsibility of their employees to choose the fund that is right for them

Four in five permanent employees regard an additional employer contribution to salary as very attractive

Three in four employees find an employer paying for income protection, TPD and life insurance cover within superannuation to be attractive

72% of SME owners and managers are male

63% of entrepreneurs consider it risky to start a business, opposed to 82% of the general population

18% of SME owners have insufficient insurance to protect their income for more than a week if they are unable to work

Introduction

The growing number of new Australian technology start-ups taking on established industries suggests that the entrepreneurial spirit is alive and well in this country.

For most Australians, today's crop of young, tech-savvy disruptors working out of a garage to create the next Facebook, Apple or Amazon is the very definition of 'entrepreneur'. But the reality is very different. According to recent Government research , entrepreneurs – that is, business founders and owner-operators - come in all shapes and sizes, and by no means conform to a single stereotype. Indeed, the average entrepreneur today is older, experienced and likely to be working in a mature industry.

We also know that entrepreneurs employ around 4.7 million Australians. This means they are making decisions about superannuation that affect the retirement of a significant number of people.

So many Australians having a stake in successful entrepreneurship and business stewardship begs the question: are Australia's business owners acting in the best interests of their employees? And, are they taking a prudent approach to preparing for their own retirement and managing risks to their business, such as being unable to work for an extended period?

We know that in Australia's system of compulsory superannuation, many employees rely on their employer to choose the superannuation fund to which their super contribution is to be directed. Given the potentially significant implications of this simple decision, are business owners exercising appropriate diligence in choosing a suitable fund for their staff? Further, could superannuation be used as a tool for attracting and retaining talent and thereby gaining a competitive advantage?

Given the growing place that entrepreneurialism and business ownership occupies in Australia, these questions have far-reaching implications, not only for business owners and their employees but for governments and the wider Australian community.

As one of Australia's largest superannuation funds by member, REST Industry Super takes a keen interest in the health of this country's superannuation system and the retirement savings within it.

This report, *Bridge the Gap*, explores in more detail the nexus between entrepreneurship in Australia, superannuation and retirement adequacy, and the potential for superannuation to be used as a tool for improving the employer value proposition.

3. Office of the Chief Economist - The employment dynamics of Australian entrepreneurship – September 2015 (Parliament of Australia http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/rp1516/Employ)

Attitudes toward business ownership in Australia

For the purposes of this study entrepreneurs are considered to be SME owners who own or part-own a business with between 1-199 employees.

Given this broad definition, it is instructive to probe what the common attitudes and preconceptions are toward entrepreneurship and business ownership among a wide cross-section of the population.

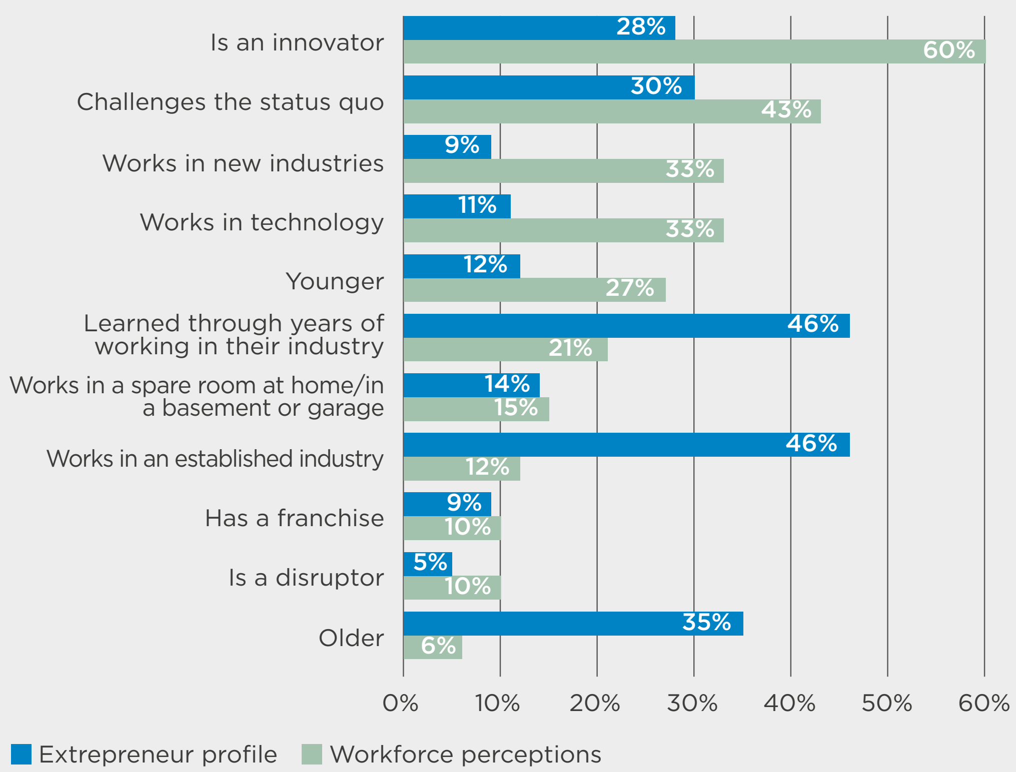
Today's entrepreneur/business owner – popular myth versus reality

It turns out that the images most people associate with the word 'entrepreneur' do not always match the reality.

This research shows that when most people think of an entrepreneur, they visualise an innovator challenging the status quo, someone working in technology or 'new' industries and, typically, younger. In fact, the typical entrepreneur is older, working in an established industry and likely to have learned through years of experience in their industry.

Where perception and reality do meet is the entrepreneur's typical place of work – at home, in a spare room or in their garage.

Description of entrepreneurs versus workforce individuals

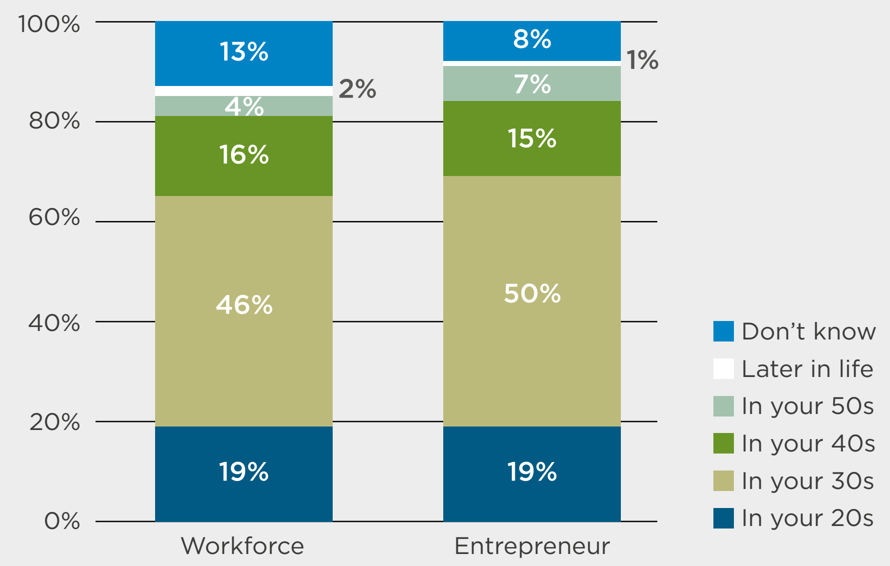


What's the best life-stage to take the plunge into business ownership?

The general workforce (46%) and business owners (50%) seem to agree that the best time for someone to launch into entrepreneurship is in their 30s, when they have some experience - and capital - to their name.

A smaller equal number from both groups (19%) believe that the 20s are the best time to move into business ownership, perhaps because with fewer dependent family and other obligations at this stage of life the consequences of failure are less significant. A smaller percentage of people still believe the best time to take ownership of a business is in their 50s or later.

