

Small and Medium Businesses in New Zealand



Report of the

Small Business Advisory Group

August 04

2004

Executive Summary

Minister for Small Business
Parliament Buildings
Wellington

This is the first annual report of the Small Business Advisory Group.

We share your desire to create an environment in which New Zealand SMEs (the 97% of our businesses that employ 19 or fewer FTEs) can grow and prosper.

In compiling this report we have drawn on our own experience as small business owners and advisors and on information from the business people at the 24 Small Business Day events that you hosted from February to May 2004 (all of which were attended by members of our Group). We have used also the extensive business networks to which we have access and have drawn on material from overseas countries – most notably the United Kingdom.

The scope of this report – things that need to be done to enhance small business growth – was potentially huge. We decided to confine ourselves to four areas where we think the government interventions we describe in this report could make a substantive difference for SMEs. Those areas are:

- > provision of advice, mentoring and practical tools
- > access to finance and business support
- > enhancing the environment for small business
- > improvements in the regulatory environment.

Our specific recommendations for government action are as follows:

1. Enhance funding to Business In The Community and/or similar providers of mentoring services to upskill their mentors and mentor co-ordinators in order to provide a superior service to clients and to market their services.
2. Provide funding to SMEs with growth potential to engage an Advisory Board to assist them in the governance of their business. The Advisory Board would typically comprise 2-4 people capable of bringing to the business an impartial eye and expertise that the founder/owner does not possess.
3. Support the use of existing and new local business awards programmes as a way of providing benchmarking information to firms. The expectation is that a common template would be devised that could be used by local business organisations and trade associations to establish and judge annual business awards. The template should be designed in such a way as to permit key comparisons with companies in already established benchmarking systems. The information from these templates could be fed into a central database that would provide benchmarking data for participating businesses across the country.

4. Make readily and cheaply available to all SMEs a checklist of things they need to do, and the assistance that is available, when starting and growing a business. Any help-sheets that are produced must be in a consistent and user-friendly format and be kept up to date.
5. Provide a complete checklist of issues to be considered when hiring an employee, together with supporting advice and guidance, quickly and cheaply for businesses.
6. Undertake policy development work aimed at making access to funds easier for SMEs with growth potential (e.g. encouraging banks to lend on cashflow/character in addition to assets; loan guarantees).
7. Urgently undertake a revision of rates of tax deduction for depreciation with the view of reducing taxation in the first three years of plant installation, and offsetting that with lower allowable tax deductions for depreciation in the following years.
8. Develop a strategy for providing assistance to SMEs to implement sales and marketing strategies and plans.
9. Ensure basic enterprise education is part of the core curriculum at Year 10 (4th form) and that provision is made for better support for enterprise education providers and for promoting careers in business to school pupils.
10. Identify and remedy the barriers to government agencies purchasing from New Zealand suppliers to ensure that the government makes greater use of its procurement powers as a tool to encourage innovation and growth in New Zealand's SMEs.
11. Make greater efforts to harmonise borders with Australia and make trading with our neighbour easier.
12. Have each government department identify a small business advocate who would be responsible for presenting the SME perspective on any proposals being developed by the department that might impact SMEs.
13. Charge a senior manager in each government department with scrutinising all the regulations designed by the department, to assess the need for them, their quality and the impact they will have on business (and SMEs).
14. Measure and publish the cumulative effects of the costs of compliance with regulations passed in the previous six months.
15. Ensure all business-related legislation and regulations come into effect on only one or two pre-determined days per annum. Common commencement dates, especially when coupled with advance notice and guidance, would offer a greater degree of certainty, and would help SMEs to plan and budget, and reduce their costs. In addition, businesses would know that they have to deal with regulatory changes only at fixed, predictable points in the year.

- 16. Ensure proposals for changes to regulations that affect business are put out for a minimum three months' consultation period and do not come into force until three months after the government or Parliament agrees to the changes. This provides adequate time for SMEs to contribute to the design of the regulations and to prepare for their commencement. Listening to businesses has a number of specific benefits. It allows government to tap the widest source of information possible and thus improve the quality of decisions reached; it alerts policy makers to any concerns and issues not picked up through existing evidence; and it helps to monitor existing policy and to determine whether changes are needed.
- 17. Have government agencies (particularly ACC, OSH and ERMA) run regular (e.g. every third Wednesday of the month) local information nights. There, businesses could learn what is required of them by way of compliance, hear what is new since last month, and have one-on-one advisory sessions (information from which is not passed on to the enforcement arm of the organisation).
- 18. Simplify FBT on business vehicles by moving it from the FBT return to an adjustment on depreciation in the employer's income tax return and base this adjustment on the depreciated value of the vehicle.
- 19. Rebalance the legal procedures for dismissing non-performing staff and provide qualifying periods for personal grievances for probationary staff. We believe that these are the single most important changes that could be made to the employment legislation and that they would lead directly and immediately to employment and business growth.

