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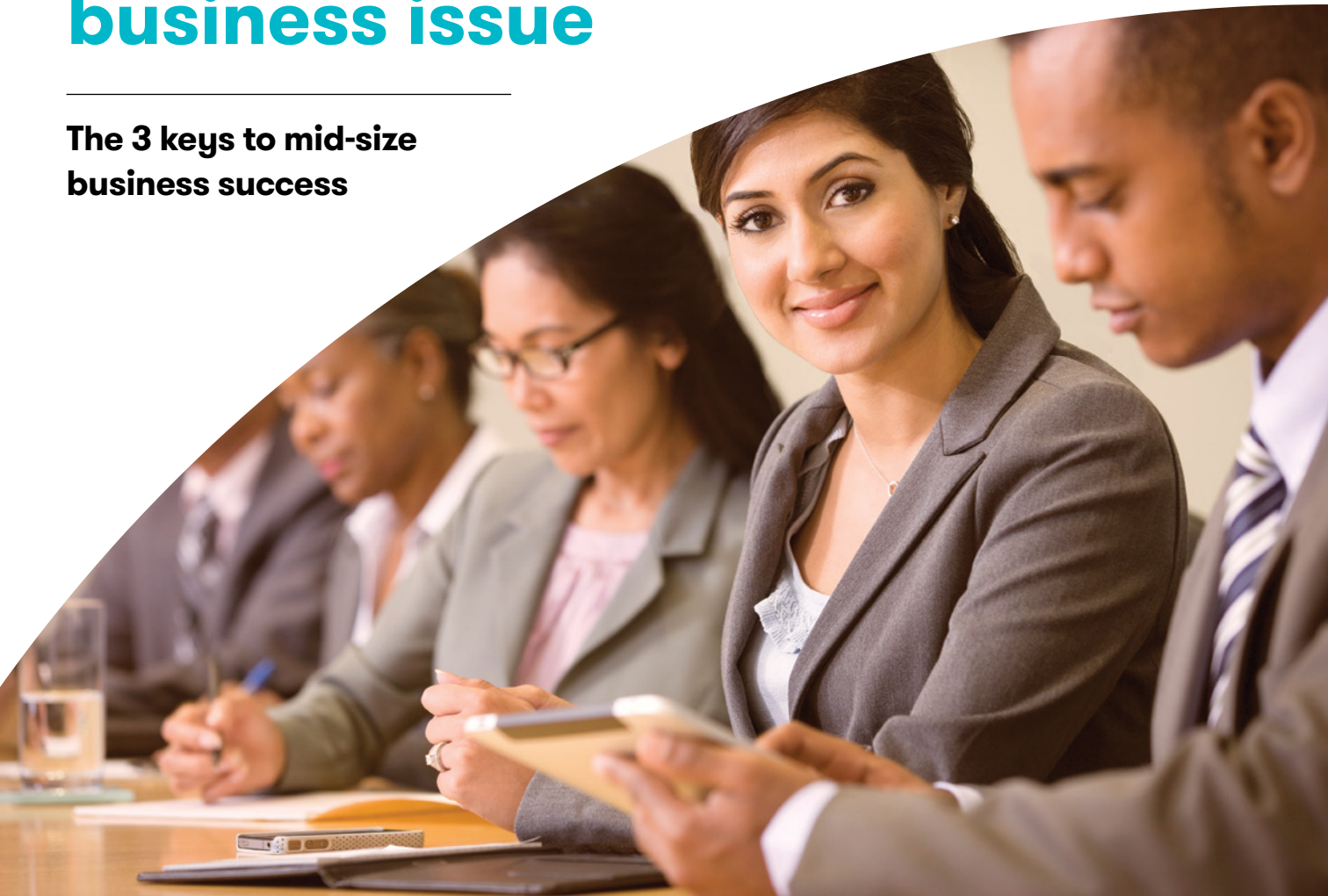
# Business Adviser

Q4 2019 Issue 78

Commentary, opinion and intelligence for the  
New Zealand business community

## The mid-size business issue

The 3 keys to mid-size  
business success



**PLUS**

Key opportunity missed in  
Government's plan for a  
productive economy

The mid-market's  
growing pains

Evolve or erode: How the  
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# Key opportunity missed in Government's plan for a productive economy

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The Government's economic plan for a productive, sustainable and inclusive economy was released in September, and includes a raft of initiatives designed to address our national productivity challenges. However, an opportunity has been missed to empower a key area of the economy that has the potential to drive a significant lift to NZ Inc's bottom line – mid-size businesses (MSBs).