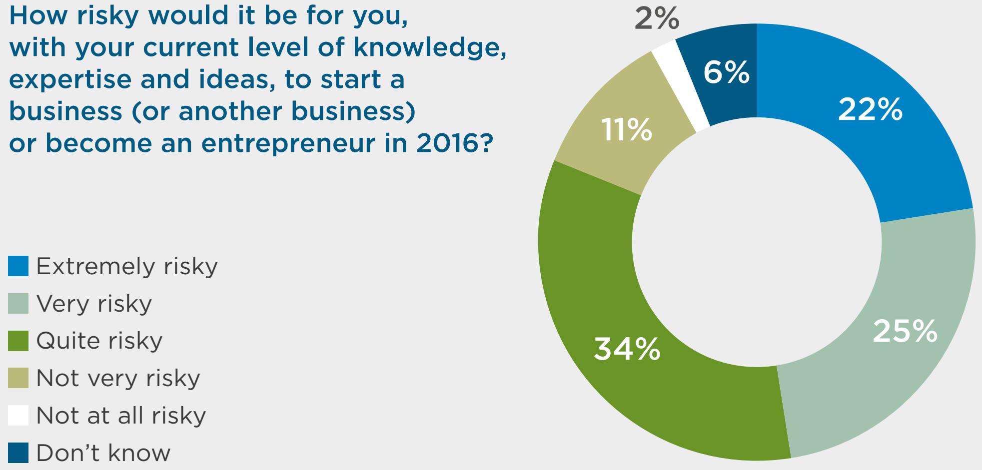
The best times to become an entrepreneur, a business owner or purchase a franchise

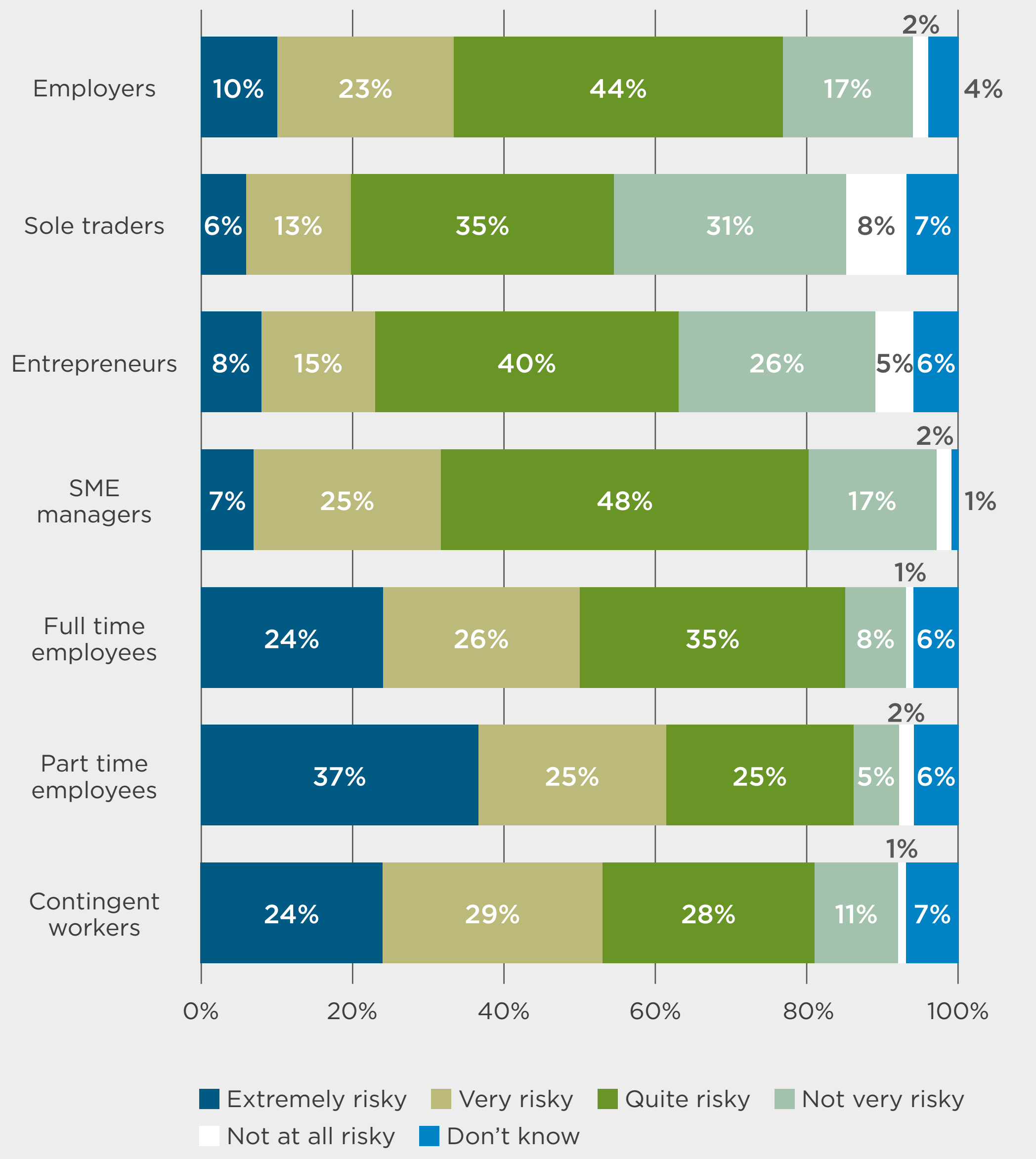


Perceived risk associated with taking ownership of a business

According to the REST research, while most of us acknowledge that taking ownership of a business comes with risk, the perceived degree of riskiness varies. Amongst the workforce, 82% consider it risky and 48% very risky. Entrepreneurs themselves, however, are less likely to see their chosen path this way: 63% consider business ownership risky and just 23% consider it very risky.

How risky would it be for you, with your current level of knowledge, expertise and ideas, to start a business (or another business) or become an entrepreneur in 2016?



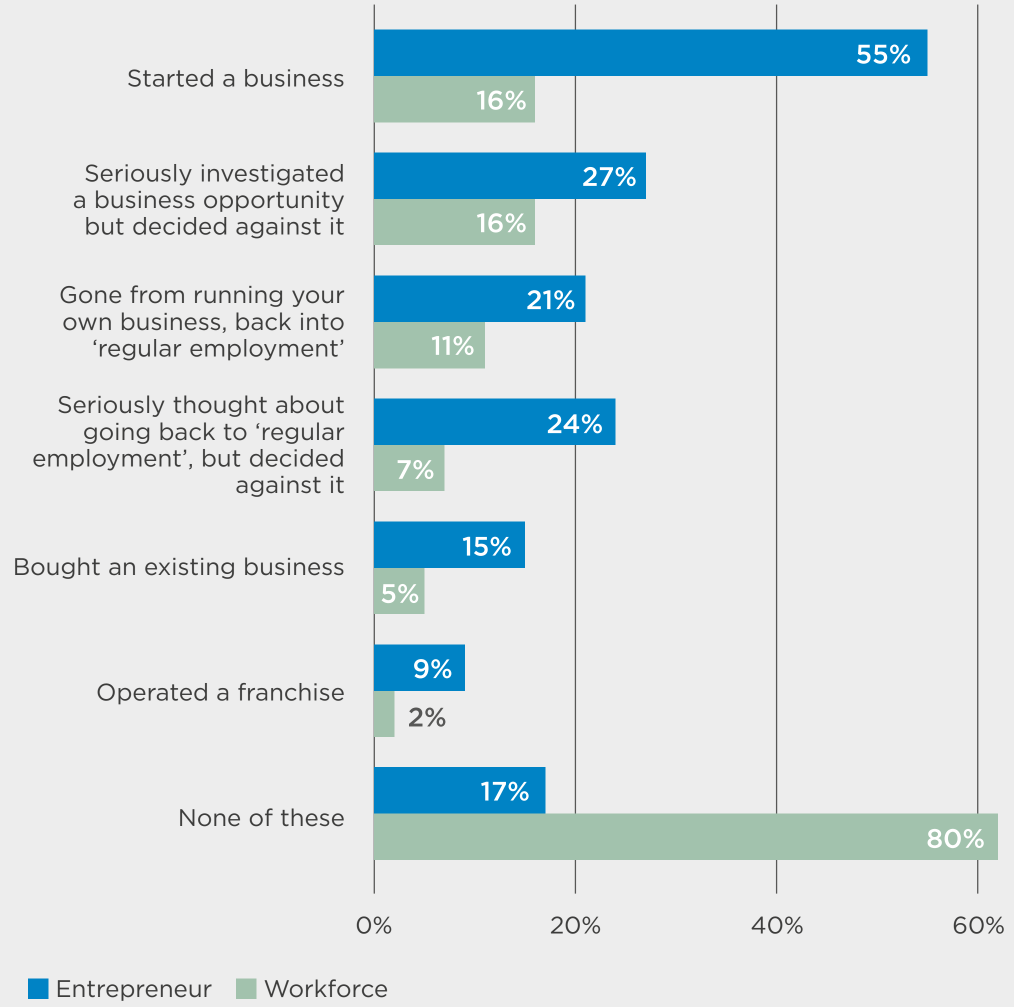


Breadth of business ownership experience in Australia

The research suggests that people with experience starting and owning businesses are well represented in the general workforce. Some 38% of employees have tried their hand, or at least dabbled, at becoming an entrepreneur. Nearly one in six (16%) respondents have started a business and a similar proportion have closely investigated a business opportunity before deciding against it.

It was also found that people with experience of running their own business are present throughout the workforce, currently making up 11% of all salaried workers. Some 21% of entrepreneurs have gone back to short-term or long-term employment at some point.

Business ownership experiences



How well are SME owners protecting their livelihoods?

The issue of underinsurance – for loss of life, serious injury or impairment, or damage to property – in Australia is well understood, a need most recently highlighted during the Blue Mountains bushfires of 2013.

Most studies canvas the general workforce, with a strong skew toward wage and salary earners, concluding that the average Australian is at significant financial risk should a catastrophic event arise.

