THE STATE OF THE ECONOMY: LESSONS FROM THE RECESSION

Based on NZIER review of MYOB Business Monitor research data 2009-2012

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MYOB BUSINESS MONITOR: THE VOICE OF NZ BUSINESS

Welcome to The State of the Economy, a white paper presented by MYOB and the New Zealand Institute of Economic Research (NZIER).

At MYOB, our goal is to make business life easier. Because we work with over 170,000 businesses from around the country, we've long understood that advocating for the needs of small to medium enterprises is very important. Too often, business owners are not given a voice, and not enough effort is made to really understand the unique challenges they face.

For the last three years, MYOB has been conducting the MYOB Business Monitor, New Zealand's largest regular survey of small and medium business owners and managers. The Monitor polls over 1000 of these business operators, canvassing their opinions on issues ranging from business performance and strategy, to economic confidence, political opinions, technology use, and the pressure and challenges they face.

The results of the MYOB Business Monitor have been tracking very closely with wider economic developments, demonstrating that the performance of smaller businesses is a good bellwether for wider conditions. This has seen the Monitor become a trusted source for journalists, analysts and policy-makers looking to understand what New Zealand business operators are experiencing and feeling.

The time in which we have been running the Monitor has been an incredibly important time for New Zealand businesses, as many have strived to find a path back to growth following the global financial crisis and the worldwide economic downturn. Working together with our partners at NZIER, we have analysed the data from this period and produced a report to help you gain a fuller understanding of what your clients have been experiencing over the last three years, and the key lessons we can all learn from the recession.

This white paper should deliver sound insights for you to draw from when providing informed advice to your clients, and for running your own operations this year.

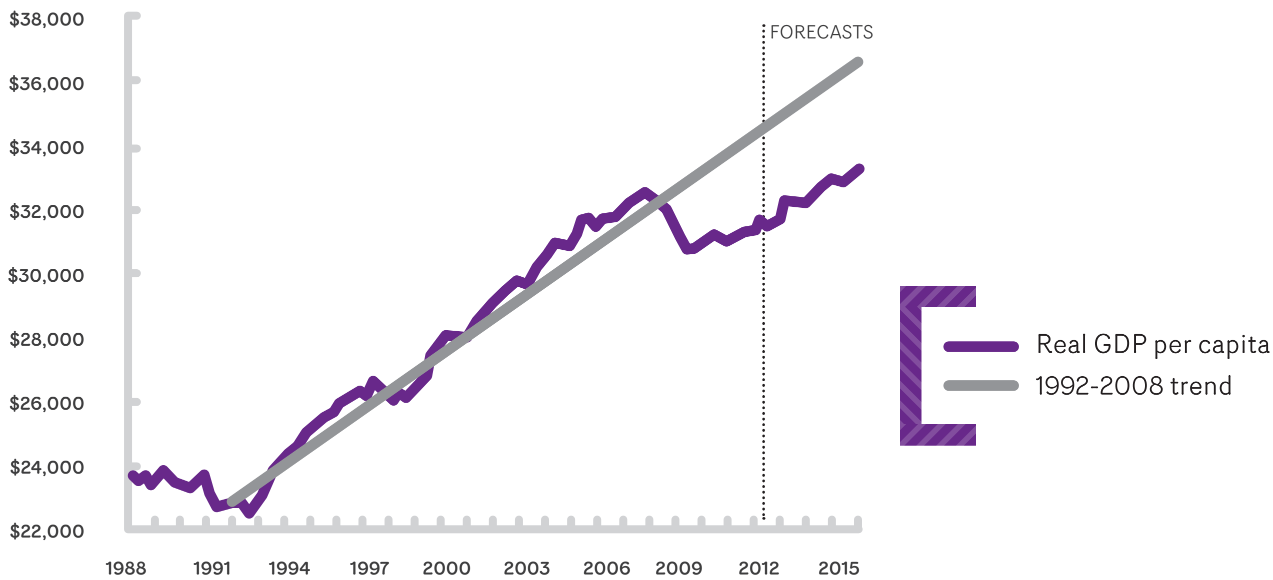
Tim Reed
Chief Executive Officer
MYOB New Zealand

A RECOVERY LIKE NO OTHER

What is immediately clear is that this economic downturn has been more severe and has lasted far longer than any other in recent New Zealand history.

