Lessons from the recession

Findings from the MYOB Business Monitor

NZIER report to MYOB

23 January 2013
About NZIER

NZIER is a specialist consulting firm that uses applied economic research and analysis to provide a wide range of strategic advice to clients in the public and private sectors, throughout New Zealand and Australia, and further afield.

NZIER is also known for its long-established Quarterly Survey of Business Opinion and Quarterly Predictions.

Our aim is to be the premier centre of applied economic research in New Zealand. We pride ourselves on our reputation for independence and delivering quality analysis in the right form, and at the right time, for our clients. We ensure quality through teamwork on individual projects, critical review at internal seminars, and by peer review at various stages through a project by a senior staff member otherwise not involved in the project.

Each year NZIER devotes resources to undertake and make freely available economic research and thinking aimed at promoting a better understanding of New Zealand’s important economic challenges.

NZIER was established in 1958.

Authorship

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Key points

The New Zealand economy is recovering gradually from a long recession. 2013 will be another challenging year, but better than 2012.

The latest economic cycle has been different. The recession was deeper than, and twice as long as, recessions of the past 100 years. The recovery has also been slower than in previous recoveries. Firms need good quality advice to navigate this slow and grinding recovery. Accountants are well placed to provide assistance to small and medium sized businesses (SMEs) by being aware of macroeconomic opportunities and risks for specific industries and regions, as well as strategies that have worked for successful businesses in recent years.

The MYOB Business Monitor provides invaluable insight into New Zealand SMEs across a number of dimensions: regions, industries and business strategies. The Business Monitor captures the broad economic trends, as well as insights on successful strategies and pressure points.

The messages from the last few years are clear. Because sales growth is slow, alongside slow economy, good profits are not a matter of luck. Good profits are a direct result of a good quality business.

Despite the weak economy, firms that identify as ‘Business Builders’ have far outperformed others by:

- Keeping and growing their customer base
- Marketing effectively
- Investing in their business systems
- Investing in staff
- Getting the basics right.

Regional economies will grow at varying paces in 2013:

- Auckland will grow at a solid pace, supported by people inflows and greater dynamism of a larger city.
- Wellington will be stagnant, influenced by a pullback in government hiring and spending.
- Christchurch will begin to rebound from the earthquake disruption, but the activity will be concentrated in construction and related sectors. Other segments of the economy will remain weak.
- The provinces will be flat, influenced by continued outflow of young people from the region and only moderate primary sector growth.

Performance by industry will also vary in 2013:

- The best performers will be business, professional, property, finance and insurance services.
- Manufacturing, retail, hospitality and construction (outside of Canterbury and Auckland) will be slower to recover.
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A recovery like no other

The economy is recovering gradually from a long recession (Figure 1). The debt fuelled bubble economy of 2000-2008 means there will be a long period of adjustment, as we pay down debt and live more conservatively.

The recovery is taking longer than initially expected (Figure 2). In early 2009, small and medium sized businesses, surveyed by Colmar Brunton on behalf of MYOB for the MYOB Business Monitor, expected the economy to start to recover in about a year. But now firms expect almost another two years before the recovery takes hold.

The recovery from the recession has been slow. While firms expected that sales growth would rebound to pre-recession highs, the reality has been more subdued (Figure 3). A net 1% of firms increased sales in the past year, while a net 25% of firms expected to increase sales a year earlier. The recovery has been disappointing to date.

History here and abroad shows a pattern of long periods of economic feast interrupted by seven years of economic famine. At the heart of this cycle tends to be a build-up of too much debt. This time is no different.

The good – and the bad – news is that we are halfway through the adjustment. In time, the economic recovery will gather pace and it will be more sustainable than the past decade. But the adjustment process is hurting, with patchy sales and razor-thin margins. Some firms are not lasting the distance.

Do not waste a crisis. The current period of slow growth is an opportunity to invest and prepare for the structural changes on the horizon, changes that will come about from ageing, technological advances, and consumer preference trend. While profits are under pressure, interest rates are low and banks are increasingly willing to lend.

Figure 1 Real GDP per capita

$ per person, 1995/96 prices
Figure 2 Expected time to recovery
Number of years from survey period before business expected recovery

Figure 3 Actual and expected sales
Net % businesses reporting increasing sales

How this recession is different
This recession has fundamental differences. Economic activity generally trends higher with an occasional bump or recession. Every hundred years or so, there tends to be a
much larger correction. The 1930s Great Depression was one. These are typically credit events. 1930 was business borrowing, while this time it is households. There are lots of individual sovereign debt crisis examples as well, such as Argentina.