The extent to which business owner-operators are responsible for employment in Australia begs the question: how exposed are they to an event that leaves them unable to continue operating their business? Sudden death, injury or impairment of a business owner could see their business at risk of severe damage, if not collapse, with consequences for their own family, their employees and the company's suppliers.

REST's research reveals that Australia's SMEs are in fact exposed to the loss or temporary incapacity of their owners. Moreover, this exposure is not being adequately covered by appropriate insurance. Is this complacency on the part of SME owners simply a lack of awareness of the risks or is the perceived cost of cover prohibitive?

Either way, there is a case for Australia's small business owners to be made aware of the need for this insurance and the options for obtaining it.

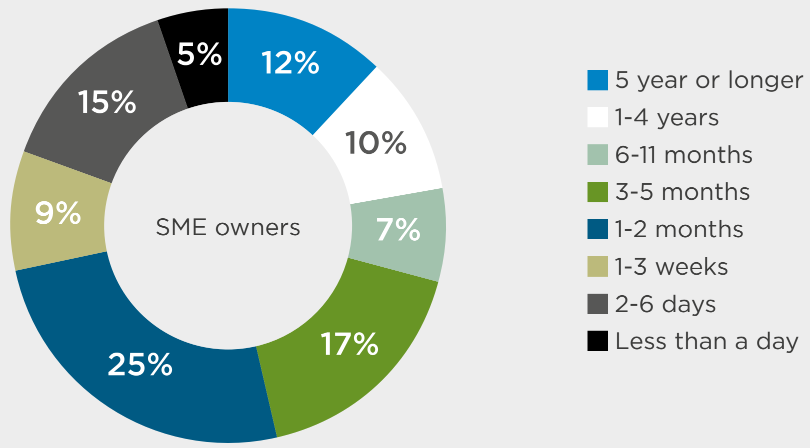
How long could SMEs survive without their owner?

It is not surprising that the successful operation of many small businesses relies heavily on the pivotal role played by the owner. Owners understand their business better than most other people and typically have the closest relationships with customers and suppliers. If the owner is unable to work for an extended period of time, business operations will be severely affected.

REST asked business owners how long they felt their business could survive (that is, remain profitable) in their absence. Based on their responses, the answer is: not for long. An alarming one in five SME owners believe their business would be unable to support their livelihood for a week, 29% say it could not last for a month and 72% would not be sustained for more than six months.

Female SME owners seem slightly less exposed, with 67% of women business owners saying their business would be profitable for less than six months, compared to 73% for their male counterparts.

Length of time an SME owner's business could remain profitable enough to pay expenses without their input and without relying on insurance

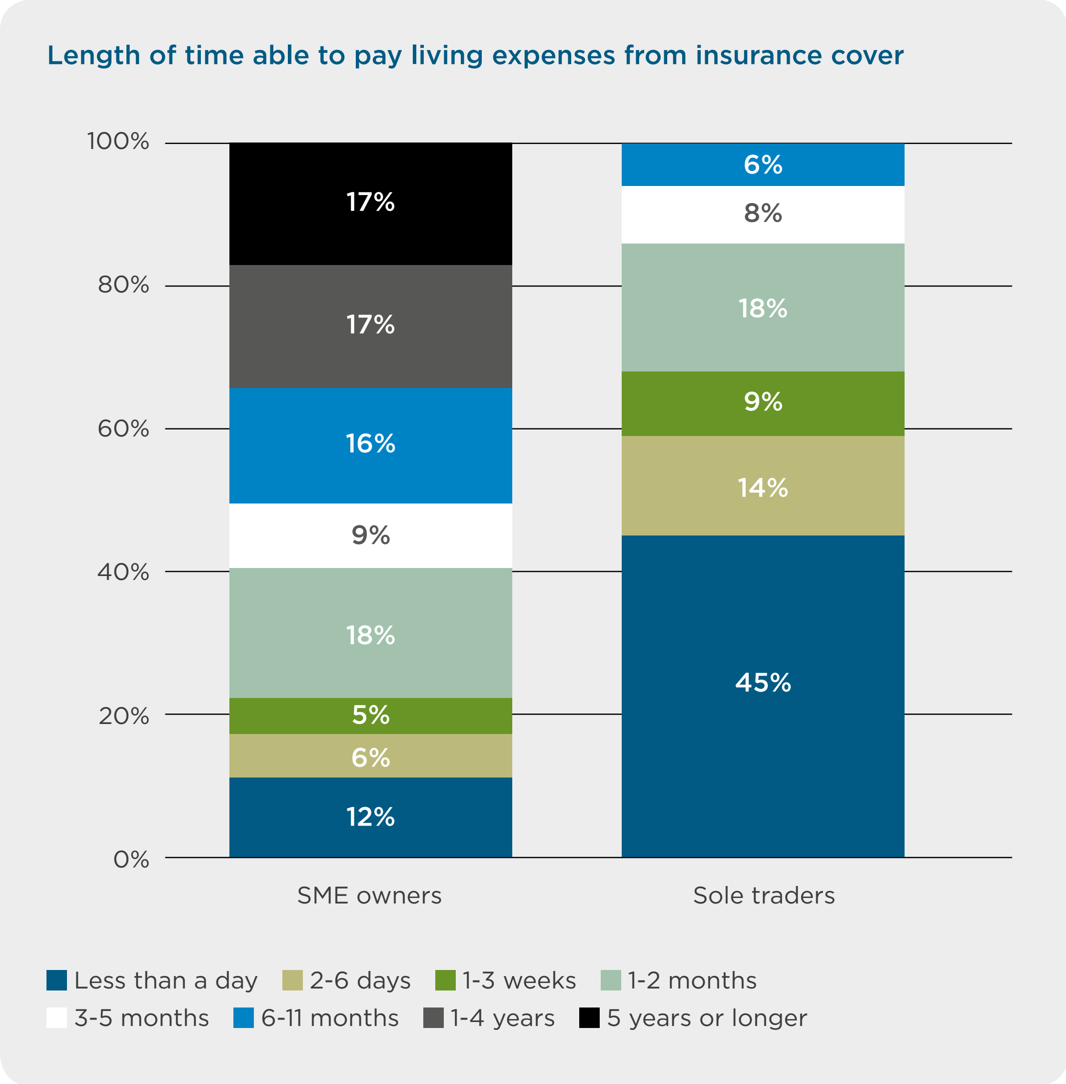


Are SME owners insured for loss of livelihood?

While the research shows SMEs are indeed exposed to the risk of lengthy, unplanned absences on the part of their owner, this risk is not being covered by appropriate insurance.

Almost one in five SME owners believe their insurance would be unable to support their income for a week, 23% believe it would be exhausted within a month, and 50% within six months. Men are more exposed, with insurance cover likely to expire in less than three months for 42% of male respondents compared to 36% of women.

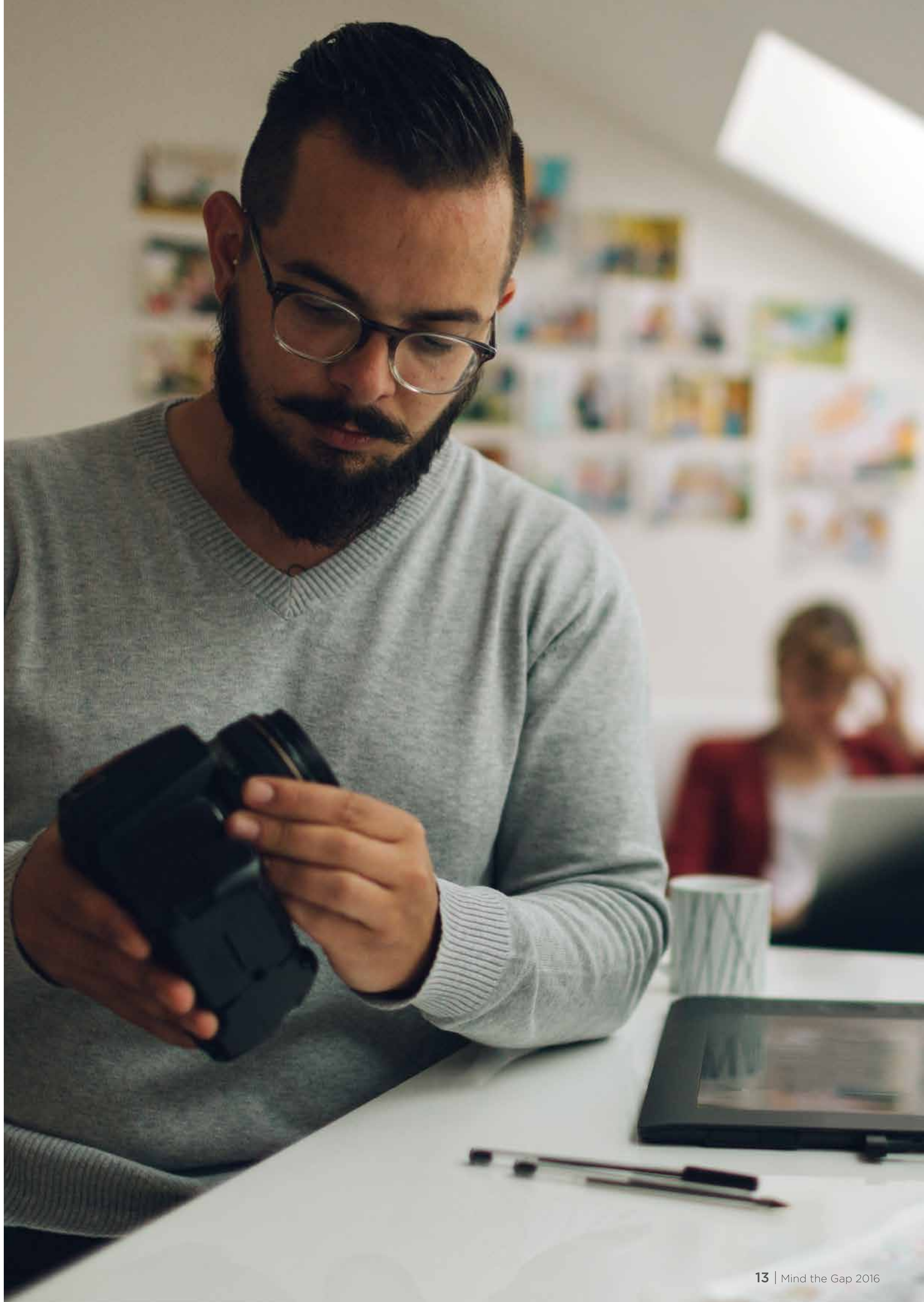
Sole traders appear especially vulnerable to this. Most had difficulty answering this question and, of those who could, 58% had insufficient insurance to last a week, two thirds had insufficient cover for a month, and more than nine in 10 (94%) had insufficient cover to last six months. This is concerning as sole traders, by definition, rely on their own ability to perform work.