According to the NZIER, economic activity usually grows relatively steadily, with cyclical downturns causing minor interruptions. In New Zealand's post-war history these downturns have tended to involve contractions of economic activity of an average of 2% of GDP. The current downturn, however, involved a contraction of 4% of GDP.

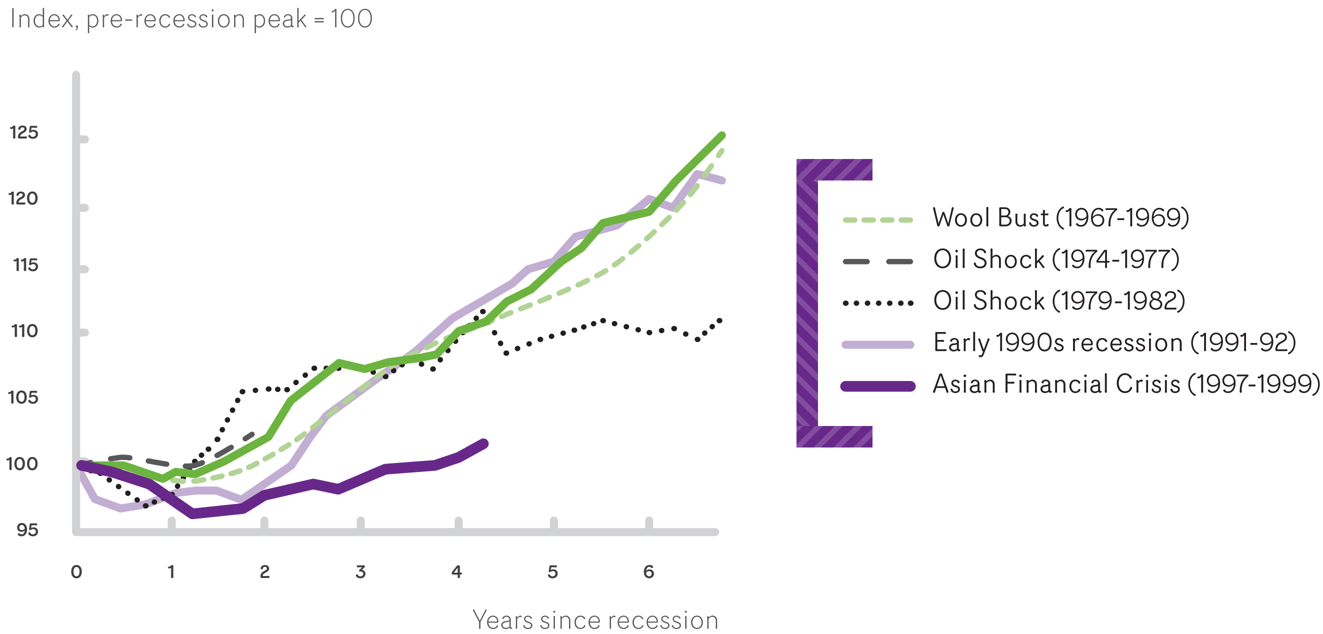
Real GDP per capita



Not only was it more intense than previous recessions, the most recent downturn has lasted far longer. The post-war average sees recessions lasting an average of nine months followed by a strong rebound. The current downturn lasted 15 months and has been marked by a slow and grinding recovery.

Source: Statistics New Zealand, NZIER forecasts

Economic activity through past recessions



The reason this time around has been so much worse is that, while typical recessions are caused by a cyclical contraction, the current downturn is the result of a major financial crisis that did far more damage to the economy's ability to sustain growth.

