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Word of **warning** for NZ businesses amid rise in global optimism

Global survey findings from Grant Thornton's latest International Business Report (IBR) reveal that global business optimism is continuing on a positive trajectory.

In the Asia Pacific region, optimism has increased significantly, leaping to an historic high of 58% over the last year and APAC GDP growth is forecast to reach 5.5% this year, ahead of global projections.

New Zealand business optimism remains at 68% compared to last quarter after a slight, but expected slump around election time, dropping from 80%. The New Zealand Institute of Economic Research has noted the decline in confidence was less severe than in previous election years.

New Zealand continues to pull ahead of Australia, who sits at 60%.

Revenue and profitability forecasts are also starting to soar globally since last quarter, and are at their highest since before the global financial crisis; businesses are expecting to see both continue to rise.

However, firms must avoid short-termism and increase their investment in long-term growth.

Unfortunately, the IBR has revealed that investment in employment and technology is starting to slip among Kiwi businesses surveyed, and investment in plant and machinery has declined to an historical low of six per cent. Meanwhile, a lot of our global counter parts are boosting investment in these areas.

New Zealand businesses will need to meet growing demand through hiring more staff and the move towards automation presents opportunities for businesses to invest in technologies to increase productivity.

We are fast approaching the peak of the current economic cycle. Businesses need to start thinking about what they can do to leverage opportunities in the current environment to ensure the party doesn't stop when the global economy comes off its current high.

6%

Investment in plant and machinery has declined to an historical low of six percent.

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Will the Tax Working Group boldly tax where no Government has taxed before?

The Government's Tax Working Group (TWG) met for the first time at the end of January to commence their quest to review the structure, fairness and balance of New Zealand's tax system.

But given that some areas are 'out of scope', including increasing income tax rates, the rate of GST, inheritance tax and making changes that would apply to the family home or land beneath it – is this largely a toothless exercise? What untaxed areas exist and what can we expect from their findings?

Sin tax

Sin taxes are levied on goods or services that are deemed "sinful", ie, vices like tobacco, alcohol, or gambling. These have always been a good source of revenue for the Government and can be easier to implement and raise, as they relate to products or services that harm the community.