The findings on SME business continuity risk associated with owner absence are a wake-up call. That is because it is not only the business owner's livelihood at risk, but also his or her employees. In REST's view, there are two important steps responsible SME owners can take to mitigate this risk:

- Ensure appropriate insurances – whether Income Protection, Death, Total and Permanent Disablement (TPD), trauma cover or key-person insurance – are in place and adequate to cover the business owner and the business in the event of a sudden incapacity to work.
- Linked to succession planning, ensure capable people within the business are groomed and prepared to step in and steady the ship for an extended period, in the absence of the owner.

If they haven't already, business owners are well advised to consult their personal financial and/or business advisers to plan for the risks revealed in this research.



SME owners and retirement planning

If SME owners are relatively unprepared for the risk of being unable to work in their business for an extended period following accident or mishap, how well are they prepared for retirement?

Retirement planning is a different issue to that of managing business risk associated with illness or injury. However, there is overlap between the two. For example, sound succession planning – the grooming of capable back-up employee-managers - not only gives business owners a stopgap if they are absent, but also a possible avenue to exit their business.

The sale of all or part of their business to one or more employees is a proven way for SME owners to capture value from the asset they have built over many years, and thereby secure their retirement. It is not clear how many SME owners are relying on this or other strategies to fund their retirement, or indeed how much thought is given to retirement planning generally.

The day-to-day pressures of running a business can make long-term retirement planning an afterthought. However our research suggests many business owners may be working with one eye to retirement and, more importantly, how to fund their lifestyle after they pull back from their business.

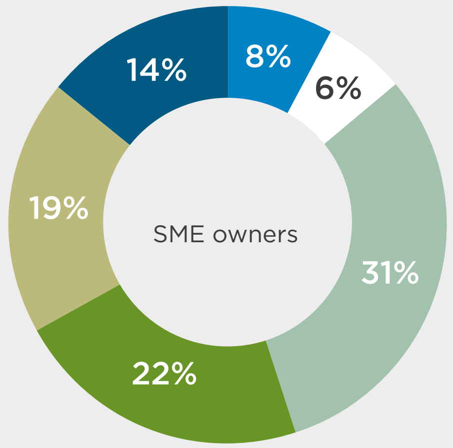
In this research, REST sought to better understand how well prepared business owners were for retirement and what strategies business owners expected to deploy to fund this stage of their life. The research then compared the different attitudes that SME owners and their employees had toward superannuation as a retirement-planning vehicle.

Business sale as a retirement strategy

REST's research shows that a clear majority (55%) of business owners surveyed consider the sale of their business to be important in funding their retirement. Indeed, one in three respondents consider this strategy to be extremely or very important, highlighting the degree to which a business owner's current and future income is inextricably linked with the financial success (and saleability) of their business.

This finding stands in contrast to the lack of action taken by most owners to protect the viability of their business in the event of a prolonged absence from the helm.

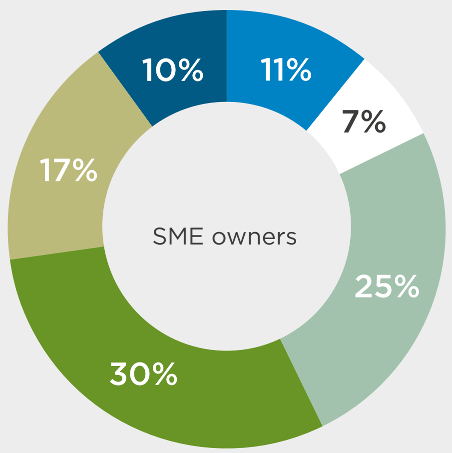
The importance of the sale of an SME owner's business to fund retirement



Future business dividends as a retirement strategy

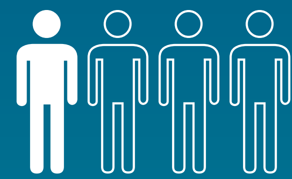
Alongside a business sale, SME owners consider ongoing dividends from their business as another important avenue to fund their retirement. Some 55% of the respondents rated it as important, with one in four (27%) considering it extremely or very important. Only 25% rated ongoing dividends as not important for retirement considerations.

The importance of dividends from an SME owner's business to fund retirement



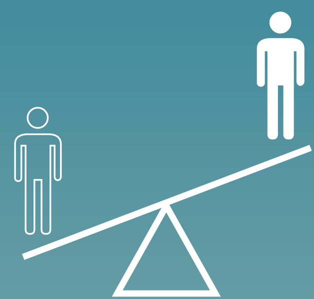
55%

of business owners consider the sale of their business to be **important** in funding their retirement



1 in 4

of business owners consider the sale of their business to be **very important** in funding their retirement



25%

rated ongoing dividends as not important for retirement considerations.

Business owners and employees: divergent attitudes to superannuation

Our research found that only 32% of SME owners surveyed, but more than half of the employee respondents, consider superannuation to be critical to their retirement, a stark contrast between the two groups as to how they plan to fund their eventual retirement.

From this we conclude that while business owners place some importance on superannuation as a retirement savings strategy, it is not necessarily the primary strategy at their disposal. For many owners accumulating wealth progressively through superannuation may be less important than unlocking the value tied up in their business upon retirement.

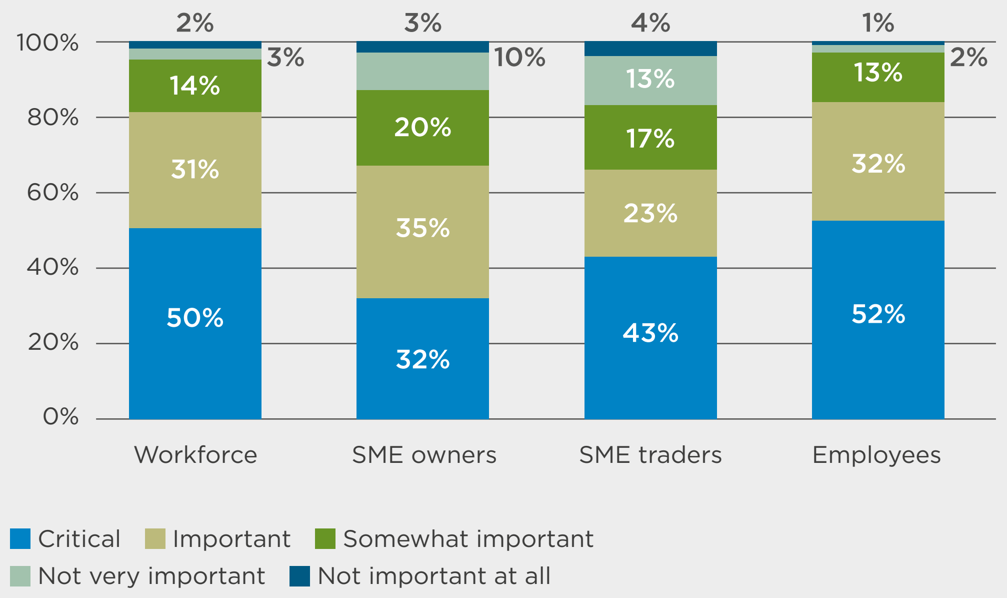
On the surface this is a reasonable position for SME owners to adopt, but there are important caveats. Firstly, it assumes the owner himself or herself will be able to remain at the helm of the business, in good health, until it is sold in part or full. It also assumes the business will always remain in a viable state to be sold, and that there will be someone willing to purchase the business at an acceptable price.

