The Good Old SME Kiwi Business Model Needs Turbo Charging

Purpose of this Presentation

- The primary purpose of this presentation is three-fold:

  A) To bring to the fore the severity of the business failure rate in New Zealand.

  B) To examine what I consider to be a major contributing factor to this failure rate.

  C) To provide plausible commercial solutions to address this unacceptable statistic.

Key Message to Take Away:

- **# 1:** In no way, shape or form does the N.Z. SME (Small-Medium Enterprise) business community reflect a rosy situation – most businesses are struggling to remain viable. This has been the case for <u>many</u> years.
- **#2:** There are simply too many SME operations competing with one-another (i.e. per business category); when instead a good number of them could be <u>combining resources/ strengths</u> to achieve more commercially effective and sustainable organisations that realise greater market share.
- **#3:** The strong advocacy that has surrounded the desirability of SME ownership to date needs to simmer and be put on the "back-burner"; allowing dialogue relating to <u>more innovative collaborative business models</u> to become more prevalent.

It’s Definitely Time to Challenge the Suitability of the Kiwi ‘SME Business Model’

- Enough to make you cry…
- Only 26 % of all Kiwi businesses that were “born” in 2007 survived the 10 year period through to 2017.

- During the year ended Feb 2017, 65,930 new businesses commenced trading and 57,500 ceased trading.

[Source: NZ Demography Statistics as at Feb 2017, Statistics NZ]

The Kiwi Business Failure Rate is a "National Tragedy"

- The average failure rate of Kiwi businesses between 2010 – 2015 was 39 %. Expressed in another way, for every 10 x businesses born in 2010 only 6 businesses were still surviving 5 years on, in 2015.
  - Break-down of casualties relating to business that were born in 2010:
    - 0 employees (i.e. owner/ operator situations) = 58 % had disappeared by 2015
    - 1 – 5 employees = 43 %
    - 6 – 9 employees = 35 %
    - 10 – 19 employees = 41 %
    - 20 – 49 employees = 39 %
    - 50 – 99 employees = 36 %
    - 100 + employees = 20 %

[Source: Ministry Business Innovation & Employment "Small Business in New Zealand" Fact Sheet]

Let’s Look At Where the Greatest Casualties Occur…

- The rate at which SME scale businesses that have 0 (zero) employees fail is greater than for any other business scale (i.e. nearly 60 % of these businesses failed within 5 years from starting-up in 2010).
- However, the story doesn’t get much rosier as the scale of operation increases – right-up to those businesses which employ 99 employees. The average failure rate for businesses that employ 1 – 99 employees sits just under 40 %.

[Source: Ministry Business Innovation & Employment “Small Business in New Zealand” Fact Sheet]

Break-down of Businesses By Number of Employees (as at Feb 2015)

• Number of businesses with 0 employees =	353,070	(70 %)
• Number of businesses with 1 – 5 employees =	97,293	(20 %)
• Number of businesses with 6 – 19 employees =	37,239	(7 %)
• Number of businesses with 20 – 49 employees =	9,459	(2 %)
• Number of businesses with 50 + employees =	5,109	(1 %)
Total:	502,170	(100 %)

[Source: Ministry Business Innovation & Employment “Small Business in New Zealand” Fact Sheet]

Qualification of SME Scale

- In my view a Kiwi 'Small to Medium Enterprise" has between 0 to 49 employees and/ or:
  - Focuses the majority of its time, energy and resources on meeting the needs of customers who are based in New Zealand (i.e. primarily have a "Domestic" market orientation), and/ or
  - Typically achieves between $35K - $20m annual revenue, and/ or
  - Doesn't typically have bricks and mortar representation in other countries.

  - Given the above qualification, in terms of 'Number of Employees' alone, the number of SME's operating in New Zealand in 2015 was a staggering 497,061 (i.e. 99 % of the number of businesses operating in N.Z.).

Implications of So Many SME's Operating in N.Z.

- Most Business Categories (e.g. retail) are already over-saturated with representation.
- The intensity of competition per Business Category/ Industry is considerable.
- The probability of new entrants achieving a level of market share which ensures their viability and sustainability within Year One of trading, is going to be low for particularly those businesses with 0 (zero) employees. i.e. for capacity/ capability reasons.

Implications of So Many SME’s Operating in N.Z. (cont…)

- For most, it is relevant to express market share per participating business per Business Category/ Industry in terms of “fragments” and not “segments”; and market share is approximately proportionate to business scale.

- Example of scale:market share relativity. Business operates in the book category within the retail sector, which (as a category) generates around $150m in revenue p.a. This particular business achieves annual revenue of $2m. So it’s market share = $2m/ $150m = 1.3 %

Implications of So Many SME's Operating in N.Z. (cont...)