**Figure 4 Economic activity through past recessions**

Index, pre-recession peak = 100

![Economic Activity Chart](source)

**Source:** Statistics New Zealand, RBNZ, NZIER

This recession is quite different from more recent recessions, such as the Asian Financial Crisis. It has been deeper. Peak to trough GDP contracted by 4%, the average recession in the past was 2%. That is twice as painful.

This recession has been more protracted than previous recessions. Typically they last around nine months followed by a strong rebound. This recession was slightly longer (15 months), but the real difference has been a very slow recovery.

The current level of GDP, which is shorthand for economic activity, is 9% below where other recessions were at this time of the cycle. We don’t have good quality historical data in New Zealand, but some partial indicators suggest the recovery profile to date has been similar to the 1930s Great Depression.

International evidence\(^1\) from the past 800 years shows that credit crises happen regularly and they can have large economic costs. On average they take around seven years before recovery takes hold.

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\(^1\) [http://www.economics.harvard.edu/files/faculty/51_This_Time_Is_Different.pdf](http://www.economics.harvard.edu/files/faculty/51_This_Time_Is_Different.pdf)
Winning strategies in a slow recovery

Business Builders provide a good road map for successful strategies for 2013. These may be the right strategies for your client.

The economic environment has been challenging, but some businesses have still flourished. The *MYOB Business Monitor* gives some insights on these successful businesses, across a range of factors, including attitude to business, focusing on key competencies and investing in their businesses.

A striking finding from the *MYOB Business Monitor* is that your business success depends on your attitude to business. The recession was painful for all businesses, but in the recent slow economic recovery the highly motivated businesses (describing themselves as ‘Business Builders’) have been the most successful (Figure 5).

![Figure 5 Sales by attitude to business](source: MYOB Business Monitor)

Business Builders are incredibly focussed on growing their businesses. They are doing more of everything, from customer acquisition to product diversification (Figure 6). There are some important themes:

- **Keeping and growing their customer base.** Business Builders place a high importance on customer retention and new customer acquisition. They are very focussed on growing sales, both online and offline. Because the economy is only growing slowly, most sales growth is coming from market share growth. Market share is going to those who are looking after their customers and acquiring those who are not being looked after. This is happening through both diversification of sales channels (online and offline) and marketing (also online and offline).
• **Marketing effectively.** Business Builders are investing more on both online and offline advertising and marketing, with a greater focus on online. This is consistent with the strategy of retaining and acquiring customers. Marketing is essential to ensure you reach the right market segments. Online marketing solutions can often be better targeted and cost effective, compared to traditional channels.

• **Investment in their business.** Business Builders are increasing investment in IT and seeking business advice. Technological advances mean that IT investments can lead to real business cost reductions and productivity gains. For example, a good customer management system will give business great insights into customer behaviour and market segmentation. Alternatively, a good accounting package will give businesses clarity of their true financial position and pressure points.

• **Investing in staff.** Business Builders are investing in their staff. They are looking to hire more staff and pay them more. They are more likely to hire part time staff, perhaps to maintain flexibility of their payroll given uncertainty of future economic conditions.

• **Getting the basics right.** Business Builders are also more focussed on getting the basics of business right. In particular they are focussed on prices and margins. In a slow sales growth environment margin, preservation is critical. They are looking to manage costs and price products appropriately. They are also making sure their product mix is meeting customer needs.

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**Figure 6 Business strategy of Business Builders**

What Business Builders are doing more of, net % basis relative to Lifestyle Seekers, 2012

Source: MYOB Business Monitor
Recent performance

The New Zealand economy sank into recession in 2009 and 2010. The recovery since then has been gradual, from deep contraction in sales in 2010 to modest growth in 2012. The performance across regions and industries has varied, with some sectors and some regions doing much better than others (Figure 7).

At the regional level the recession bit hard in the major cities, with Auckland and Wellington feeling the brunt of the recession through 2010 and 2011. But the large centres are also leading the recovery, performing better than provinces in 2012.

Christchurch was adversely affected by the earthquakes in 2011, which caused widespread disruption. There is encouraging evidence of a gradual rebound.

The provinces fared the recession well, helped by very good weather conditions that led to strong gains in agriculture production and economic activity. But that momentum has faded.

At the industry level, there has been one area of sustained strength – the business professional and property services sector. The performance in finance and insurance has been generally positive, but also volatile.