In addition, we have established a short list of key performance indicators that we will use to judge your performance as the Minister responsible for New Zealand's SMEs. Our evaluation of your performance against the KPIs will be contained in our second annual report.

Murray Cleverley	Cameron Moore	Peter Kitchen
Alison Quesnel	Denise L'Estrange-Corbet	Robyn Reid
Lachlan McKenzie	Stuart Wilson	Nigel McKinlay

Abbreviations Used in this Report

ACC:	Accident Compensation Corporation
BITC:	Business In The Community – a business mentoring organisation
Biz:	The free information and advisory services provided by NZTE, including the website www.biz.org.nz
CER:	Closer Economic Relations (between New Zealand and Australia)
ERMA:	Environmental Risk Management Authority
FBT:	Fringe Benefit Tax
FRST:	Foundation for Research Science and Technology
FTE:	Full-time equivalent – defined in business statistics by Statistics New Zealand as the total number of employees and working proprietors working full-time in a business plus half the number of employees and working proprietors working part-time
GDP:	Gross Domestic Product
KPI:	Key Performance Indicators
MED:	Ministry of Economic Development
NZTE:	New Zealand Trade and Enterprise
OECD:	Organisation for Economic Co-operation and Development
OSH:	Occupational Safety and Health – a part of the Department of Labour
R&D:	Research and Development
SME:	Small and medium-sized enterprises

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Section 1: SMEs in New Zealand: The Context

Business enterprises are the producers of the wealth, jobs and tax base of the New Zealand economy.

They prosper best when the business environment is conducive to entrepreneurship and learning. Such an environment includes stable and well-designed macro-economic policies, an enabling regulatory framework and a sound legal system.

SMEs are often the focus of attention in the New Zealand economy. They comprise most of our enterprises. In smaller, rural centres, they are at the heart of local economic, social and community activity. Most commentators agree that SMEs face barriers to growth over and above those experienced by larger firms.

SMEs over the next decade can anticipate an uncertain future. They will be challenged by new competitors, new technologies and changes in their regulatory environment. The state has a large role in shaping an environment in which SMEs can prosper, grow and contribute to New Zealand.

Therefore the government's approach to fostering SMEs should be focused primarily on creating an environment that is supportive for all businesses. However, in doing so it must recognise also the particular make-up of, and the particular circumstances faced by, SMEs.

Section 2: Characteristics of SMEs

There is no globally recognised definition of an SME. In this report SMEs are defined as businesses with fewer than 20 employees¹.

While SMEs are diverse, typically an SME may:

- > have begun spontaneously from just one idea or new product and may continue to be an incubator for innovative ideas and products
- > have an owner/manager with little formal business experience or few generic business skills
- > have begun because the founder/owner has a particular technical expertise
- > comprise the founder/owner and up to four employees (often with an unpaid family member providing administrative support)
- > have the owner as the only person in a managerial position, and no board or formal governance arrangements
- > operate on trust, rather than on systems and contracts
- > have a tight family-like culture where the values of the owner are strongly shared by the staff and workplace practices are flexible and suited to individual employees' needs
- > focus on a small range of products or services sold mainly on the local domestic market
- > have all personal assets, including the owner's home, committed as security for the business
- > acknowledge the owner's time as one of its scarcest and most valuable assets
- > operate flexibly, on a 'reasonable person' basis, rather than on an informed and strict observance of regulations

¹ In New Zealand 96.8% of enterprises employ 19 or fewer FTEs and 86% employ five or fewer FTEs. The number of SMEs increased 4.9% in 2003. SMEs accounted for 42.3% of all FTEs and 38.1% of the economy's output in 2003. Between 1997 and 2002 new firms employing 0-5 FTEs created 180,370 new jobs. The proportion of SMEs in New Zealand is similar to a number of other OECD countries, although SMEs account for a higher proportion of employment in New Zealand relative to other countries.

- > have a vision and outlook that is bounded by the horizons, skills and experience of the founder/owner, the pressures of day-to-day management and tight resource constraints (i.e. a tactical rather than a strategic approach)
- > endeavour to operate independently of other businesses and institutions and to favour self-help over seeking advice
- > not be aware of the regulations to which it is expected to adhere
- > in provincial areas, be a key part of the social fabric of the community
- > close within three years of its inception, not infrequently in circumstances that could easily have been prevented.

These characteristics mean that managers in successful small firms need to be multi-skilled rather than specialists, with expertise in a diverse range of areas.

Section 3: A Vision for SMEs

We acknowledge the government's vision for New Zealand SMEs as *well-run, innovative* and *world-class* businesses.