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Grant Thornton New Zealand's 2019 mid-market report, *The power and potential of the mid-size business*, revealed our MSBs are not performing as well as their counterparts overseas, but with targeted interventions by both Government and the businesses themselves, there is huge potential for this sector to accelerate its growth. But first, there needs to be a fundamental change in the way we define and talk about the business groups that make up our economy.

The Government's productivity report has correctly identified the need to develop skilled, adaptable people with access to lifelong learning. We know one of the trickiest areas, particularly in a small economy like ours, is finding and utilising the right skills. The Government's Review of Vocational Education (RoVE), is also focused on addressing how we develop those skills in the workplace. Our research demonstrates that MSBs are acutely aware that to grow, they need skills. Employment growth within the mid-market was 24% across the five years to 2018 compared to 8.9% and 13.9% for small and large businesses respectively. However, while mid-sized businesses are investing in people, that isn't leading to results in terms of productivity. It's not a people problem, it's a productivity problem, and our mid-sized businesses' low productivity (measured by income per employee) could indicate that the right skills aren't being found or correctly utilised.

The Government's assertion that access to capital is critical for growth is also pertinent and mid-sized businesses feature on the wrong side of the scales when it comes to capital investment as well. Our study found that while 76% of mid-sized businesses requesting financing in 2018 favoured debt financing, only 9% of all mid-sized businesses requested equity financing. Owners are reluctant to give up a share of ownership to an investor, however, in many cases it's necessary to achieve

meaningful growth.

Productivity has been a challenge in New Zealand for a long time, with consecutive governments trying to find a solution. A fresh, more targeted approach is required, otherwise government programmes, initiatives or investment will continue to grapple with our productivity problem and struggle to deliver desired outcomes.

The one thing successive governments have shared is the inclination to put small and medium sized businesses into the same bucket. With around 500,000 businesses in that bucket, it's a big ask to both leverage opportunities and meet the needs of such a diverse group. By forming a sharper definition of what a mid-sized business is, Government can then identify and address the specific needs of these businesses, which differ greatly from their smaller counterparts.

MSBs employ nearly 400,000 New Zealanders and contribute \$35 billion to national GDP. There is a need and opportunity for Government and government agencies to provide specific support and interventions. And they need to take New Zealand mid-sized businesses into account as well. Only then will we see the sort of economic transformation the Government's plan is aiming to achieve.

Visit [grantthornton.co.nz](http://grantthornton.co.nz) to download your copy of *The power and potential of the mid-size business*.



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# The mid-market's growing pains

## Meaningful mid-size business growth means solving 'the people problem'

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What prevents mid-size businesses (MSBs) from growing their revenues and profit margins, and even becoming large businesses? One factor is how daunting growth can be: choosing how and where to grow; stepping out of a secure position into a more precarious one; a fear of overreaching and putting the whole business at risk. Even though the reward can be a bigger, more solid and long-lived company, a lot of MSB owners are up against some significant challenges.

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### How Kiwi MSBs get stuck

The New Zealand market is small compared to other economies, and when you target a particular niche, like government for example, you can rapidly saturate it; so expanding your market becomes an obvious solution.

Grant Thornton's 2019 mid-market report, *The power and potential of the mid-size business*, reveals that 27% of Kiwi MSBs exported in 2018, and only 1.9% have international operations, which is relatively low compared to approximately one third of UK and Australian MSBs and nearly half of those in Germany.

However, setting up operations overseas and exporting poses several challenges.