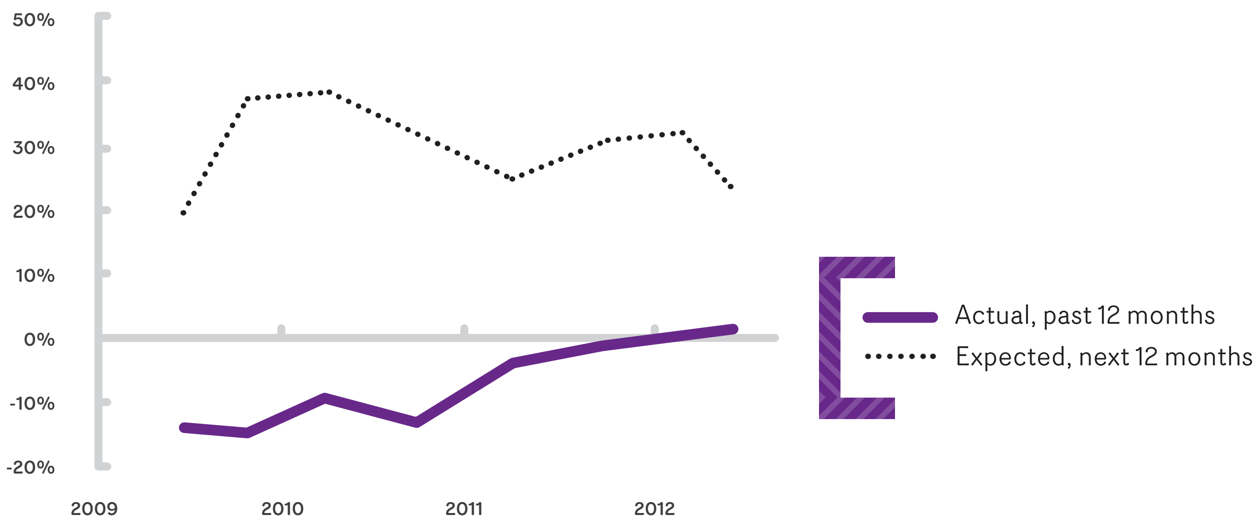
Source: Statistics New Zealand, RBNZ, NZIER

Historically, recessions caused by a large build up of debt and an ensuing financial crisis tend to not only be more severe than normal, but also take much longer to recover from. This is because businesses and consumers must first undergo a difficult period of deleveraging before the economy can begin growing again.

What the MYOB Business Monitor data shows is that New Zealand's small and medium business operators (SMEs) were not prepared for the unusual nature of this recession and did not expect to be impacted as severely as they were. Throughout the downturn and the slow recovery, SMEs have been consistently over-optimistic in their revenue forecasts, clearly expecting the sort of strong rebound that follows a traditional recession.