Well-run businesses are those that:

- > work closely with customers and suppliers, for example when developing new products and services, dealing with customer complaints and assessing customer satisfaction
- > have good and productive relationships with stakeholders and employees, reward staff for good performance and protect them as a critical asset through good employment and health and safety practices
- > are active in creating and developing business networks or linkages with other firms
- > have management, human resources and financial systems that support day-to-day management
- > enjoy leadership that provides them with a clear view of where they want to take the business in the future
- > understand their legal obligations and have in place systems to ensure they comply.

Innovative businesses:

- > seek to compete on innovation, for example with new and improved products, services and processes, rather than simply on cost and quality
- > are one step ahead of the competition not just because they have good ideas but also because they have the ability to transform their ideas into marketable products or services
- > recognise that what is in demand today may not be the same in the future and therefore are scanning the environment looking for opportunities to improve and grow
- > are prepared to learn from others and invest in innovative activities, for example, in-house and external R&D, training, marketing related to new products, and new technologies.

World-class businesses:

- > have a global mindset
- > may export a product or service or they might exist to provide world-class intermediate goods and services to our export companies
- > may endeavour to benchmark themselves against the best equivalent businesses in the world.

Section 4: Growing SMEs

Based on our experience in business, our knowledge of a range of SMEs and the learnings from our involvement with the Small Business Day Events 2004, in this, our first annual report to the government, we have decided to highlight four areas where the unique features of being an SME can act as a barrier to business growth.

Capability:

Small enterprises face a much stronger need for assistance in building their business capabilities than larger businesses. In many SMEs both owners and employees are required to play a number of, often disparate, roles. Managerial capabilities in particular may be stretched, as entrepreneurs, often with little training or experience, become responsible not only for management, but also marketing, accounting, and various other tasks involved in running a successful business. The mentoring activities we undertook during the Small Business Days events reinforced for us the critical need to enhance the mentoring and advisory services currently available to SMEs.

Finance:

SMEs are usually funded largely through the personal savings of the owner, often augmented either by loans from financial institutions or, occasionally, through equity finance. SMEs may have trouble accessing debt finance as they have little to offer as collateral. Also, many potential entrepreneurs may lack the knowledge and skills required to create the formal business plans needed to access the finance that is available, particularly venture capital. Training, aimed at assisting entrepreneurs to identify potential sources of finance, structure their financial plans appropriately, and present their proposals in a suitable way, can help. However this may not be as effective for SME survival and growth as providing direct, targeted financial assistance or enabling access to available finance.

Business Environment:

An Industry New Zealand survey in 2003 found that business, and the economy in general, is not a high interest subject for most New Zealanders. When New Zealanders do take an interest in business, they frequently do so with a negative attitude². Such attitudes discourage potential business owners from considering self-employment. Also they influence the priority given within government generally to the promotion of measures designed to foster business growth. SMEs do not have the time or resources to, for example, form lobby groups to pursue their interests or to research for themselves the most effective

² Industry New Zealand (2003), The Business and Enterprise Culture Project: Benchmark Study, pp. 6-7.

ways of accessing new export markets. However, SMEs do not lay claim to special treatment or subsidies based solely on their size and limited resources. What they seek is for government to recognise, endorse and encourage their role as engines for innovation, growth and employment in the New Zealand economy.

Regulation:

Inappropriate and costly regulation was the most frequently cited impediment to SME growth in New Zealand at the Small Business Day events. The costs of regulation are associated with both the substance of the regulation itself, such as the impact of labour laws on hiring additional employees, and the direct compliance costs incurred in fulfilling regulatory requirements, including the time taken to complete paperwork.

Although all businesses face costs in complying with regulations, the fixed costs associated with compliance create a higher relative burden for SMEs. The implementation of a new system is basically the same whether the firm is small or employs 100 people. The paperwork involved in compliance does not relate directly to the scale of the business, and can divert a significant amount of a small business owner's time away from productive activities.

The direct costs are compounded by a lack of specialised knowledge in SMEs. As many small business owners take on a variety of roles within the business, they are assumed to have the capacity to absorb a wide range of information about regulation. They are expected not only to deal with the complexity and weight of regulation but also to stay abreast of the multitude of changes and the local variations in the application of the law. Uncertainty about the details and consequences of regulation may prevent SMEs from making optimal decisions.

Conclusion:

Our report therefore sets out a number of recommendations for government action aimed at addressing each of those barriers to SME growth.

Section 5: Access to Advice for Building Capability and Lifting Business Performance

Running an effective business requires marshalling knowledge about the day-to-day management of the many different functions of a firm, as well as about longer-term strategic issues. The practical skills and knowledge required to run a business are acquired through a host of mechanisms – formal training, on-the-job learning, mentoring, networks with other business owners, the expertise of employees, and external advice. If entrepreneurs and managers have difficulties in accessing or developing the necessary skills, this lowers economic efficiency and national productivity.