The cyclical parts of the economy faced the worst of the recession. Construction, retail, hospitality, transport, postal and warehousing were hit hard, but are now recovering.

Figure 7 Sales growth in recent years
Sales growth past year, net % of businesses reporting increase

<table>
<thead>
<tr>
<th>NZ, all industries</th>
<th>2010</th>
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<th>2012</th>
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<td><strong>Regions</strong></td>
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<td><strong>Industry</strong></td>
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<td>Business, professional &amp; property</td>
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<td>Finance &amp; insurance</td>
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<td>Construction &amp; trade</td>
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<td>Transport, postal &amp; warehousing</td>
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<td>Importers</td>
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**Key:**
Better than NZ total
Similar to NZ total
Worse than NZ

**Source:** MYOB Business Monitor
Regional outlook

The economic recovery from the recession has been varied across regions. In 2012, Wellington and Auckland have grown. But Christchurch’s economy is still dampened by the earthquakes, which created significant economic damage and disruption. The provincial economies are flat to contracting slightly.

**Figure 8 Sales by region**

Net % businesses reporting increasing sales, 2012

Auckland is New Zealand’s largest and most dynamic economy. It grows by the virtue of its scale and concentration of people and businesses. Its population is also growing fast, helped by migration from overseas and other regions. Auckland will grow at a solid pace through 2013.

Wellington’s economy is closely linked to the government given its capital city role. SMEs have reported robust performance to date, but sales could slow in 2013. The government has been cutting back on spending and a number of staff in Wellington. This will weigh on the region’s economic activity through 2013.

Christchurch is recovering from the earthquakes in 2011, but activity remains weak. There has been widespread disruption following the earthquakes. Many businesses have moved from the CBD to other parts of Canterbury; others have closed. Many people have also left the region. The rebuild will spur significant economic activity over the next few years, but other sectors will face a slower recovery.

The provinces are flat. Even though farm incomes have been boosted by good production and prices, provincial economies are only growing moderately. The biggest headwind has been from emigration, particularly of those aged under 40 years. This is dampening economic growth and is a long-term challenge.
Sector outlook

The economy is recovering from recession. But some sectors will face greater cyclical and structural pressures than others. Knowing your client’s industry will help you provide better advice.

Economic performance has varied across sectors (Figure 9). Some of these variations are cyclical, for example the weakness in retail sales and construction activity. Some factors are structural, such as the hollowing out of some types of manufacturing, which is being offset by growth in wholesaling. The outlook for 2013 will be divergent across industries, which are detailed by broad industry categories below².

Figure 9 Sales by sector
Net % businesses reporting increasing sales, 2012

Source: MYOB Business Monitor

² Outlook comments are based on the New Zealand Institute of Economic Research forecasts published in the September 2012 Quarterly Predictions.
Business, property and professional services sales are growing strongly. This reflects a long shift in the economy towards the services sector. The experience of urban centres and internationally suggests that these sectors will continue to grow strongly in 2013.

Finance and insurance sales slowed in the recession, but are recovering. Lending by financial sector companies is gradually increasing and there is increasing demand for financial advice for retirement planning and investing more generally. The insurance sector is undergoing significant change. The Canterbury earthquakes have changed...
the risk profile of New Zealand and insurance products now need to be better tailored for customers. Financial and insurance services sales will continue to improve through 2013.

**Figure 12 Sales in manufacturing and wholesaling**

Net % businesses reporting increasing sales

Manufacturing and wholesaling are on contrasting paths. Manufacturing is shrinking, but wholesaling is growing. Sales have been declining in every category of manufacturing, but are weakest in areas where New Zealand does not have a comparative advantage, such as textile and furniture manufacturing. Food manufacturing, in which New Zealand is a world leader, has contracted less.

The pullback in manufacturing, due to long-term forces of globalisation, short-term forces of weak global demand, and a high exchange rate, is being offset by growth in sales in import substitutes, which requires middlemen, such as wholesalers.

Wholesale activity is growing in line with the broader economy and will expand in 2013.
Primary sector activity is broadly stable. Agriculture production has been strong, helped by good weather over the past year. A slowing global economy means farm product prices have fallen, which dampens income growth. A developing El Niño weather pattern, which can bring dry weather to key dairy areas, is a risk for 2013. Forestry production has been strong, with exports going mainly to China. A slowing Chinese economy could dampen the forestry sector in 2013, but it will be offset by demand for forestry products for the Canterbury rebuild. Fishing has been broadly stable and will grow gradually in 2013.
Retail and hospitality sectors face challenging conditions. Consumers are cautious. They are living frugally, spending less on discretionary items and paying down debt. Spending by local consumers will grow only modestly, as jobs remain insecure and wage increases are countered by the rising cost of necessities.