Actual and expected revenue growth

Net % of businesses increasing revenue



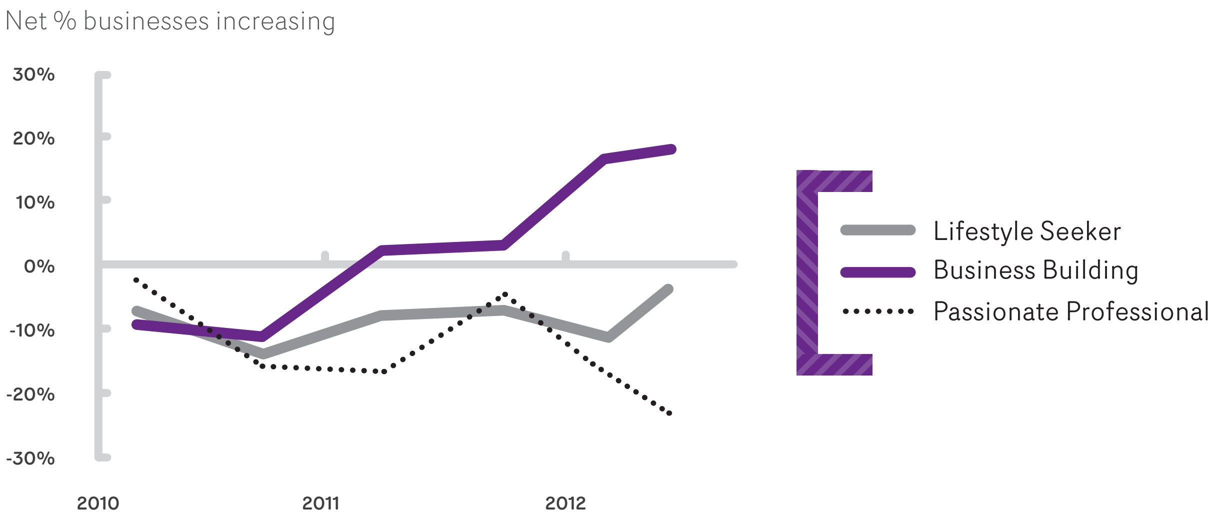
Source: MYOB Business Monitor

WINNING STRATEGIES IN A SLOW RECOVERY

The unexpected depth and length of the downturn presented a real challenge for New Zealand businesses, which were operating in an entirely new environment. One of the key insights that the Monitor data provides is a look at the different ways in which businesses adapted to these difficult circumstances, and which strategies and approaches proved the most effective.

The key lesson is that business owners and managers who adopted a 'business builder' strategy – making prudent investments in technology, staff and in growing market share – have performed far better across the recession than those who have followed the traditional recession playbook of cutting costs and hoping to wait out the downturn.

Sales by attitude to business



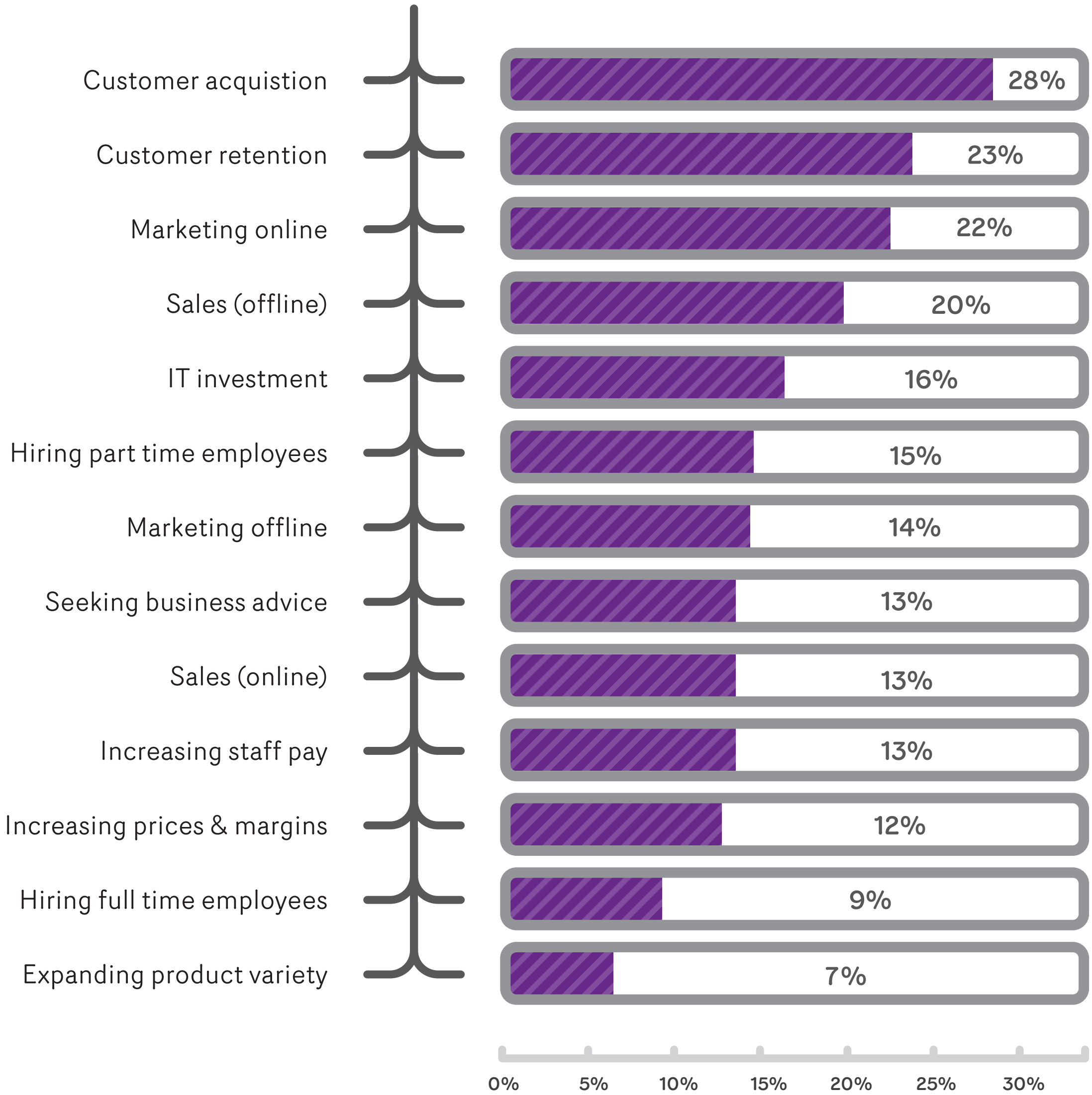
In April of 2010, a net 9% of businesses following a business building strategy reported revenue loss over the previous 12 months. By June 2012, those businesses had grown so much that a net 17% reported revenue gains over the last year.