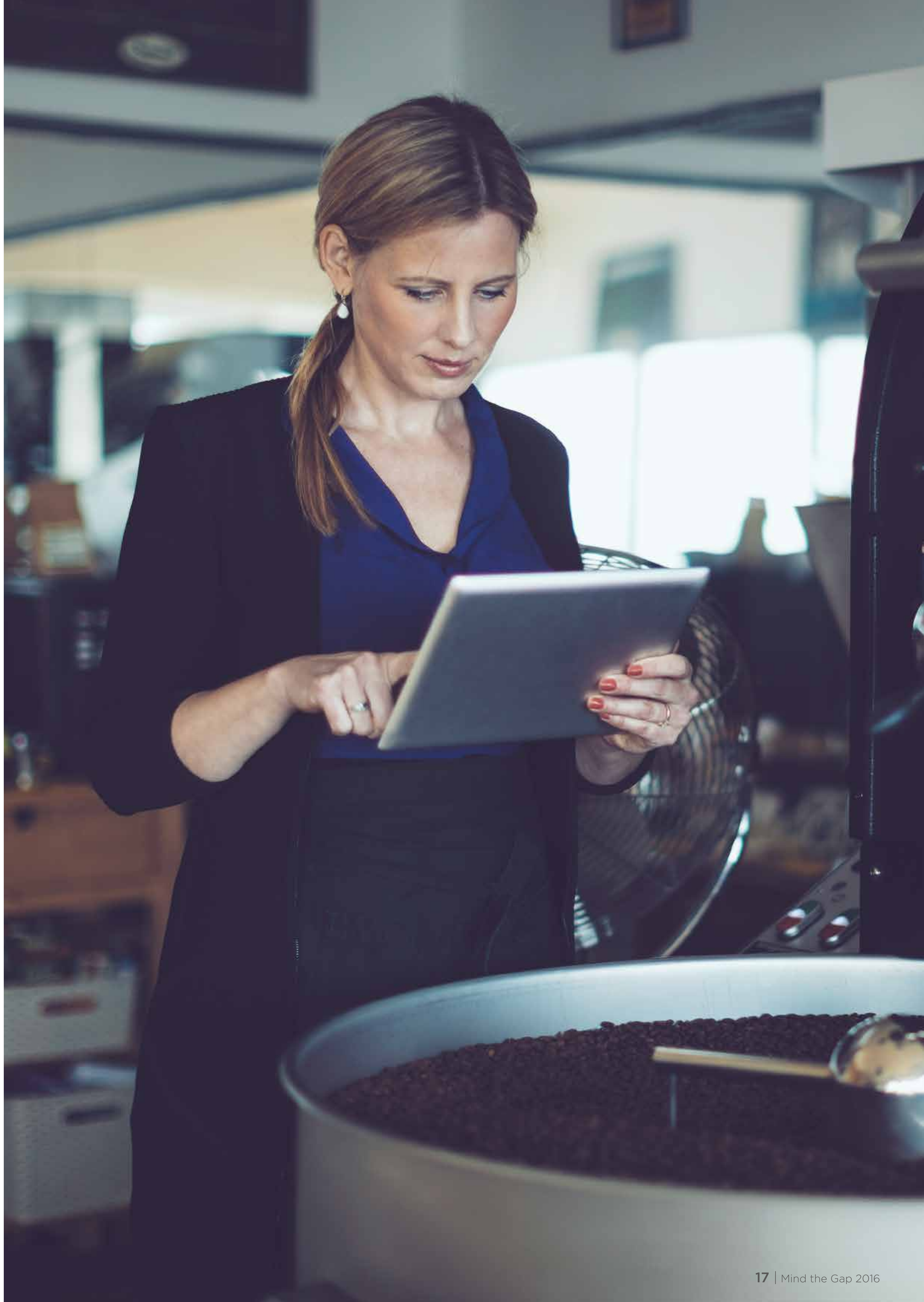
REST's research has already shown that business owners are exposed to the risk of their business falling over if they are subject to a prolonged and unexpected absence through injury and illness. Should a catastrophic event happen and their business be impaired, not only will the business owner's short-term income-producing potential be at risk, but their primary retirement savings strategy may be impacted.

Business owners appear to face retirement savings 'concentration risk' - a situation where future retirement savings are locked up in a single asset that is illiquid today and subject to significant financial risk. SME's may wish to consider the value of financial advice in relation to retirement planning – or include discussions with a financial advisor when considering their retirement planning.

Salary and wage earners are urged as a matter of responsible planning to secure insurance – Death, Income Protection, and TPD - to protect their financial position in the event of devastating injury or illness. For the same reasons, SME owners need to ensure that their key asset on retirement – their business – is protected in the event of a major illness or injury.

The importance of superannuation for your retirement





SMEs and employee superannuation

If the average SME owner/manager is not spending much time planning for their own retirement, are they looking after their employees any better?

While the primary responsibility for superannuation lies with the employee, actions taken by employers at different stages of the work journey can make a huge difference to the financial wellbeing of employees upon retirement.

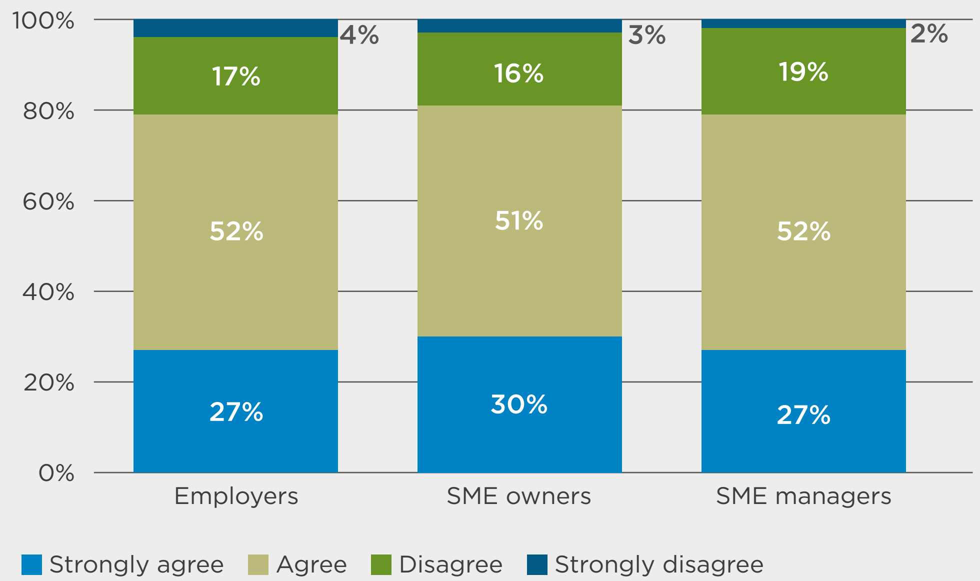
Many SMEs do not have employees dedicated to HR, or the budget and capital available to outsource their HR function. However regardless of the skill level and knowledge base of their owners and staff, all SMEs are legally bound to pay superannuation contributions for their employees. Their responsibility also extends to choosing an appropriate default fund if their employees do not nominate a preferred super fund.

SME attitudes to managing employee superannuation

So how well are SME owners/managers discharging the responsibility they have for their employees' superannuation? According to REST's research, four in five SME owners (82%) and managers (79%) believe that it is the responsibility of their employees to choose the fund that is right for them. In other words, they are reluctant to get involved in the decisions employees make about a superannuation fund.

This is in line with the responses given by employers generally (across large and small businesses), and appears to reflect a broader belief across the workforce.