New Zealand is still a long

way from the rest of the world in geographical terms and this presents extra costs and logistical headaches. It feels like that shouldn't be a problem considering the advances in technology and globalisation, which has broken geographical barriers. However, most products do have geographical challenges when it comes to export. Take technology itself for example; to get your tech into other countries, you need to be there, in person, talking to people and setting up partnerships, offices or distribution. The travel alone is onerous and expensive, and takes owners away from their families and their core businesses operations back home (Rod Drury, for example, has said how stressful he found it to be travelling while he grew Xero.)

Additionally, exporting may not be

a realistic expansion option for certain industries. In New Zealand, the majority of our mid-size businesses operate in sectors that make opportunities for export problematic – wholesale, retail and construction.

In other cases, if an MSB is in a sunset industry, expansion and export might require an enormous pivot – which could be both risky and expensive. Does a successful owner, already enjoying the Boat, Bach and Beamer lifestyle, want to start pivoting in a whole new direction? Do they want the challenge of bigger contracts and the bigger risks that come with them? Do they have the energy and enthusiasm to turn the sunset into a sunrise? Maybe not. At the same time, we need to respect that each business and owner is different and has different goals.



## I believe developing and/or accessing specific skillsets is one factor preventing MSBs from growing

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I believe developing and/or accessing specific skillsets is one factor preventing MSBs from growing.

## The skills solution

One of the trickiest areas, particularly in a small economy like ours, is having the right skills. Our research demonstrates that MSBs know that to grow, they need people; employment growth in the midmarket was 24% over the five years to 2018 compared to 8.9% and 13.9% for small and large businesses respectively. However, MSBs' low productivity (measured by income per employee) is a barrier to growth and could indicate that the right skills aren't being utilised.

Adding new employees is a major commitment. It's challenging if you don't have quite enough work for them at the time, and they're not adding enough value to the business; it's a serious cash investment that can take time to get a real payback.

The calculations aren't simple, either. Working out whether a new full-time role will pay for itself always involves an element of guesswork. It's so much easier to do a cost-benefit analysis on new plant or a company car.

But there are some tried-and-true ways to grow in a measured, balanced way when it comes to your workforce, and these can help MSBs to grow or even transition into large businesses. And by doing so, owners and other stakeholders get to experience all the longevity and profitability that comes with that.

There's a laundry list of skills that your MSB might lack, but which don't yet call for a full-time employee. It includes industry-specific expertise, as well as HR, finance, IT, legal, sales or marketing.

Take marketing for example. When

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## MSBs should have a strategy to create a future focused talent pool all the way from senior management to the shop floor.

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you run a small business, you might begin by doing all of the company's promotion yourself. Then as you grow, you start to outsource parts of your marketing activity to someone else who spends a few hours a week on branding, maintaining your website and working on other areas of your online presence, and charges you an hourly rate. Eventually, you're going to need someone to spend a bit more time on maintaining a presence in your market to remain competitive – eventually implementing regular advertising or blogs, and certain campaigns to keep your business visible and aligned with your business's strategic objectives. That work might go to an external provider, although you could employ someone part time or a freelancer. The difficulty with part-timers is that good part-time and freelance workers can be tough to find, which is where consultants and agencies can come in handy.

I often see this with our clients: they recognise that they aren't yet ready to commit to a full-time staff member, but they can still use specialist resources to help them as they transition towards growth. You can turn the tap on and off, as you need it – often on a project basis – to help you get to that next stage, and in the meantime you tend to gain a clearer picture of the skills and

expertise required to keep moving the business forward.

Once you're at that stage, the cost for external consultants and agencies will begin to exceed a full-time salary. That's often a signal that you can start to think about bringing some of those skills in-house. Typically, that would mean a full-time marketing person for example, but as your company grows it will mean a marketing team led by a senior marketing person. The gap between paying a part-timer and needing a Chief Marketing Officer (or any other C-suite expertise) seems like a chasm, but it doesn't happen overnight and it's a journey that several of New Zealand's large businesses have made successfully.