Source: MYOB Business Monitor

By contrast, although a net 6% of other businesses reported revenue losses in April 2010, by June 2012 growth amongst these businesses had fallen further, with a net 8% reporting lower revenue.

Investments of business builders

What business builders are doing more of, net % basis relative to lifestyle seekers, 2012

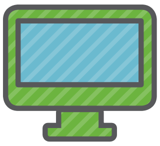


Source: MYOB Business Monitor

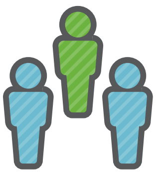
The specific strategies business builders followed that led to stronger results included:

Growing Market Share. With the economy's overall health developing very slowly, most business growth during the downturn was achieved through growth in market share. For business builders, this meant investing in strategies to retain existing customers and being aggressive about opportunities to take on their competitors.

Effective Marketing. A vital element of the ability to grow their market share has been a consistent investment in better and/or broader marketing techniques, especially more effective use of the online space. One benefit of online marketing is that it can be comparatively cheap and allows for more focussed targeting than traditional methods, often making it more cost effective.



Investment in Systems and Processes. Another tactic that has helped business builders is prudent investment in upgrading their systems and processes. In an economy where competitive advantage is becoming more and more important, having better systems than other businesses has given them a real edge. They were not only investing more in technology, they were more likely to be seeking business advice and making use of management tools like accounting solutions. Implementing these strategies results in a better understanding of their business, the challenges they face and the opportunities they can capitalise on.



Investment in Human Capital. The final key area in which business builders were focussing their investments was in their commitment to attracting and retaining top talent. While other businesses have cut staff or held off hiring to defer costs, business builders have been more aggressive in bringing on part-time and full-time staff, and in paying their staff well in order to retain talent. This emphasis on the value of human capital reflects not only the importance of competitive advantage in a tight economy, but also the larger role that talent is playing as the economy changes to become more service focussed.

PRESSURE POINTS FOR BUSINESS AND MITIGATING STRATEGIES

THE PRESSURES ON BUSINESSES

Despite the economy technically having been out of recession for some time now, a wide range of external forces have been putting pressure on business profitability.

As part of the MYOB Business Monitor, business operators are asked to identify what is placing the most pressure on their operations. After examining the last three years of responses to these questions, NZIER ranked these forces by the frequency with which businesses owners cited them as placing acute pressure on their profitability. This data provides an important insight into what is making life difficult for New Zealand businesses, and allows us to look at strategies to mitigate these factors.