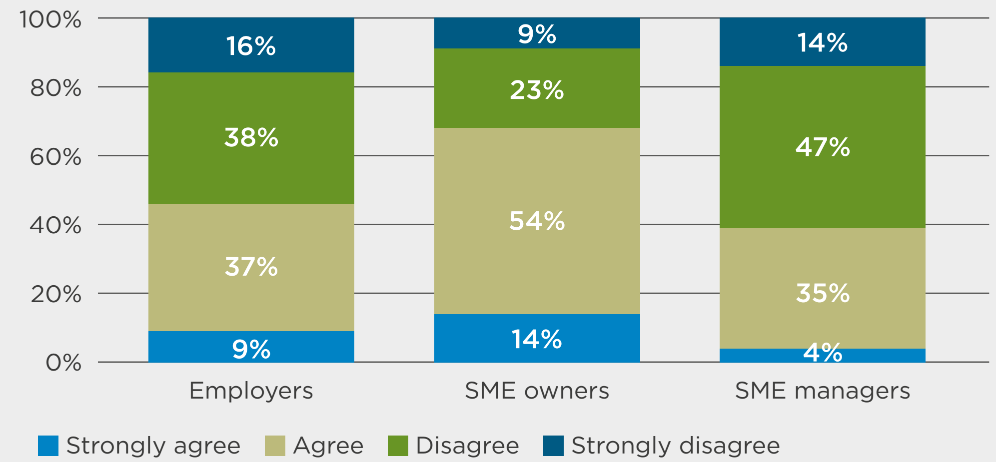
Belief that it is an employee's responsibility to choose the superannuation fund that is right for them



There could be two reasons for this response - employers may not have the time and resources to guide employees, or they do not feel confident doing so. Evidence from REST's research points to the former.

Two in three (68%) SME owners and two in five (39%) SME managers surveyed agree that administering payment of superannuation contributions is a chore, and that they want this task managed as quickly and cheaply as possible. This attitude is held far more strongly by entrepreneurs/SME owners than managers or employees more generally.

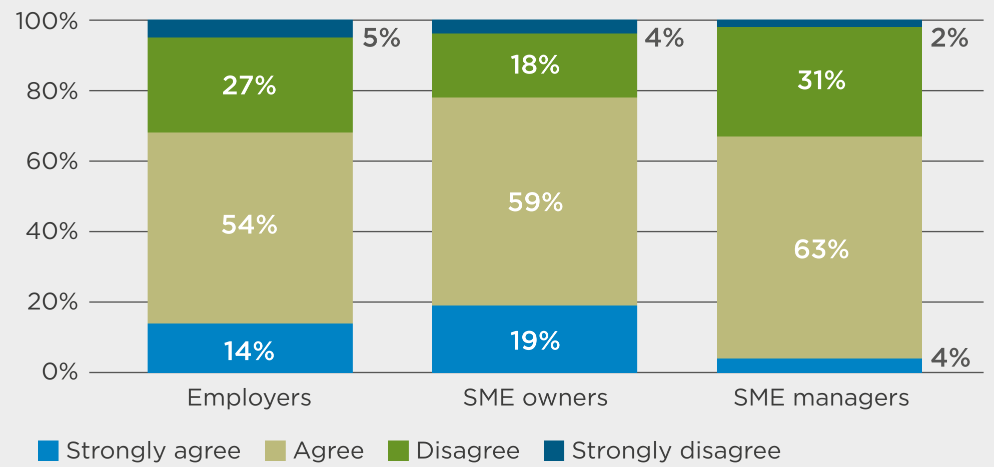
Belief that paying employees' super is a chore to be done as quickly and cheaply as possible



Despite this apparent indifference, most employers acknowledge the importance of superannuation as a tool for their employees to save for retirement. Around four in five (78%) SME owners and two in three (67%) SME managers surveyed say that they want to do the right thing by their employees' superannuation, but there is a limit to how much time and effort they will spend on it.

Again, this belief is held more strongly by SME owners than SME managers or employers more broadly.

Wanting to do the right thing by employee's superannuation but there is a limit to how much time and effort will be spent on this



There are many pressures facing SMEs and it is not surprising that owners and managers within SMEs would be ambivalent at best about the administrative burden attached to managing payment of their employees' superannuation contributions.

Yet we know from experience that time spent getting superannuation settings right through an employee's workplace journey is time well spent. Decisions over fund manager, asset allocation, quantum of contributions and fees payable now, can have significant financial consequences when applied to decades of investment within superannuation.

Time spent by SMEs on choosing their default fund

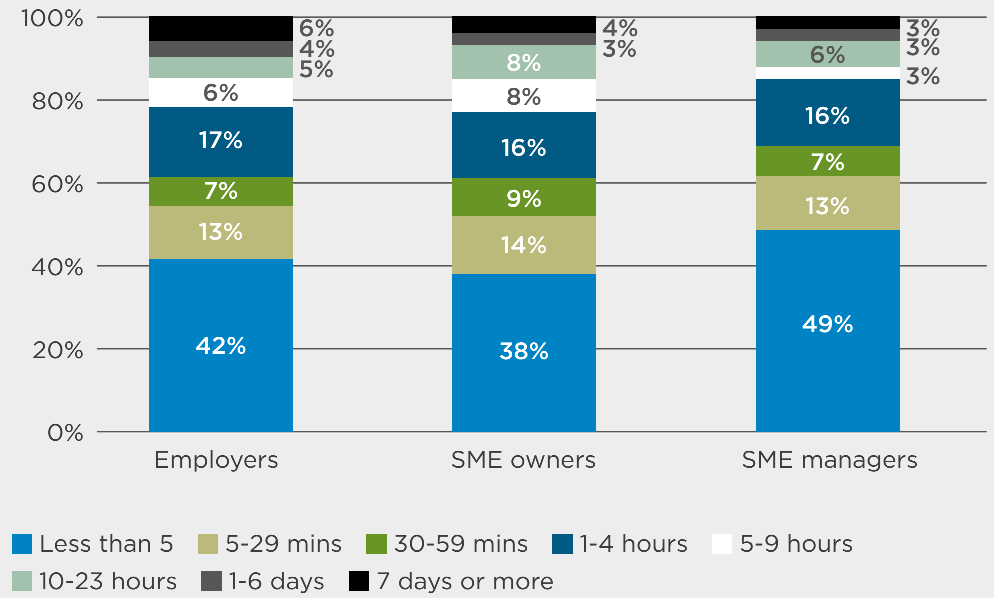
The selection of a default superannuation fund may be one of the most important decisions that an employer can make on behalf of their employees. A default fund should ideally meet all of these criteria:

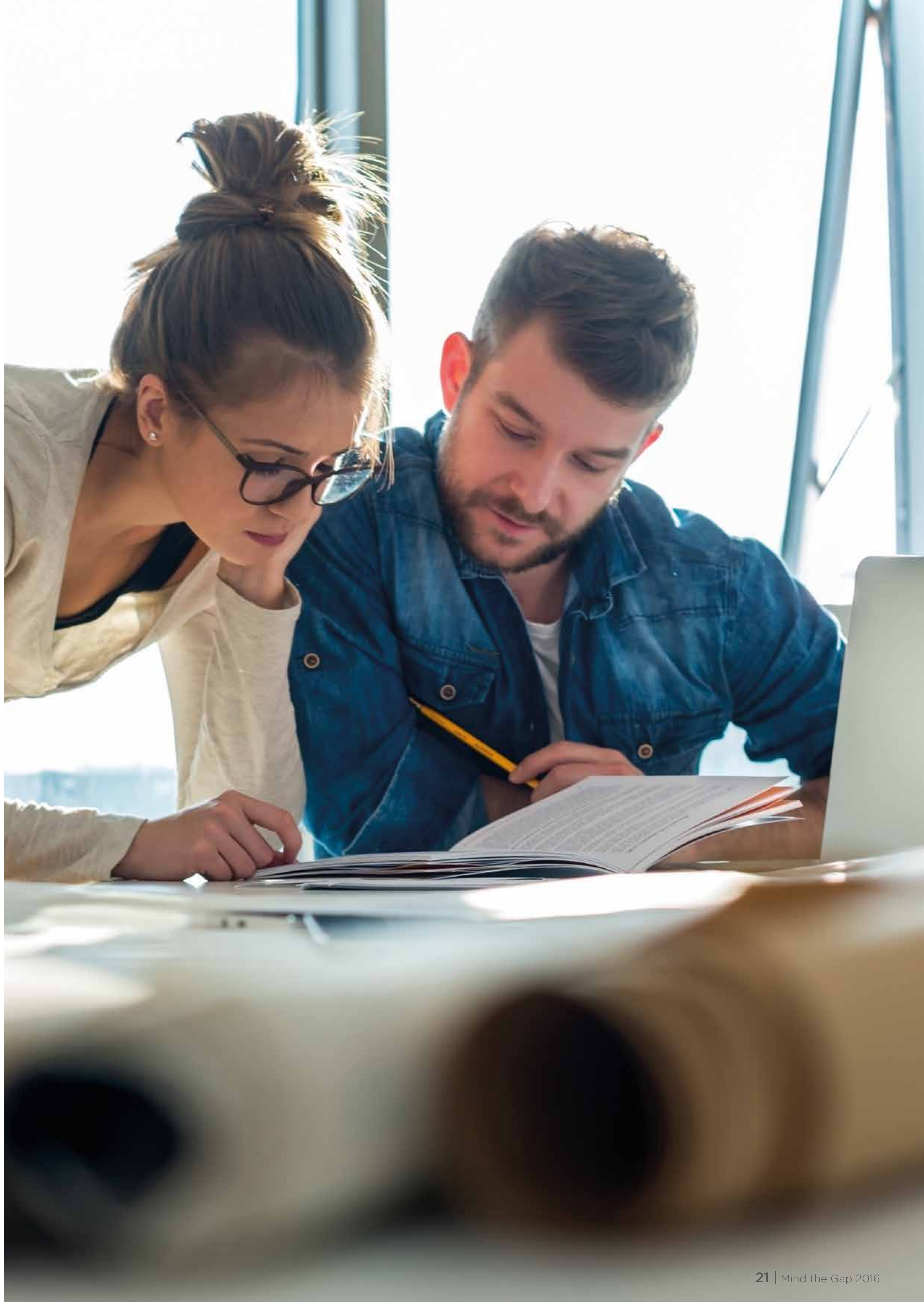
- Low fee structures
- Has a good track record for investment returns over a long period (10 years plus)
- Offers a simple choice of investment strategies including balanced and conservative
- Ideally provides Death, Income Protection and TPD insurance within the superannuation policy
- Have an impeccable record for compliance.