- For particularly those businesses that are focused almost 100 % on the "Domestic" market, most market share gains are mostly going to happen by way of "market warfare" - i.e. eroding/ taking market share from competitors. "Niche" opportunities are becoming more and more difficult to identify.
- This form of growth doesn't serve to grow the overall "Domestic Pie" (i.e. overall GDP). Rather, it mostly serves to only redistribute commercial wealth domestically based on the relative strength of each player per Business Category per Financial Year.

Implications of So Many SME's Operating in N.Z. (cont…)

- It makes it very difficult for SME's to grow through increasing productivity in response to heightened customer demand. After all, there is a finite number of domestically based B2C and B2B customers to go around !
- Those businesses that can't achieve growth and scalability become vulnerable to business failure through not being able to generate sufficient cash flow and profitability to be sustainable and remain viable.

Implications of So Many SME's Operating in N.Z. (cont…)

- When you're "small" you're vulnerable to certain risk situations that larger businesses are not so exposed to.
- For example:
  - Having to borrow finance simply to cover trading requirements, such as purchasing stock, paying creditors.
  - Having to "wear all of the operational hats" (plus the governance hat) – and consequentially become so stretched from a capacity perspective that none of your responsibilities are discharged at the level (and with the attention) that is needed.

Implications of So Many SME's Operating in N.Z. (cont...)

- The social cost of business failure is <u>considerable</u>:
  - Financial burden on taxed income (WINZ).
  - State of mental wellbeing.
  - Degraded interaction (communication) between people generally – as pride and sense of purpose wanes.
  - Increased incidence of relationship dysfunctionality – in and outside the workplace.

The Status Quo <u>Must</u> Be Challenged If New Zealand is to Reduce its Business Failure Rate

- If, as leaders, we either keep quiet about (or "play down") the challenges that SME owners/ operators face, and/ or support individuals (e.g. tertiary commerce students) following their desire to establish a SME operation without putting in front of them other potentially <u>more sustainable/ viable business models/ structures</u>, I don't foresee the current 40 % business failure rate reducing any time soon.

My Recommendation for Change

- #1 – start taking the "rose coloured glasses off the faces of tertiary students", and provide students with factual realistic insights into what it actually takes to operate a SME competently (I am underway doing exactly this in my delivery of 3 x EIT commerce courses that I teach).
- #2 – start holding conversations with tertiary students and existing SME business owners alike around the implications of choosing business models that are available other than the traditional models; and most particularly in respect of what it means to merge businesses and how a parent company structure could benefit likeminded SME business owners.

My Recommendation for Change

- #3 – start communicating to SME owners that "it's okay to reach out to other parties who have no vested interest in your business, to receive input/ insights/ contributions as to how you could achieve greater commercial success and/ or sustainability".
- #4 – start facilitating conversations between aligned businesses, with the objective of identifying how such businesses could combine skills/ strengths/ resources so as to achieve growth and/ or sustainability.

Merged Entities

- Bring together owners of aligned entities which reflect significant synergies, so that their combined strengths/ resources/ skills enable greater probability of them being more successful and sustainable as a combined entity, versus battling on as separate entities (competitors).
- Influence minds to think about the benefits of working together as "comrades" versus working against one another as "competitors".

Parent Company structure

- Identify synergies between SME's that offer related business functions, and instigate conversations that aim to influence aligned entities to operate as a Parent Company under a single brand.
- For example: website designer, IT programmer, SEO specialist, marketing generalist, graphic designer.

Parent Company structure (cont…)

- Each SME business could already be either a sole trader or Limited Liability Company, and could retain their respective legal structure status in joining forces under the Parent Company.
- The owner/s of each SME become shareholders of the Parent Company. E.g. Gemtime N.Z. Ltd company structure.
- The Parent Company becomes the owner of the single Business Brand that this company trades under.
- A Shareholder Agreement defines the roles, responsibilities and rights of each shareholder.
- Roles are formulated in reflection of the strengths and skills of each shareholder.

Advantages of a Parent Company structure:

- The individual stakeholders combine their respective strengths to work in the same strategic direction as articulated in the Parent Company Strategic Plan. In doing so, the weaknesses of each stakeholder are diluted/ minimised.
- Enables role relief between colleagues as/ when one person is away (holiday/ sickness).

Advantages of a Parent Company structure:

- Enables pooling of financial resources to achieve resources/ programmes that (as individual business units) they may not have been able to afford (e.g. IT systems, licences relating to certain products, high calibre employees, etc).
- Would allow the stakeholders to focus just on performing their respective specialist functions/ practices; with admin type functions being performed either in-house or by out-sourced contractors by suitably skilled people. Some of the “operational hats” could be taken off the heads of the stakeholders.

Vision for 2018 Onwards:

- More people who own (or who want to own) their own business choosing to align themselves with likeminded people who have complementary skill sets/ knowledge/ resources to form either larger traditional Limited Liability Companies or Parent Companies.
- More businesses choosing to merge, to achieve benefits that aren't realisable under a traditional SME business model.
- Government (through the likes of Chamber of Commerce), industry organisations (e.g. Retail NZ), business leaders and education providers (e.g. EIT) guiding existing and prospective business owners to consider collaborative-based business models more so than the traditional SME business model.