Tourism is also weak. While the number of visitors to New Zealand is strong, the amount of spending by visitors is falling. There are fewer visitors from North America and Europe, who typically spend more. There will be more visitors from emerging economies like China, India and Indonesia, but they require a different strategy than traditional market visitors. 2013 will continue to be challenging, because of slow global growth.

**Figure 15 Sales in construction and trade**

Net % businesses reporting increasing sales

![Figure 15 Sales in construction and trade](image)

*Source: MYOB Business Monitor*

Construction and related trades have been hit hard by the recession. This in part reflects a surge in building in the lead up to the recession. New building activity has been very low over the past four years, similar to the lows seen during the Great Depression of the 1930s. In 2013, there will be significant building work in Canterbury as the earthquake repair work gets under way. Auckland is also beginning to recover, as a long period of inactivity means there is now strong demand for new homes. But activity in other regions will be slow to pick up, as there are many empty homes and the outlook is too weak to encourage significant new borrowing and investing.
The transport and storage sector has been weak. This partly reflects the broader weakness in the economy, particularly in manufacturing and retail. However, there has been some offset in import substitution, which has benefitted the wholesaling sector so far. A gradual recovery in retail spending, but continued weakness in manufacturing, means the outlook for transport and storage will remain challenging. There will be some growth from the import substitution sector, but those benefits will become visible over a longer period.
Pressure points and mitigating strategies

Businesses are always managing a multitude of pressures. The slow recovery from the recession over recent years has seen this continue (Figure 17). Business advisors should be prepared for these common issues facing SMEs.

**Figure 17 Sources of pressure for SMEs**
Ranked by frequency of acute pressure, 2009-2012

![Diagram showing sources of pressure for SMEs]

Source: MYOB Business Monitor

The most cited pressure for businesses has been fuel prices. In economic downturns, commodity prices – including fuel prices – tend to drop, giving relief to businesses. But, over recent years, international oil prices have remained elevated because of continued demand from emerging economies such as China and India, and also geopolitical tensions in the Middle East. Fuel prices are likely to remain elevated. SMEs can consider a number of strategies, ranging from using more fuel-efficient cars to reducing transport use through better inventory management.

Businesses are also affected by interest and exchange rates, but these are largely out of their control. The most practicable solution is to have a well-managed risk position, using fixed terms, hedges, forward cover and other instruments. Because of the complexity and uniqueness of these interest and exchange rate risk solutions, it is best to seek advice from a bank manager, accountant or advisor.

The next set of pressures is at the crux of managing a business: prices, margins, profits, customer acquisition, competition and cash flow. While each business is unique, there are some generalisations. In particular, the way sales, margins and financial leverage interact to affect profits (Figure 18).
• A slow economic recovery is most apparent in sales, which are growing slowly. While the economic recovery remains gradual, businesses wanting to grow fast will need to increase market share through customer acquisition. But it is important to take care with this strategy, as the cost of gaining new customers must be more than covered by the increase in sales and profits. Advertising and other expenditure needs to be carefully assessed to ensure best value for money.

• Margins are a very important driver of profits for business. In finance it is called operating leverage – that is, how much of sales gets turned into profits. SMEs are reporting acute pressure in margins and competition. These are related. Businesses are wary of passing on cost increases for the fear of losing customers to the competition. This is holding down prices and eroding margins. There are no easy solutions, but careful attention to margins by product and service lines is crucial. Many businesses grow organically through the good economic times, but often in areas where they have limited expertise. A careful study of the business could highlight a need to refocus on its core competencies. For example, a bakery may find it more efficient to use couriers for delivery rather than having their own delivery service.

• Financial leverage, or the amount of bank debt or other forms of financing used to run the business, is also a key factor. For most businesses, having some debt can be a good thing. It can help smooth out seasonal cycles in the business and grow the business to a larger size than if only using equity funding. But borrowing has risks too. During the recession and its aftermath, many SMEs are finding it difficult to manage their cash flow and get access to finance from banks and other sources. For SMEs, this can be an existential threat. Having well organised accounting data and good relationships with financiers can reduce some of these risks.

Figure 18 Drivers of profit
Simplified DuPont disaggregation of profitability

Source: NZIER