Sources of pressure for SMEs

Ranked by frequency of acute pressure, 2009-2012

1. Fuel prices
2. Prices, margins, profits
3. Attracting new customers/competition
4. Cashflow
5. Interest rate
6. Exchange rate
7. Business: Finance/Funding /Overdraft

Source: MYOB Business Monitor

The most significant pressure points over the last three years were as follows:

Fuel Prices. According to NZIER's analysis, the impact of fuel prices on businesses was worse over the last three years than in traditional economic downturns. The reason is that when the economy is underperforming demand for oil is, generally, significantly lowered because of reduced economic activity. This in turn helps to lower the price. Thus, it is relatively rare for fuel prices to be a major concern for businesses during a recession. However, over the last few years, due to unexpectedly high demand from emerging economies like China, India and Brazil – alongside ongoing tensions in the Middle East – the price of fuel has stayed high. This has left businesses with economic pain caused by the downturn, alongside significant pressure from the high fuel prices usually seen when local demand is higher.

Businesses looking to mitigate pressure placed on them by high fuel prices may find ways to reduce fuel consumption while still providing the same level of service. This could include switching to more fuel efficient means of transport, using communications technology to offset travel requirements, or improving business systems like inventory management so less transportation is required overall.

Competitive Activity. As we have seen, with slow economic growth one key tactic to achieve sustained business growth is to increase market share, often at the expense of other businesses. As the experience of successful business builders has shown, the most effective way to deal with increased competitive activity is to look to make prudent investments in areas that will increase business capacity and competitive advantage. More effective use of marketing, especially in the online space, and better use of human capital and technology can provide businesses an edge over the competition.

Prices, Margins and Profits. NZIER's analysis also found that in an economic downturn there are strong links between greater pressure from competitive activity and greater reticence to move prices and margins. Not only does increased competition make it more challenging for businesses to attract new customers or maintain their existing client base, it also means business operators are less likely to pass along any rise in costs for fear of losing market share. This means that inflation in costs, especially for things like rising fuel prices, are often carried by businesses at the expense of profitability.

For those looking to find room to improve their profits and margins without having to pass costs along to consumers, the key is a better understanding of where their costs are coming from. This is where a quality accounting system and an enhanced relationship with an accountant, business mentor or advisor is a real advantage.

Business Finance. One other aspect of the downturn making life difficult for New Zealand businesses was a lack of access to finance, with financial institutions having tightened up on lending over the last three years. Over the course of the downturn, access to debt was a real advantage for businesses, as it opened up productive avenues for investment and could help to smooth out seasonal cycles. For smaller businesses, a lack of finance can often exacerbate any cash flow issues they may be having, as fewer financing options mean reduced ability to use debt to cover any short-term cash flow issues.

For business operators looking to increase their access to finance, one key strategy is to engage in more transparent bookkeeping and more effective business systems. Being able to present clear information to lenders can make a business a far less risky proposition for finance. Again, prudent advice from an accountant or financial advisor is vital in identifying the best financial instruments for each business.