The time it takes to search for and analyse the information, and the limited capacity of firms to digest that information, means that entrepreneurs and small business managers often do not devote the resources required to seek out and acquire up-to-date information that might be beneficial to the business. These barriers could be overcome if access to information was made simpler and less costly³ and business operators were provided with better opportunities to acquire the skills and knowledge needed to improve their management capability.

Small businesses and entrepreneurs often cannot afford to employ all the expertise they need to get new concepts and projects up and running. They also tend to undervalue the potential contribution of expert advice on key elements of their business. Some fear that their ideas might be ‘stolen’ if shared with others. However, without such advice, they are often unable to satisfy the requirements of investors, banks and other financiers for information, including business planning. As a result, small businesses often do not realise their full potential.

³ In this context we note that many useful business-related statistics that were previously provided free are now charged for by Statistics New Zealand.

Mentoring: Management Issues

Mentoring can provide an invaluable service to SMEs, particularly in their early stages of development. There are many mentors working throughout New Zealand, several through Business In The Community, and others operating privately or through ‘coaching’ franchises. Many others, who are not involved in mentoring, including retired business people, would welcome the chance to pass on their knowledge to young businesses. Business In The Community already receives financial support from the government for its administration and is highly regarded for the services it provides. While the current Business In The Community customer survey shows good scores, there is still an inconsistency nationwide in the provision of ‘ideal’ mentors. This is partly because of differences in the agencies recruiting mentors, and in mentors understanding their role. Also, many clients have unrealistic expectations of a business mentor. They often listen to the mentor’s advice but do not take it, or don’t have time to put it into practice. Therefore, expectations and perceptions need to be managed as well.

Recommendation 1
That funding be enhanced to Business In The Community and/or similar providers of mentoring services to upskill their mentors and mentor co-ordinators in order to provide a superior service to clients and to market their services.

Independent Advisory Boards: Governance Issues

An average SME owner is busy working in the business. They usually have an in-depth expertise in one particular area of their business: technical expertise in the products or services they are providing; marketing; or the financial management of the enterprise. Only rarely will they have the passion or skills to perform all those disciplines well.

Owners of large businesses normally have a group of specialist and/or independent advisors around them, including a board, in order to cover all the required business disciplines.

SMEs, too, could benefit from equivalent, impartial, external business advice.

Recommendation 2
That the government provide funding to SMEs with growth potential to engage an Advisory Board to assist them in the governance of their business. The Advisory Board would typically comprise 2-4 people capable of bringing to the business an impartial eye and expertise the founder/owner does not possess.

Business Awards and Benchmarking

Businesses perform better if they know what better performance consists of and that higher levels of performance are achievable. They also respond to receiving recognition within their own community for their achievements.

These principles lie behind schemes and programmes aimed at providing enterprises with relevant benchmarked performance measures. Benchmarking systems that allow businesses to compare their performance to other similar businesses, and those that pass on information about the practices that may have contributed to the superior performance of the top-ranked firms, are particularly beneficial. The principles are also the reason we have so many national, and local, business awards. We consider that such benchmarking information should be more readily available to SMEs.

Recommendation 3

That the government support the use of existing and new local business awards programmes as a way of providing benchmarking information to firms.

The expectation is that a common template would be devised that could be used by local business organisations and trade associations to establish and judge annual business awards. The template should be designed in such a way as to permit key comparisons with companies in already established benchmarking systems. The information from these templates could be fed into a central database that would provide benchmarking data for participating businesses across the country.

Practical Tools to Assist Managers

Regulations are useless unless they are well known and understood by the audience to which they are addressed.

Small business owners do not have time to read the detail of legislation or policies. Instead they need practical assistance to make sure they have covered all the requirements of particular legislation and know how to comply with it.

The business regulatory environment can be complex and confusing. Often legislation and compliance processes are daunting and difficult to understand in the context of an individual business. More often than not the regulations have not been designed with SMEs in mind. Consequently a business owner may often avoid learning about how to comply unless forced to by law enforcement or circumstance.

Practical tools help to simplify and explain good business practices and provide support mechanisms that allow the business owner to retain knowledge and information to improve performance. Better knowledge levels lead to improved performance and practical tools provide short cuts to learning and competence.

Generally government agencies have a flurry of activity during the first round of communication of a new rule or programme – but this is not sustained, and new enterprises that start after that point cannot readily access the information they need. Too often the communication method is not suited to the SME audience or is confusing because of the different styles and approaches taken by the authors.

Recommendation 4

That there be readily and cheaply available to all SMEs a checklist of things they need to do, and the assistance that is available, when starting and growing a business. Any help-sheets that are produced must be in a consistent and user-friendly format and be kept up to date.

Employment regulation and good employment practices are often perceived as posing insurmountable problems for SME owners. Generally they are not skilled in the complexities of staff selection and engagement. Assisting them in making better selection decisions should lead to enhanced business growth.