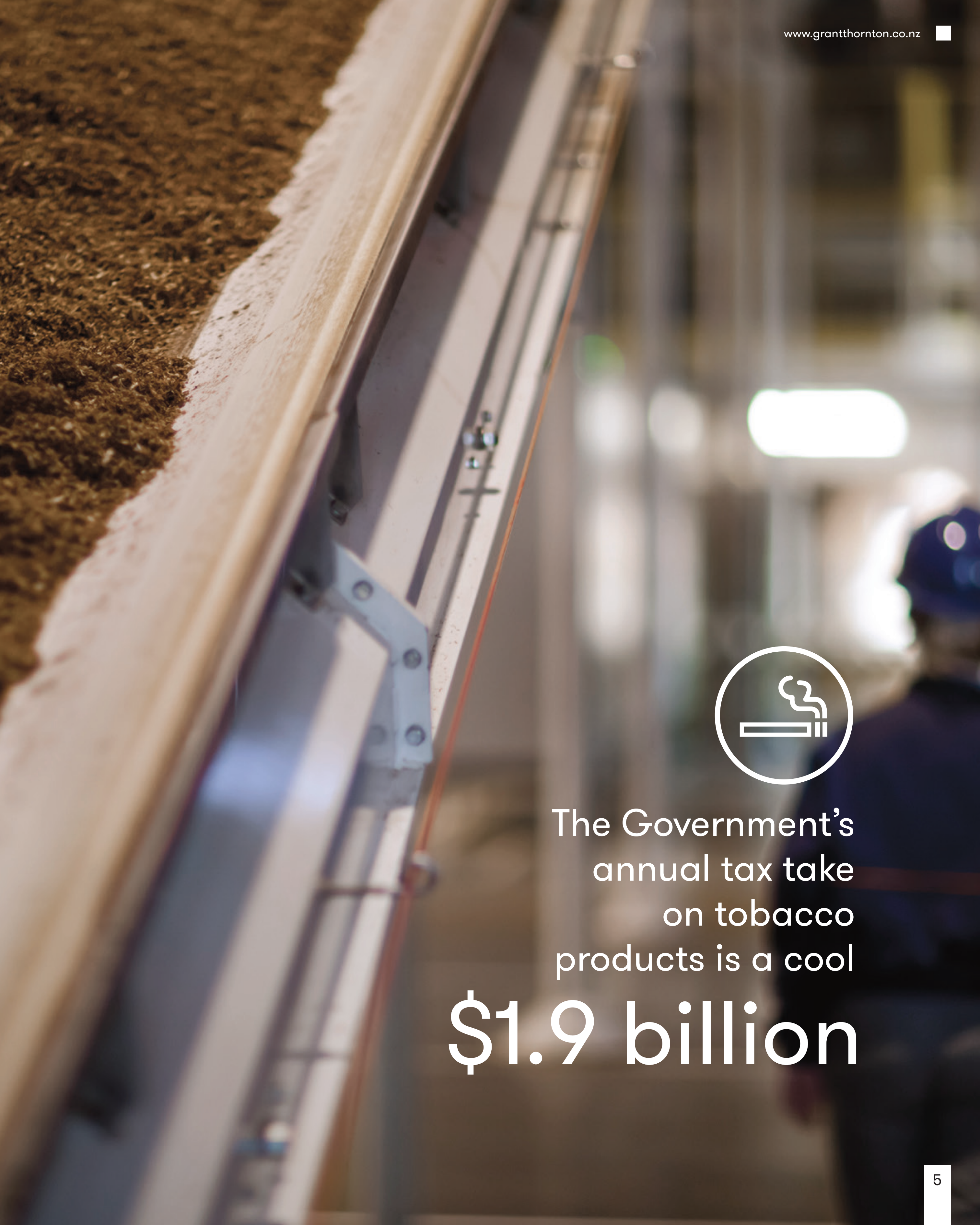
Starting a beef with farmers?

Our newly elected Government is committed to creating positive environmental outcomes, so could a focus on farming remain on the agenda despite the suggested water tax on farmers being scuttled before Christmas?

The United Nation's Food and Agriculture Organisation says livestock accounts for about 14.5% of the world's total greenhouse-gas emissions. This number will only increase with the massive growth in the middle classes of most BRIC countries, and the subsequent demand for meat that will no doubt be associated with that. With heightened public awareness about the impact farming has on our environment and climate change in general, meat production could be badged as a sinful activity in New Zealand with a tax to boot. This would not be popular on a range of fronts, leaving many voters unhappy, particularly meat consumers who would inevitably wear these costs. So the chances of this coming to fruition are unlikely, but one to watch going forward.

Replacing a traditional tax take that's slowly going up in smoke?

The Government's annual tax take on tobacco products is a cool $1.9 billion. Numerous price hikes on cigarettes, and alleged lower health risks have seen 'vaping' take the smoking world by storm. In New Zealand, the number of smokers stubbing out their cigarettes for good in favour of this trendy new market entrant is growing exponentially. A positive change at a holistic level, but this new uptake in e-cigarettes will surely be giving Government withdrawal symptoms over the prospect of losing millions in the annual tax take. Although there is no conclusive research about the true nature of adverse long term health problems caused by vaping, there will no doubt be some discussion about how to regulate and potentially tax these new products sooner



The Government's annual tax take on tobacco products is a cool

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rather than later. It's a big revenue hole that will need to be filled by some alternative thinking – perhaps legalising cannabis to boost tax takings may become a front-runner.

Bed tax

Last year, Auckland City Council introduced a 'bed tax' much to the dismay of commercial operators. What made it more pointed was the explosion of casual and more sophisticated Air BnB hosts which were given a reprieve from this; this could present a prime opportunity to increase the tax take while ensuring 'efficiency and fairness' are maintained.