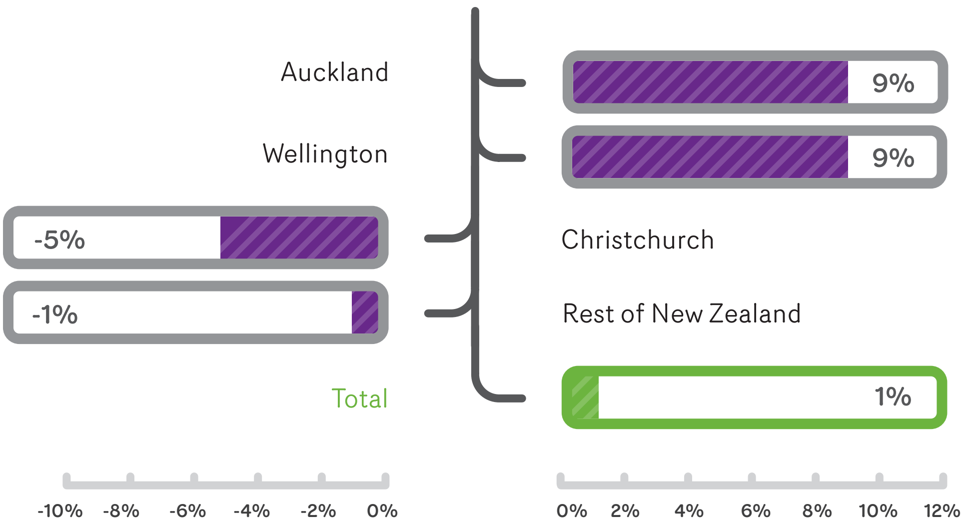
THE UNEVEN RECOVERY

What is clear from the results of the last three years is that not only has economic recovery been very slow, it has also been remarkably uneven.

Not all regions of the country have been growing at the same pace, with businesses in regional New Zealand consistently behind those in the main centres. The result is a 'two-speed' recovery where businesses in the main centres are performing far stronger than those in the regional economies, which are continuing to see stagnant growth or even ongoing revenue losses.

Sales by Region

Net % businesses increasing, 2012



In Auckland, revenue growth had rebounded strongly over the last few years. NZIER's analysis found that as New Zealand's largest city, Auckland enjoys large natural advantages by virtue of its scale and concentration of its people and businesses. Businesses in Auckland can expect growth to continue throughout 2013.

In Wellington, business performance has improved significantly over the last three years. However, many business owners in Wellington were cautious about their progress, amidst concern about international stability and the effect of cutbacks in government spending, a major source of income and employment for the region. This could be a drag on the region going forward.

In Christchurch, the combined effects of two major earthquakes and significant population loss has been a real challenge for the city's businesses, with many businesses suffering big losses over the last three years. Looking towards 2013 however, the effect of the $30 billion rebuild should be a strong source of growth for the city.

On the whole, businesses outside the main centres are still struggling and have not been able to return to the sort of growth seen in the larger cities. According to NZIER, part of this is being driven by population loss, as more and more young people leave the regions in search of better opportunities. Getting the regional economies performing again is important if New Zealand is going to be able to return to robust growth.

CONCLUSION

The New Zealand economy is still recovering from a financial crisis and a global economic downturn more severe than any in the post-war era. For New Zealand's SMEs, the last three years have been a challenge, with many businesses still reporting revenue losses now. Others have found a path back to growth.

There is reason to be hopeful. According to NZIER, the sort of severe recession that usually follows major financial crises tends to last for an average of seven years. By that measure, New Zealand's businesses have made it through the halfway point of the cycle and can expect better times ahead.

As we look towards a time when the economy has fully recovered from the downturn, a number of new opportunities will present themselves for businesses. Healthy economic growth should relieve many of the most acute pressure points that business owners and managers have told us they are struggling with. Stronger growth should create more room for businesses to reduce costs and grow their profit margins. A recovered financial sector should make more capital available for business operators who want to invest.

Moreover, we know from the MYOB Business Monitor that there are already real opportunities for those who choose to take a business development approach to the downturn. Business owners that make prudent investments in growing their business capacity and securing market share will not only perform better, they will lock in major gains that will pay off when the economy returns to strong growth.

One area of real opportunity for businesses is greater use of the online space. With fuel prices and competitive activities emerging as key pressures, better use of online marketing, cloud solutions and communications technology can help to make businesses more effective at communicating with customers while also helping them to reduce costs. With the internet set to play an even larger role in the economy over the next few years, operators that embrace these new opportunities will have a big advantage.

For accountants and other business advisors, their role in the year ahead will be critical. Many of the best business strategies – not only for maximising growth, but also for mitigating the impact of pressures such as high fuel prices – will require expert knowledge, advice and support. Those businesses that are best able to make use of this assistance are poised to perform well.

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