### A future-focused talent pool

To have the right people – and keep them – you need a roadmap for long-term workforce planning. A strategy to create a future-focused talent pool, all the way from senior management to the shop floor. That roadmap needs to take into account customers' needs now and in the future, and the

changing way that employees want to work: how will the business move and keep up with the use of technology, flexible working and home-life balance?

Long-term strategic workforce planning will help any business to thrive, retain skills and reduce staff turnover. The business will change and flex, the mix of people will vary over the years, and technology will continue to disrupt your model. But your business can flow into its next life cycle – if not growing into a large business, then maintaining or improving its current profitability for less work, making its owner and its employees all better off.

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# The **3** keys to mid-size business success: Products, people and processes

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What makes an outstanding mid-size business (MSB)? According to Marcus Lemonis, the secret lies in the three Ps: products, people and processes.

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## **Product:** you've got to keep it up to date

Even if you have great products or services today, it's important to continually review your offering or risk becoming extinct tomorrow.

You don't want to get left behind by technology that's constantly evolving or shifts in what your customers want or need. Keep your product real – don't become complacent. Regularly ask yourself questions like: "What will my customer be buying from us in the future?" And: "How will they be buying from us?"



## **People:** Get the right people into the right roles

While a business grows, its revenue generally increases and the number of customers surges – and yet, many businesses continue to operate as a small business when it comes to their people strategy.

People can pose the biggest challenge within any business but they can also provide the biggest opportunities.

From my experience, businesses generally have a very loyal and hard-working team supporting them – some

However, it's rare to find a business that can do all three aspects well. It's much more common, in my experience, to find companies that provide a great product or service but still have plenty of untapped opportunities when it comes to their people and/or processes.

of whom have been with the company since it started. As the business grows, these people are often rewarded by being promoted into management roles and all of a sudden, become responsible for managing large teams. However, they generally haven't had any management training or support and often don't have the skillset or drive required for a position in management; some of these people don't even want the extra responsibilities that come with a more senior role.

Teams operating within a small business look quite different to those within a MSB – the structure is bigger, there could be multiple divisions and teams, and more governance is required; so it's important that you invest in the right people who can provide the right level of support to ensure that the organisation can continue to flourish. This could involve upskilling your existing people, or bringing in new blood.

Bringing in new skill sets and experience can be challenging, especially when you want to preserve the existing culture. It can also force you to have some tough conversations with those loyal and long-standing team members when you're looking to employ new people to manage them. However, you may often find that these team members are more than happy to step aside as they don't want the risks and responsibilities that come with new roles; and besides, there are other ways to reward and retain those loyal and hard-working people.



## Processes: Invest in future growth

Kiwi MSBs can also make some dubious decisions when it comes to investing in improved processes and technology – they are reluctant to commit. Sometimes this is due to the large initial outlay that might be required, they may be nervous about moving away from a familiar system, or maybe they don't feel confident that they have the right team around them to implement a change.

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## Inefficiency is a growth killer for MSBs.

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For example, a small business may have grown from selling \$200,000 widgets per year to \$10m, but their team is still using spreadsheets to process inventory orders. The owners are hesitant to invest, say, \$100,000 up front on a whole new e-commerce website with stock management technology if they can defer it. They'd rather spend in areas that grow sales and employ an additional person to

help with the increasing orders and inventory levels.

Short-term, this seems like a far more cost-effective approach, but long term, it's essentially throwing people at a problem which is an expensive and somewhat inefficient way to do business.

Inefficiency is a growth-killer for MSBs. When you own a small business with an annual turnover of \$2 million, the various inefficiencies might only cost you \$10,000 or \$20,000 a year. You and your team do whatever you need to get the product to the customer – and the losses caused by inefficiencies aren't enough to hamper growth significantly.

Scale that business up to turnover of \$10 - \$20 million a year and suddenly those inefficiencies have also scaled up, and you're losing \$400,000 a year. Basics like holding too much inventory, inventory outages, inaccurate pricing, quality issues, customer refunds and team turnover are exponentially more costly. And in the meantime, the customer experience is suffering because of an outdated user experience.