Getting these ingredients right can make a big difference to an individual's retirement balance over the several decades that superannuation savings accumulate. In REST's view, employers can and should invest an appropriate amount of time to ensure their employees have access to a high-quality super fund, should they not want to choose their own.

Unfortunately, the research suggests this is not the case in most workplaces. Of business owners and SME managers who have spent time on this decision, 38% of owners and 48% of managers devoted less than five minutes to the task, and 61% of owners and 68% of SME managers spent less than an hour. These findings are not out of line with larger businesses; among all employers 42% spent less than five minutes and 62 less than one hour on the task.

Time spent on choosing a default superannuation fund for employees





Superannuation as a lever for attracting and retaining talent

REST's findings suggest employers do not generally prioritise employee superannuation responsibilities as part of their HR processes.

It seems few SME owners and managers invest in the due diligence required to select a strong default super fund, which is one of the most significant decisions they can make if this decision is not covered by an enterprise bargaining agreement (EBA).

But what if there was a shift in mindset such that employers saw employee superannuation not as an administrative burden but an opportunity to make their company more attractive to current and prospective employees?

Today's workforce is highly mobile and large and small employers alike must compete to attract and retain talent. They have multiple tools at their disposal for doing that, which collectively form their employer value proposition (EVP).

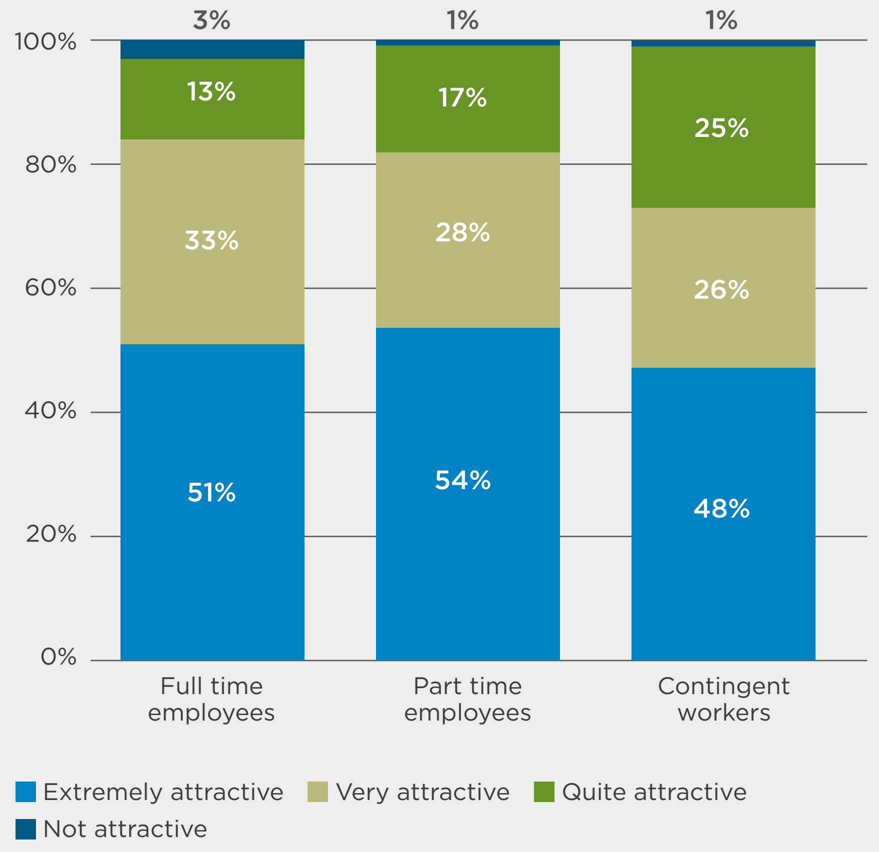
Typically, superannuation does not loom large in EVPs, but REST's research suggests it should. Feedback from the sample of employees gathered in the *Bridge the Gap* research probed workers on how much they valued the following superannuation-related benefits:

- Additional employer contributions (+5-10% and +2-5% of salary in absolute terms)
- Matching employee contributions dollar-for-dollar
- Covering Income Protection and TPD insurance within super
- Extending superannuation contributions to people earning less than the minimum threshold ($450 per month).

Additional employer superannuation contributions

Perhaps not surprisingly, employees surveyed found the offer of an additional 5-10% superannuation to be an attractive incentive to work for an employer. Indeed, an overwhelming majority of permanent employees (84% of full-time employees, and 82% of part-time employees) and contingent workers (72%) found it 'very attractive' and 'extremely attractive'.

Value of an employer offering an additional 5-10% super as part of a salary



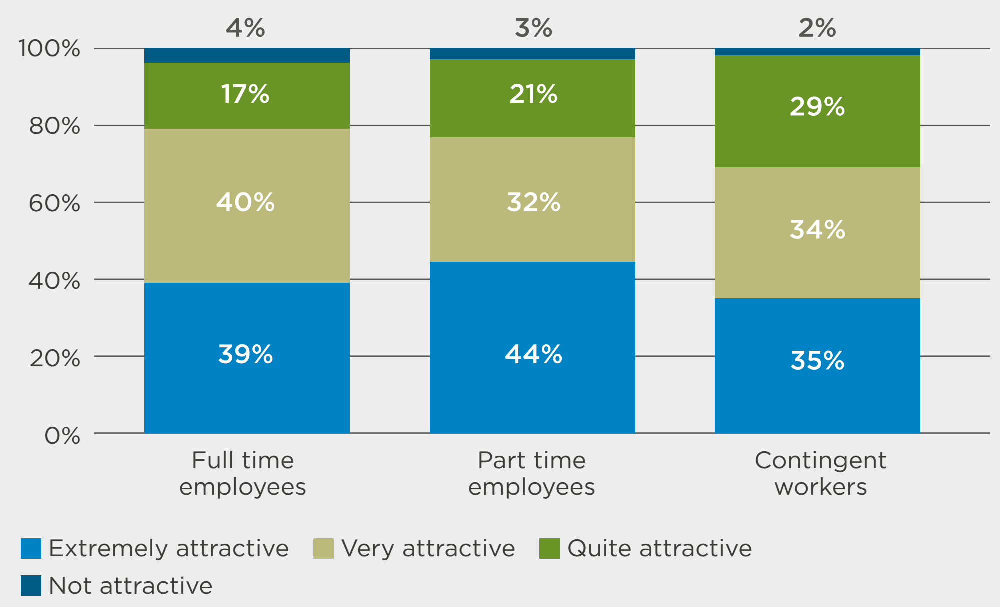
The offer of a smaller additional employer contribution to super – something in the range 2-5% -resonates with workers. Roughly four in five permanent employees surveyed (79% of full-time employees, 76 of part-time employees) and 69% of contingent workers found this offer at least very attractive.

over 34% of **all employees** find income protection, disability and life insurance extremely attractive

50% of full time and part time employees consider 5-10% additional super to be **extremely attractive**

over 40% of **full time and part time employees** are extremely attracted to matching dollar-for-dollar super contribution