Although the bed tax is currently an Auckland centric levy, why not consider focusing on national operators, including the Air BnB and other short-term rental accommodation providers. Many of my clients are steering away from traditional residential rental activity and moving towards the more lucrative Air BnB business model. This has heightened the shortage of rental properties available, which is a problem not unique to New Zealand. San Francisco is currently suffering a serious housing crisis which has been exacerbated by the growth of Air BnB hosts; so, earlier this year a law was enacted that required all Air BnB hosts to become registered providers (for a fee) resulting in an almost 50% reduction in hosts. The intention is to reduce the squeeze on rental supply, while increasing the revenue take. It also provides tax authorities with access to a central register to ensure all landlords are declaring this additional income. Almost half of the hosts were removed from Air BnB due to non-registration, so it seems the tactic may have worked (initially anyway).

In addition to the registration cost ($250 USD every two years), a bed tax of 6% is imposed on short-term rentals offered in San Francisco. New Zealand has in excess of 20,000 Air BnB hosts who rent their properties out for an average 28 nights per year earning $2,900. A 6% bed tax in conjunction with an annual registration fee at say, $200 could net north of $7.5m annually. If we factor in those who use other sites such as Book a Bach and Trademe, then the tax take will easily be in excess of $10m, and that is just from non-commercial operators. Add in the balance of commercial accommodation providers outside of Auckland (in excess of 30 million 'guest nights') and the revenue take would be significant.

Capital gains tax

Looking at the terms of reference provided to the TWG, and given the areas that are specifically 'out of scope', I wonder whether everything has been geared towards a more comprehensive capital gains tax (CGT) which will form a significant part of the TWG's potential recommendations.

It's no secret that CGT has long been on Labour's wish list; the substantial restrictions being imposed during the review process are likely to lead to an inevitable conclusion - the subsequent recommendations will then be used as a mandate come election time.

New Zealand is a clear outlier with our trading partners around the world in that we do not have a comprehensive capital gains tax regime. I personally consider the lack of CGT to be a flaw with what is otherwise a broad based tax system, which creates unwelcome distortions in our investment activity.

Draft legislation has already been introduced to capture gains on residential property sold within five years of acquisition. This extension to the brightline test is intended to 'dampen' the heated property market and provide a disincentive to speculators – but it has far reaching ramifications for investors too. You have to wonder why the focus is only on residential property. Why not commercial property, farmland or the sale of a business – it may be that the introduction of a full blown CGT regime is drip fed to the voters to make the concept more palatable.

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Is social enterprise the right move for your Not for Profit organisation?

To social enterprise, or not to social enterprise: that is the question.

It's a hot topic around the globe as the gap between 'funding needs' and 'funding reality' continues to grow wider.

Done well, social enterprise can deliver opportunities to generate revenue while delivering on your organisation's mission and purpose. They allow Not for Profit entities to gain greater financial independence, expand their activities and scope of services, and to build better connections with the community.

However, there are risks, especially if your organisation has limited commercial and governance capabilities. When executed poorly, social enterprise can burn through your 'social capital' at an alarming rate and jeopardise not only the social enterprise, but the organisation it supports.

So how do you know if setting up a trading operation is the right move for your organisation?

Focus on the golden rules of social enterprise. The services or products it offers should be innovative, unique, people oriented and environmentally friendly. It should also operate with a purpose of creating value for the community it serves. So start by establishing two key fundamentals: identify the issues your social enterprise seeks to resolve and clarify how it will help tell your organisation's story.

You then need to dig a little deeper. To ensure a social enterprise is a step in the right direction for your organisation, ask yourself four key questions:

1. What is the social enterprise's business model?
2. What corporate form should it take?
3. What is your plan for capital and growth?
4. How will you measure your impact?

If you don't know the answers, it's critical to seek the right advice before investing your organisation's valuable resources into a venture that could rapidly turn into a serious misadventure.

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Heads up for PBEs:

new service performance reporting standards are on the way

A public benefit entity's (PBE) purpose is use its resources to implement initiatives that benefit the community. So, a key aspect of its annual reporting should be focused on communicating the impact of its operations to its various stakeholders and society as a whole.

Tier 3 and Tier 4 entities have produced service performance reporting for several years now, and the conspicuous absence of service performance reporting for larger Tier 1 and Tier 2 organisations has now been addressed via the new financial reporting standard issued by the External Reporting Board, PBE FRS 48 Service Performance Reporting (PBE FRS 48).