The good news is that these challenges can be resolved, and results can be impressive once the right systems and processes are put in place.

Some of the symptoms of a business that may need to invest more in systems and processes are:

- **Wages have blown out:** they're far higher than they used to be in relation to sales
- **Margins are dropping off:** wastage and inefficiencies are chipping away at profits
- **Customer complaints are rising:** errors or lack of communication are leading to frustration and loss of business
- **The team is not engaged:** they're working harder for the same results as inefficiencies ramp up
- **Invoicing is late or inaccurate:** time or products are not captured quickly and accurately

- **Information is unavailable:** timely updates about how the business is tracking aren't available

One of the most valuable services an advisor can provide for clients is spotting inefficiencies within their businesses and working with them to understand the benefits of investing in the right people and/or processes. When looking at the costs of making any changes, you need to take into account both the direct and indirect benefits that could be obtained: *i.e., how can we put a value on an improved customer experience?* Other questions that you might want to ask yourself are, "Will a new system take your business, into the future?", and more importantly, "What is the impact of not investing in the right people and systems?"

These aren't always easy questions to answer, but by investing

some time and energy into getting it right, you can build a highly successful business that excels in all three key areas.

Ultimately, it's important to remember that what worked when you were a small business won't necessarily work for you now that you're an MSB.

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# Evolve or erode:

## How the right advisors can help you grow your mid-size business

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Mid-size businesses (MSBs) are a vital part of the New Zealand economy, providing hundreds of thousands of jobs and contributing significantly to our GDP. Yet our research shows that there are some areas where our mid-market is underachieving and even stagnating.

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The step from a MSB to a larger business is a sizeable one, and few MSBs are ready to make the leap. More typically, mid-size businesses are on a treadmill of comfortable incomes but flat growth. Our data joins the dots to draw a picture of this type of MSB:

- A mature business with solid revenue
- Modest profitability and productivity
- Under-investment in R&D and innovation
- Static income levels
- An owner-manager who is highly involved in the business
- A reluctance to take on more debt or ask for help; owners likely prefer to be independent and in control

In many cases the owners of these businesses feel comfortable where they are right now. They are not keen to take on additional risk in the form of debt or investment to facilitate expansion. They are also not enthusiastic about giving up any control of their business. There appears to be a certain level of complacency in New Zealand MSBs that is preventing them from growing into large businesses.

These attitudes are understandable, and we certainly cannot expect every business owner to be constantly aspiring to grow. There's nothing wrong with enjoying a comfortable position in life and business, particularly if you are close to retirement.

However, everything in life has its risks, and that includes doing nothing. Complacency carries a serious risk of business retraction. Change is happening at record speed in the modern economy; you need to embrace disruption simply to keep up with your competitors. Failing to evolve means your business model will likely become redundant and the value of your company will gradually erode over the years.

## The right advice to drive growth

If you're motivated to increase the value of your business in the long term, the first step is being ready to accept advice and new ideas. You need to be open to innovation and disruption, which means being challenged on what you're currently doing. It's not going to be comfortable or easy – it's going to require a willingness to listen. You need a diverse team of people around you who will ask the difficult questions, rather than simply agreeing with management because it's the path of least resistance.

Engaging professional advisors and specialists provides an independent perspective on the business from a range of different lenses. One option to engage specific expertise is to establish an advisory board. An advisory board's role is to provide advice to the directors and management, without having the formal authority to govern. It has no powers of veto, instruction or direction – either actual or implied. That means the advisory board can exercise its best judgement and offer advice in good faith, without the same responsibility as a constitutional board.

An advisory board should bring in the skills and experience that are required in your business; it also provides additional flexibility to substitute board members on a more regular basis to meet the current business needs. That might be industry-specific expertise, or skill-based expertise like finance, IT, marketing or HR. You need a diverse range of people with myriad experience – packing a board with yes-men adds little to the decision-making process. By including

external professionals such as your accountant or lawyer, you can get the benefit of their experience working with businesses who have similar challenges and opportunities.