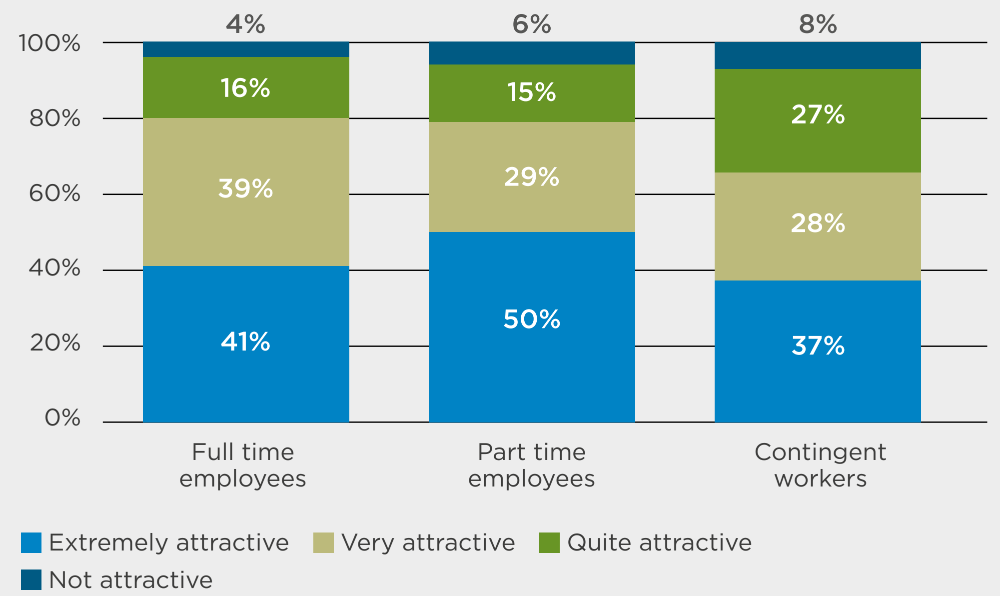
Value of an employer offering an additional 2-5% super



Dollar-for-dollar matching of contributions

Additional contributions in the form of the employer matching employee contributions dollar-for-dollar ranks highly - this model is considered very attractive and extremely attractive by four in five permanent employees surveyed (80% of full-time employees, 79% of part-time employees) and 65% of contingent workers. Although marginally more attractive to older workers, this proposition was well received across all age ranges.

Value of and employer matching voluntary super contributions dollar-for-dollar



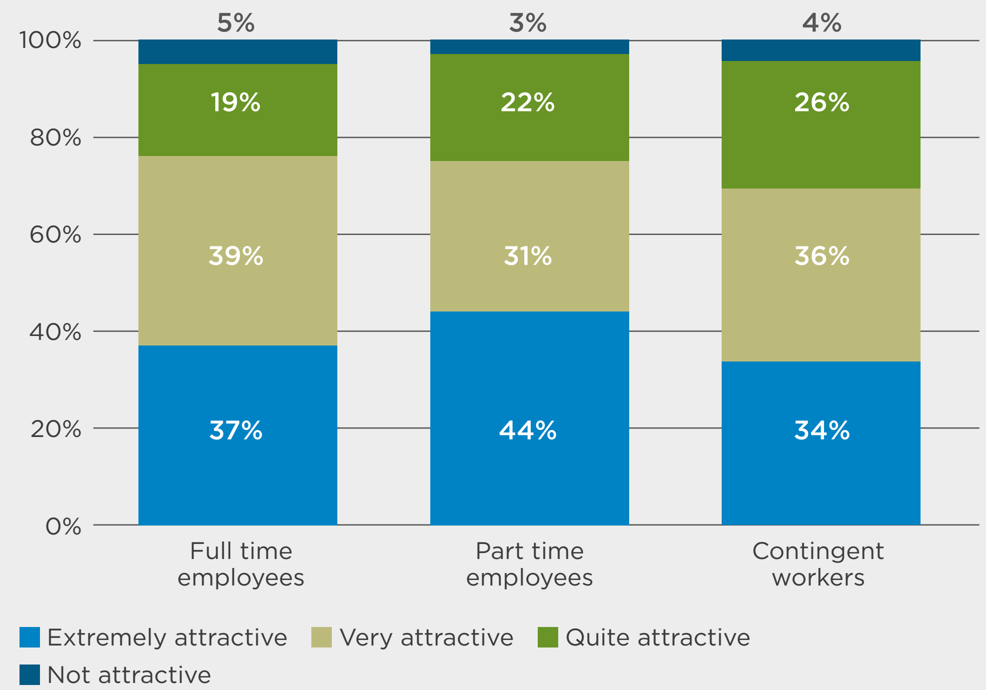
Offering insurance cover within superannuation

For people on moderate to low incomes, insurance cover such as Income Protection and TPD cover can be considered a luxury purchase and out of reach financially. Indeed they may not be able to access such benefits outside super, however, this type of insurance is readily available within group life insurance cover attached to superannuation accounts. Importantly, it is something that employees overwhelmingly would value if offered it.

Three in four permanent employees surveyed (76% of full-time employees, 75% of part-time employees) find Income Protection, TPD and Death cover within superannuation to be an attractive option, as do 70% of contingent workers.

Providing payments for group life cover offered through an employee's superannuation funds is a convenient way for employers to assist employees in accessing insurance cover that provides essential protection in the event of death, illness or injury, but that might otherwise be out of financial reach. While group life cover may require administrative focus on the part of the employer in the set-up stage, it is a low-cost strategy to assist employees in accessing an important and highly-valued benefit.

Value of an employer paying Income Protection, TPD and Death cover



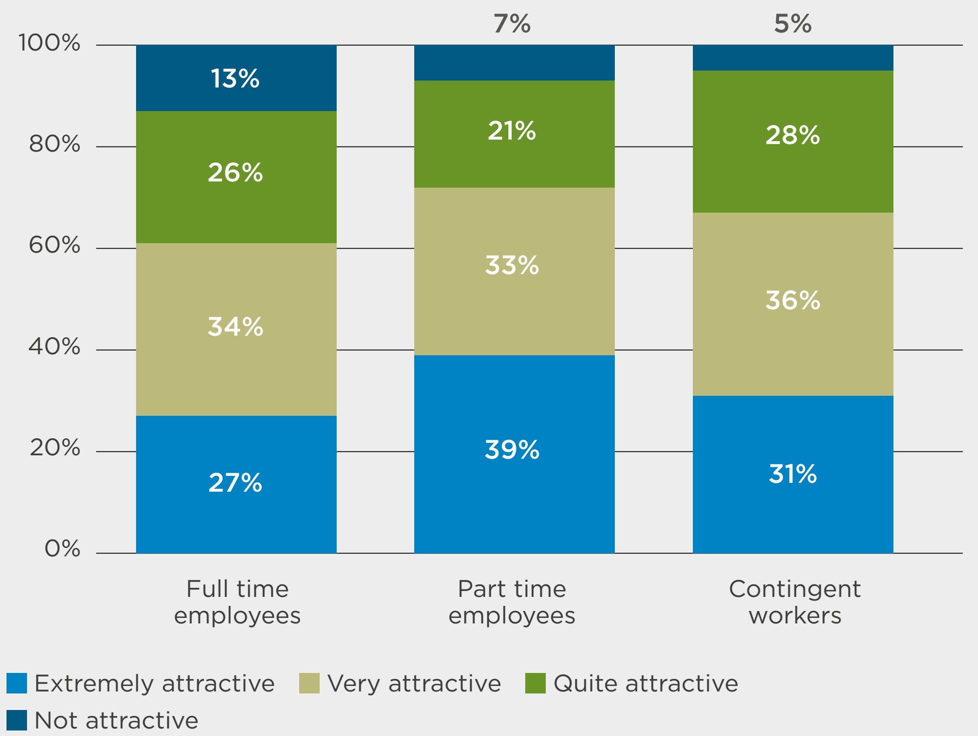
Extending superannuation to workers earning less than $450 per month

Presently, there is no obligation for superannuation contributions to be made on behalf of employees earning less than $450 per month. This would be a relatively small group, but one that might include large numbers of part-time or contingent workers.

Notwithstanding the smaller numbers of employees affected, REST's research suggests there is widespread support for the idea of an employer exceeding their statutory obligations extending contributions to employees earning less than the $450 threshold.

Some 61% of permanent employees, 72% of part-time employees and 67% of contingent workers surveyed consider this a very attractive proposition.

Value of an employer paying super for all employees, including those earning below the current minimum of $450 a month



This research demonstrates that while superannuation is given relatively little attention by employers, it is recognised and highly valued by employees as a retirement savings vehicle. Further, employees would highly value additional benefits that accelerate accumulation of funds within superannuation or deliver extra value – in the form of insurance cover – from superannuation.

In REST's view, a carefully calibrated response from employers to a range of superannuation-based benefits should be considered as part of shaping a competitive EVP. If packaged and implemented correctly, such benefits could make an employer more attractive to current staff and prospective hires, leading to reduced staff turnover and recruitment costs.

Methodology

Bridge the Gap is based on research conducted among Australian workers and employers using a customised online quantitative survey between 27 May and 6 June 2016.

Employers were categorised depending on the nature and size of the business or role and their level of responsibilities in an organisation, as follows:

- The workforce includes employees and employers
- Entrepreneurs are SME Owners who own or part-own a private business with 1-199 employees
- SME Owner/Managers include those responsible for managing the business and staff of a private business with 1-199 employees
- Sole Traders operate a business entity of which they are the sole employee
- Employers includes those working for SMEs and larger businesses who make hiring decisions for all or part of their organisation.

In total, 1,701 surveys were conducted around Australia including 184 entrepreneurs, 282 SME owners/managers and 64 sole traders.

This research was conducted by Lonergan Research in compliance with the ISO20252 standard.

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