In recent months the Department of Labour has produced useful tools to assist businesses to establish and maintain good employment relationships with their staff. In particular, the Employment Agreement Builder located on their website is proving helpful and popular. As good human resources management is critical to SME prosperity, we would encourage the Department to make rapid strides to enhance all its aids, and pitch them at a level that suits SMEs.

Recommendation 5

That a complete checklist of issues to be considered when hiring an employee, together with supporting advice and guidance, be made quickly and cheaply available for businesses.

Section 6: Access to Finance and Grant Assistance

Access to capital in New Zealand for purchasing a house, a car, a boat or even household items, e.g. televisions, refrigerators and furniture, is relatively uncomplicated. Larger items, like houses and cars, in themselves, are sufficient security for a bank or finance company to loan against. However, efforts to source capital on the basis of a business idea or expansion of a business that offers little hard security for the lenders are generally rebuffed by financial institutions.

Therefore, SME owners normally have to mortgage personal assets to fund the start-up and growth of their business. This demand by financial institutions for the provision of personal securities also effectively undermines the status of a small, limited liability company.

Some SMEs can borrow from family, friends and the rare business angel. However, more often than not, the growth potential of many SMEs is not realised because they cannot secure capital.

In New Zealand, the government's Venture Investment Fund experiment appears to have had minimal effect to date in expanding the size of the venture capital funds available for new ventures. In many overseas jurisdictions, governments have responded to the challenges SMEs face in raising finance by providing funds at subsidised rates or providing guarantees for SME lenders. We recognise the inherent challenge of governments making lending judgements in competition with those of well-functioning financial institutions. However, we think that there is an important role the government could play in encouraging the financial institutions in New Zealand to revisit their asset-based lending criteria and to look at criteria more suited to the situation of SMEs.

Recommendation 6

That the government undertake policy development work aimed at making access to funds easier for SMEs with growth potential (e.g. encouraging banks to lend on cashflow/ character in addition to assets; loan guarantees).

Accelerated Depreciation

Lack of finance and financial stress during periods of expansion are inhibiting factors for many SMEs when contemplating making a significant capital investment in their business. This flows on into lower national productivity levels.

During expansion periods, when installation, operational, training and marketing factors dominate management's time, SMEs are at high risk. Financing expansions is difficult for SMEs. Lending institutions concentrate on short-term security which impacts on cashflows during business expansions.

Adjusting taxation outflows seems to us to be a straight-forward way of reducing risk and smoothing cashflows at these critical times for SMEs.

This proposal would involve increasing the currently allowable tax deduction for depreciation in the first three years of plant installation and offsetting that by lowering the current deduction for depreciation rates in the following years when the expansion is maturing. Therefore, this proposal would be fiscally neutral in terms of tax revenues received over the life of the plant. It is not reducing tax owed – merely changing the timing of taxation flows.

Recommendation 7
That the government urgently undertake a revision of rates of tax deduction for depreciation with the view of reducing taxation in the first three years of plant installation, and offsetting that with lower allowable tax deductions for depreciation in the following years.

Sales and Marketing Support

A major challenge for SMEs is generating more sales. To achieve this they need to implement sensible sales and marketing strategies.

Most SMEs will have a sales programme of some kind in place, but will not have a marketing strategy. Both of these problems are endemic in the New Zealand context as we do not have a large enough domestic market to create brand presence and income for sales and marketing activities.

The government already provides grants for the development of marketing and sales strategies through NZTE. This includes basic marketing advice and training, information on particular markets, methods for accessing and selling in overseas markets, and funding for high growth firms to obtain professional strategic advice. This support is helpful, but often SMEs then lack the funding to execute these plans or strategies.

Therefore, there is a need for funding for the implementation of the marketing strategies. The recently announced Market Development Assistance Grant appears to move towards assistance in this area, but the precise terms of its operation have yet to be formulated. The FRST ‘SmartStart’ programme also provides limited marketing assistance for innovative products.

Recommendation 8
That the government develop a strategy for providing assistance to SMEs to implement sales and marketing strategies and plans.

Section 7: Opening the Way for Business

Enterprise Education and Support for Business Careers in School

Promoting entrepreneurial activity amongst young people is recognised internationally as critical to encouraging and assisting people successfully into self-employment.

Unfortunately the majority of New Zealand secondary school students leave school without having been exposed to the concepts of business enterprise. This is despite the fact that there are many enterprise education schemes currently being supported by the government, some of which (notably those promoted by the Enterprise New Zealand Trust) are recognised as world-leading.

Our observation is that the work of youth enterprise education providers in New Zealand is fragmented. They appear not to link with each other. Moreover, careers in self-employment seem to us not to be actively promoted by most school careers advisors.

We consider that it is time to give greater prominence to enterprise education in our curriculum. We note for example that in the United Kingdom 14-16 year-old students now have an entitlement to five days' enterprise learning each year. We think too that the government should act now to co-ordinate, raise the standards, and better support the best of the enterprise education initiatives available in New Zealand.