It's easy for a business to fall into the groupthink trap; independent advice helps you avoid this by identifying risks you haven't spotted, and to develop solutions that might not have occurred to you.

## Direction and distance

Opening up your perspective means you can consider new ideas and let go of the day-to-day tasks of running your business. To grow your company, you need to step back from the minutiae of filling orders or talking to new clients. And no matter how well you know your business, you can't possibly be good at everything: marketing, finance, sales, HR, customer service and IT. You need to stop doing the jobs that you're not particularly good at or value adding.

Instead, you should stand back and be more analytical. Where is the business going? What will it look like in five years? What's your exit strategy? Where can your specific expertise be best applied? I've found a surprising number of business owners can't really answer those questions. They're often stretched too thin trying to do everything, despite not having the skills to do it all well. Engaging an advisor to help implement strategic changes reduces stress levels and frees up time for owners to really concentrate on building a stronger, more valuable organisation.

The right advisors will provide a sounding board for your analysis, while assisting to set a strategic direction for the business. It means seeing beyond what's happening

today and talking through long-term decisions that will shape the future of the company.

## Risk and reward go hand in hand

Investing in your business increases your financial exposure but it also increases your potential for improved returns. If your company is well-established, it should be able to withstand some knocks along the way toward growth. For many owners the business is their largest asset and you can maximise its value

As the owner of a stagnating MSB, you can own 100% of a business worth \$5 million. Invest cleverly, borrow when you need to, get the right people on board and you can grow it into a large business. Then you might own 50% of a business worth \$20 million.

Open your mind, build an advisory board of people who will challenge you, and your business could successfully make that leap from mid-sized to major player. A solid first step is to talk to a business advisor who can help you navigate some of the challenges and support you in driving profitable growth.

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# Separations highlight problems in family law



People in their forties and in relationships of between 10 to 20 years are most likely to separate, with three-quarters of New Zealanders getting divorced because they fell out of love, according to the New Zealand Relationship Property Survey 2019.

Extra-marital affairs were the second main cause, followed by unreasonable behaviour. Another trend identified in the research is the increasing number of separations and section 21 pre-nuptial agreements of those over 50 years old, the so called “silver splitters”.

Produced by Grant Thornton New Zealand and the New Zealand Law Society’s Family Law Section, the research is based on the views of over 250 law practitioners and builds on the previous survey undertaken in 2017.

The survey results also show a significant decrease in lawyers also undertaking relationship property work on legal aid. Forty-four per cent of participants have ceased doing legal aid for relationship property matters in the last two years. This is consistent with recently

publicised concerns about access to justice in the civil courts, and highlights concerns about the impact on the public’s access to justice in relationship property matters. Twenty-five per cent of lawyers indicated encountering problems due to the inequality of financial resources as between parties to pursue the resolution of their relationship property matters.

This survey also indicates broad agreement by the legal profession with the Law Commission’s recommendations for reviewing the Property (Relationships) Act 1976. This includes a recommendation that if one partner owned the family home before the relationship, only the increase in value during the relationship should be shared.

## Other key findings



Many lawyers agree with the Law Commission’s proposed income sharing arrangements after separation where there are children involved or the relationship has lasted more than ten years.



Lawyers involved in relationship property matters engage a range of experts. Valuation professionals remain the “go-to” advisors for relationship property lawyers.



A significant number of practitioners also obtain legal opinions from senior counsel, further enhancing the quality of advice they can provide their clients.



Relationship property practitioners continue to undertake some of the most significant legal work for most New Zealanders when it comes to their assets and offer high levels of experience and related expertise in this complex area.

The survey shows that family lawyers have been busy and are expecting to get busier.

The report is an important resource to help build awareness into the practise of relationship property law and identify the challenges lawyers working in this space and the people they advise are facing; it can be downloaded here: [tinyurl.com/gtnzrp](https://tinyurl.com/gtnzrp)



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