Why is service performance reporting important?

Prior to the introduction of PBE FRS 48, annual reporting for PBEs has focused on the financial performance of the entity concerned. While this is clearly important, focusing on financial reporting only tells half the story - many would also argue that isn't even the important half! Accordingly, the new reporting requirement shouldn't be viewed as pointless busy-work for PBEs, but an opportunity to tell their story and communicate about the wider impact they have on society.

The principles and requirements for presenting service performance information will establish greater organisational accountability and facilitate better decision making. This is particularly pertinent in a world where funders want more bang for their buck for each funding dollar they provide.

How is the new standard applied?

The standard establishes high-level requirements for entities to determine how best to 'tell their story'. The requirements are flexible and provide scope for entities to identify appropriate and meaningful service performance information for users of general purpose financial reports.

In particular, the standard requires a PBE to provide:

- contextual information to help users understand why the entity exists, what it intends to achieve, and how it intends to achieve its aims and objectives
- information about what the entity has done during the reporting period to work towards achieving its aims and objectives.

The nature of the information reported by each PBE will depend on a number of issues. The following factors require some thought when determining what information to report:

1. What the entity is accountable or responsible for
2. What the entity intends to achieve during the reporting period
3. How the entity went about achieving its service performance objectives
4. Other factors that are relevant to the entity's service performance during the period (eg, financial, legal, economic or social factors)

PBEs will have to apply judgement in each particular circumstance and disclose the judgments made in the selection, measurement, aggregation and presentation of service performance information reported in applying the standard.

PBE FRS 48 also requires service performance information to be presented for the same reporting entity and period covered in financial statements (unless permitted otherwise by legislation). As a result, comparative information should be prepared so that it is available following adoption of the standard.

PBE FRS 48 is effective for reporting periods beginning on or after 1 January 2021, and early adoption is also permissible for those who are keen to tell a more complete story about their organisation sooner rather than later.

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Valuing and raising finance: golden rules for your small business or start up

Ambitious, small, early-stage business owners looking at options for funding growth often ask "How much is our business worth?" or "How much equity should we sell?". There is no easy answer, and here is why.

There are all sorts of methods and formulae for valuing companies with a trading history, but it is much more difficult when you are looking at a pre-revenue enterprise, or a small business with a potentially great product, but no customers yet.

The logical first step is to look around the market and research other businesses of a similar size, sector and potential, how they have grown, scaled and exited, and how they were valued.

Benchmarking exercises can be useful, but no business is ever the same, and valuations vary wildly across sectors - just look at how some online platforms have been valued. Generally speaking, the earlier the stage of the company in its growth cycle, the harder it can be to value.

Having an honest conversation with founders at an early stage is essential. Our advice is often about trying to change their mindset away from 'giving away' a stake in their business to 'selling' a percentage in return for funding and/or additional expertise providing the foundations for the business to grow and scale far

We encourage our small business clients to get out, meet potential investors, and understand there are different types.

quicker. Different ideas as well as new equity can be a real gamechanger and can super charge the growth of a company.

Advisers have an important role to play between the entrepreneur and the investor particularly if this is the first time they have looked to raise finance. It's almost a mentoring/coaching role, where you highlight that dealing with investors is a negotiation - it's a business deal at the end of the day - and you have to try and manage the personal emotions that can distract from closing a potentially good deal for all parties.

There needs to be understanding of the investors' position - investing in a start-up or early stage businesses is risky - it's a high risk asset class - and investee companies should expect rigorous questioning of their business plan and strategy.

Another important point in this area of raising finance is to be open-minded. For instance, we encourage our small business clients to get out, meet potential investors, and understand there are different types. Some will want to be really hands-on, while others will be prepared to take a back seat. Finding the right investor is key - you need to share the same goals and ambitions.

Here's four golden rules for fundraising:

1. Be prepared to negotiate
2. Have some evidence of how you have come to the valuation of your business
3. Don't do it alone - take advice - and don't rush in
4. Don't forget the day job - raising finance can be a lengthy and distracting process

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