Recommendation 9

That the government ensure basic enterprise education is part of the core curriculum at Year 10 (4th form) and that provision is made for better support for enterprise education providers and for promoting careers in business to school pupils.

Government Procurement Policies

Government is the largest purchaser of goods and services in New Zealand.

Even the smallest government contract can provide the momentum for an SME to grow.

However, the procurement practices and processes of many government agencies work against the interests of SMEs. For example, risk-adverse purchasing officers will often automatically prefer a larger international firm to a small New Zealand-based provider.

Similarly, the government does not make the most of the opportunity it has to encourage higher product and services standards and innovation through the way it structures and awards its procurement contracts.

Recommendation 10
That the barriers to government agencies purchasing from New Zealand suppliers be identified and remedied to ensure that the government makes greater use of its procurement powers as a tool to encourage innovation and growth in New Zealand's SMEs.

Single Market with Australia

Exporting is vital to the growth of the New Zealand economy. Australia is our largest market and the one most SMEs would look to export to in the first instance.

Many SMEs rely on small orders and quick repeat orders. The high and rapidly growing fixed costs imposed by governments, at the customs border on both sides of the Tasman, therefore inhibit the growth of exports by SMEs.

CER has been in place for 20 years. While it has brought considerable benefits to firms on both sides of the Tasman, there is a need now to move quickly to a regime that establishes the concept of a Shared Economic Market, including common border arrangements and common product standards.

Recommendation 11
That the government make greater efforts to harmonise borders with Australia and make trading with our neighbour easier.

Section 8: Establishing an Enabling Regulatory Environment for Business

One of the significant challenges faced by SMEs is in finding out about which regulations are relevant to their businesses and then what it is they need to do in order to comply.

From the data collected during the Small Business Day events this year, the burden of regulatory compliance emerged as the single most important perceived barrier to SME growth.

As well as the costs faced in finding the regulations, the disproportionate cost to SMEs of compliance means that the effect of regulation/legislation is greater on SMEs. That is because they don't have the resources to deal with it, and also because many of the existing rules are impractical in the SME environment.

When regulations become too complex or too numerous, SMEs do not have the resources to comply. New Zealand's SMEs are not alone in feeling overwhelmed by regulation. A 2004 survey by the Federation of Small Business in the United Kingdom found that 60% of small business owners were dissatisfied with the complexity of legislation, 59% with the volume of it, 56% with the rate of legislative change and 55% with the costs of compliance⁴.

We acknowledge the work of the New Zealand Business Compliance Costs Panel established in 2000 and the efforts the government is making to implement their recommendations. We acknowledge, too, the clear and pertinent specification developed by MED of what is required in a Regulatory Impact Statement and Business Compliance Cost Statement. However, we consider that still too few government agencies accurately or rigorously consider the cost of compliance issues relating to the regulation that they recommend.

We believe that the process of developing regulation may be biased against the interests of business, and of SMEs in particular. This arises from a combination of misconception and disinterest on the part of regulators. These two things must be attacked head-on if progress is to be made.

SMEs are not baby enterprises waiting to grow up. They function in precisely the same way as larger businesses. The main differences are the size of the resources available to assist the owner to manage the business and the 'family-like' environment that typifies most SMEs.

⁴ Sara Carter, Colin Mason, Stephen Tagg (2004), *Lifting the Barriers to Growth in UK Small Businesses*, p.15.

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We do not argue that SMEs should be treated differently, or by exception, under the law. Rather we believe that when making regulations, regulators should design the rules with SMEs as the template. Larger companies would then also find compliance easier. Such a change would mean that government agencies would have to get a far clearer understanding of the realities of business activities in an SME.

This 'Think Small First' approach has been adopted by regulators in the United Kingdom.

We have a range of recommendations that would assist in creating the changed approach to business regulation in New Zealand that we believe is essential in order to enable SMEs to grow.

Recommendation 12
That each government department identify a small business advocate who would be responsible for presenting the SME perspective on any proposals being developed by the department that might impact SMEs.

Recommendation 13
That a senior manager in each government department be charged with scrutinising all the regulations designed by the department, to assess the need for them, their quality and the impact they will have on business (and SMEs).

Recommendation 14
That the government measure and publish the cumulative effects of the costs of compliance with regulations passed in the previous six months.

Process for Regulations

The 'Think Small First' approach should not be limited just to the design of regulations, but should also be applied to the way in which they are created and promulgated.

Recommendation 15
That all business-related legislation and regulations come into effect on only one or two pre-determined days per annum. Common commencement dates, especially when coupled with advance notice and guidance, would offer a greater degree of certainty, and would help SMEs to plan, budget and reduce their costs. In addition, businesses would know that they have to deal with regulatory changes only at fixed, predictable points in the year.