Take-Home Messages:

- **#1 -** to date, education/ training providers have mainly focused education/ training delivery on addressing management and governance related understanding deficits/ shortcomings. For example:
  - Lack of leadership capability
  - Lack of formal planning processes
  - Lack of innovative/ creative/ strategic thought
  - Poor understanding of good governance practices
  - Poor financial management capability

- I believe that our education delivery needs to continue to cover the above elements, yet also needs to be widened to incorporate exposing students and business owners to business structures beyond those which typify SME operations (i.e. beyond sole trader, partnership and limited liability company structures).

Take-Home Messages:

- **#2 -** if no shift of focus away from strongly favouring/ advocating the traditional SME (Small-Medium Enterprise) business model occurs, to educate students and business people on alternative "scale-orientated" organisation structures more so, then it would be reasonable to expect the unacceptably high historic and current N.Z. business failure rate to continue.

Take-Home Messages:

- **#3 -** the only realistic (affordable) way that the overall wellbeing and prosperity of Kiwis can be improved upon is where heightened productivity (i.e. increased GDP) occurs. To achieve heightened productivity, businesses need to have the opportunity to grow – which most commonly is derived from either increased efficiencies and/ or increased capacities and/ or improved capabilities.

Take-Home Messages:

- #4 - typically expanded capacity and capability improvements will create greater opportunity for productivity improvement than improvements made to efficiencies alone. Unfortunately, most SME’s (as individual Business Units) don’t have the financial wherewithal to expand their capacity and/ or capability without borrowing funds – which then creates risk situations that many SME owners don’t have an appetite for.

Take-Home Messages:

- **#5 -** scale of operation, intensity of competition per business category, capacity constraints, fiercely independent SME owner mind-sets, commercial immaturity/ naivety and an unwillingness of many SME owners to reach-out for help as/ when they need it is are key factors causing Kiwi businesses to fail.

Take-Home Messages:

- **#6 -** due largely to intensity of competition per business category - where market share is divided between thousands of participants per business category/ sector, most SME's are characteristic of very "small slices of the pie" and are not being successful at increasing their market share.

Decisive action needs to be taken by government and business leaders and educators to influence consolidation/ unification of the vast number of SME's, so that increased capacity and capability per business occurs. Which should then create greater potential for greater market share per Business Unit to be realised due to increased/ improved resources per Business Unit being applied to marketing and productivity activities fundamentally.

Take Home Messages:

- **#7 -** the consequences of <u>not</u> making the conscious decision to try and influence greater collaboration in the business community where business structure/ organisation is concerned will include:

  - Continuation of an unacceptably high business failure rate.
  - Deepening adverse impact on socialisation between Kiwis (e.g. further degradation of the quality of communication between individuals).
  - Increasing pressure put on mental health services – relating to unemployment issues and/ or businesses failing.
  - Greater draw on taxed income to pay unemployed people.

Take Home Messages:

- **#7 -** the consequences (cont…)

- No real change in national GDP (productivity) – and therefore no real change in the level of taxed income that becomes available for redistribution by central government for whatever purposes.
- Growth in the ratio of export related GDP to overall GDP will remain lower than desired (i.e. to step-up from a domestic focus to an international focus requires significant capacity and capability).
- No real change in the number of employment opportunities (i.e. foregone opportunity for increased scale and market share per Business Unit to create the opportunity for additional employment roles).

Summary -

- Fact #1 - Businesses can't grow significantly without being endowed with appropriate resources (financial/ people/ infrastructural/ assets), and particularly most small businesses can't acquire such resources without borrowing funds.
- Fact #2 - Businesses can't consider engaging talented new employees without an appropriate working capital base – to be able to afford such engagements.
- Fact #3 - Kiwi business owners need to be influenced to develop a more "collaborative" mind-set, which causes more owners to allow others to provide input/ insight into their business to see where/ how their business could become more successful/ sustainable.

Summary (cont…) -

- Fact # 4 - The traditional SME business model (because of the proliferation of SME’s in N.Z.) is contributing materially to the high Kiwi business failure rate, and this is likely to continue to be the case unless leaders/ advocates/ educators incorporate more dialogue about alternative business models in their communications.
- Fact # 5- Primary focus on the “traditional business model” needs to change; for the conversation to encompass a wider range of business model options being illustrated to existing and prospective business owners.

Change Starts With the "Will" to Change.

- There is 20 + years worth of evidence (hard data) which unequivocally supports the essential need to "change the tune" – to move in the direction outlined in this presentation.
- It is a choice to do so – or not (no more and no less). We already know the consequences of choosing the "not" option.

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