Recommendation 16

That proposals for changes to regulations that affect business be put out for a minimum three months' consultation period and not come into force until three months after the government or Parliament agrees to the changes. This provides adequate time for SMEs to contribute to the design of the regulations and to prepare for their commencement. Listening to businesses has a number of specific benefits. It allows government to tap the widest source of information possible and thus improve the quality of decisions reached; it alerts policy makers to any concerns and issues not picked up through existing evidence; and it helps to monitor existing policy and to determine whether changes are needed.

Advice from Government Agencies

A number of businesses have commented that they would like to receive more personalised advice from government agencies about their legal obligations. Usually, the only time they see a government agent is when they are being investigated or inspected for failure to comply.

Many of the businesses that attended the Small Business Day events in 2004 welcomed the chance to talk freely with the representatives of government agencies in attendance about what they could, and needed, to do to comply with regulations. The public servants reported that they too learned much about how their regulations practically affected businesses, and that feedback will assist them in redesigning regulations to remove unintended consequences.

Recommendation 17

That government agencies (particularly ACC, OSH and ERMA) run regular (e.g. every third Wednesday of the month) local information nights. There, businesses could learn what is required of them by way of compliance, hear what is new since last month, and have one-on-one advisory sessions (information from which is not passed on to the enforcement arm of the organisation).

Fringe Benefit Tax

There are two other areas of regulation that affect SMEs adversely and attract heavy criticism. These concern FBT and probation periods in employment.

FBT is a difficult and complex tax to apply to vehicle ownership and use. For example, the present regime does not deal well with situations where cars have little personal use, but are used a lot in the SME owner’s day-to-day business. Also, FBT is not calculated on the depreciated value of the vehicle. In these areas the application of the tax is unjust.

Recommendation 18
That FBT on business vehicles be simplified by moving it from the FBT return to an adjustment on depreciation in the employer’s income tax return and that this adjustment be based on the depreciated value of the vehicle.

Employment Law: Probation Periods

Employment law can be a minefield for SMEs. Continual changes to the law and the complexity and uncertainties surrounding its interpretation have led to the triumph of process over substance in many employment disputes. SMEs often avoid taking on staff for fear of the potential risk if the employee proves not to be suitable. Many other countries have responded to this problem by putting in place laws to deal with the situation in a fair and equitable manner. For example, in the United Kingdom there is a qualifying period of 12 months before an employee can take personal grievance action for a performance-related dismissal.

Recommendation 19
That the legal procedures for dismissing non-performing staff be rebalanced and qualifying periods for personal grievances for probationary staff be provided. We believe that these are the single most important changes that could be made to the employment legislation and that they would lead directly and immediately to employment and business growth.

Section 9: Small Business Day Series – an Afterword

Background

The Small Business Advisory Group was invited to participate in the delivery of the Small Business Day series. This comprised a series of small business-focused events held from February to May 2004.

Its aims were to:

- > celebrate New Zealand's small business successes
- > build relationships between government, its agencies and small business owners
- > explore issues and barriers to small business growth and performance.

The programme included:

- > visits by Ministers and MPs to around 30 local small businesses throughout the country
- > launch in Wellington of the Small Business Day series on 13 February 2004
- > Small Business Day events in 23 more centres around New Zealand.

The series was arranged by MED and delivered by local Chambers of Commerce, Economic Development Agencies and Employers and Manufacturer's groups.

Achievements

- > Every event drew positive attention to SMEs' contribution to their local communities
- > Over 5000 visitors attended the 24 regional events
- > More than 175 seminars were delivered
- > Over 300 business people received individual mentoring
- > On average 15 exhibitor stands from government agencies and business organisations were featured at each event.

Overall we consider that those attending found the events useful and informative.

Observations

We understand that the Ministerial visits to individual businesses provided Ministers with insights into the operations and concerns of SMEs.

The Small Business Day events were attended mainly by people who had recently started or were planning to start a business. They displayed a strong appetite for information about government services and a need for assistance with planning and marketing.

Business owners from mature businesses who attended were looking for new ideas or help with expansion plans. These people wanted more detailed information and specific assistance.

The format of the Small Business Day events (they were held from 12 noon to 7.00pm) did not readily suit experienced business owners, who had difficulty leaving their business for such an extended period and who were unsure ‘what was in it for them’.

The capability and motivation of the local co-ordinator and the host organisations significantly influenced the quality of each event. Accordingly, there was considerable variation in performance across regions.

More money could have been spent on advertising and promoting the events.

Conclusions

SMEs need a one-stop interface with government through which they can source information and advice about where they can get assistance.

The Biz brand is recognised as a useful place to gain early stage information. Its value could be extended if it offered more information and if more government agencies used Biz as a complementary communication channel to their own. This would be in line with the whole-of-government approach that is being promoted presently. However Biz needs a great deal more marketing effort to ensure a greater percentage of SMEs are aware of what it has to offer.

The Small Business Day events showed SMEs’ desire for better communication and interaction with government. It was apparent that many government agencies have the resources and skills to meet that need. We have recommended one way in which these interactions could be enhanced (Recommendation 17). We consider, too, that government agencies should be encouraged to support (through providing content and attending) small business events that are arranged by local business groups (e.g. Chambers of Commerce).

Finally, we consider that the Small Business Days series initiative created a positive relationship between SMEs and government agencies. While in some places its delivery this time may not have met expectations, the Group believes a repeat of the series should be contemplated every year or every second year.

Section 10: KPIs – Measures of Performance

We consider that the following measures will, on balance, comprise a fair reading of the success of the government's policies and programmes as they affect small business:

- > Higher growth in small business than in economy-wide activity– as measured by the National Bank Small Business Monitor
- > Continued improvement in the average productivity growth in SMEs (as measured by contribution to total economic output) – from the MED annual SME Structure and Dynamics report
- > Increase in the numbers of start-up businesses – from the MED annual SME Structure and Dynamics report
- > Decrease in negative red tape perceptions – as revealed, for example, in the KPMG-Business New Zealand survey.

In terms of your personal performance as Minister for Small Business, we will judge you on the following:

- > Every recommendation in this report is responded to within 12 months
- > The quality of Regulatory Impact Statements improves
- > More SMEs take up mentoring opportunities
- > There is an increase in the number of local business award competitions
- > More New Zealand SMEs win government procurement contracts
- > There is an enhanced, government co-ordinated information portal for business.

REPORT FROM THE SMALL BUSINESS ADVISORY GROUP

RESPONSE FORM

The Small Business Advisory Group welcomes any feedback on this report.

Please take time to complete this response form and return it to:

Small Business Advisory Group, PO Box 1473, Wellington

or fax it toll free to 0508 775 775.

We'd like to know how you rate our recommendations for government action (please tick your choice):

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Mentoring services	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Advisory Boards	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Local business awards and benchmarking	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Checklist for starting and growing a business	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Checklist for hiring an employee	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Enhancing access to finance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Accelerated depreciation on capital equipment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Grants to implement sales and marketing plans	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
More enterprise education	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Government procurement practices	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Harmonising borders with Australia	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Small business advocates in government departments	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Senior managers in government departments scrutinising regulations	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Calculating the cumulative costs of compliance with regulations	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Business legislation and regulations to come into effect on two days per year	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Minimum three months' consultation on regulation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Regular government agencies information nights	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
FBT on business vehicles simplified	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Qualifying periods for personal grievances during probation periods	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Other comments on the Group's report:

Respondent's information. Please complete the following:

Industry sector: _____ Region: _____

No of employees: 0-5 6-19 20+

Would you like further information on the work of the Group? Please complete the following:

Name: _____ Company: _____

Address: _____

Email: _____

Type of information wanted: _____

Small Business Advisory Group

Purpose

To give SMEs a greater 'voice' in policy development and to advise Ministers of issues facing SMEs. The Advisory Group provide a means for departments and the government to take more fully into account the interests of SMEs in policy initiatives and provide a deeper understanding of how government can work most effectively with SMEs. The Advisory Group also provide a means for dialogue with SMEs that goes beyond individual and immediate issues.

Functions

- > To provide ongoing advice to the Ministerial Group on Small Business on any issues affecting SMEs:
 - Identifying issues impacting the growth and development of SMEs
 - Suggesting priorities
 - Exploring solutions
- > To provide assistance and advice to government departments on consultation with SMEs
- > To provide, for discussion with government agencies, suggestions on ways for enhancing SME and government agency performance.

Means

- > Conduit – the Advisory Group seek input from SMEs utilising existing stakeholder groups and their own networks. They also provide feedback on government initiatives to these same groups.
- > Analysis – the Advisory Group use their business expertise to analyse the impacts of proposals on small business and assist the government to identify areas where further work should be undertaken. They work with relevant government departments on the issues being investigated.
- > Advocacy – the Advisory Group advise the government on any matters affecting SMEs.
- > Sounding Board – the Advisory Group may provide advice on policy issues as they develop.

Membership

- > Peter Kitchen, Kaitaia, tourism sector, SME owner, Māori
- > Nigel McKinlay, Dunedin, footwear manufacturer, business owner
- > Alison Quesnel, Auckland, country manager health products firm, business mentor, SME owner
- > Lachlan McKenzie, Rotorua, farming, SME owner
- > Denise L'Estrange-Corbet, Auckland, fashion design and retail, SME owner
- > Murray Cleverley, Timaru, CEO Economic Development Agency, meat processing, SME owner
- > Cameron Moore, Christchurch, manufacturing, SME owner
- > Stuart Wilson, Wellington, information technology, SME owner
- > Robyn Reid, Nelson, aviation, SME owner

