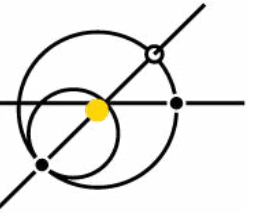


**ASTROLABE
GROUP**



NEXT MOVES

**Helping Small and Medium
Businesses enhance
productivity**

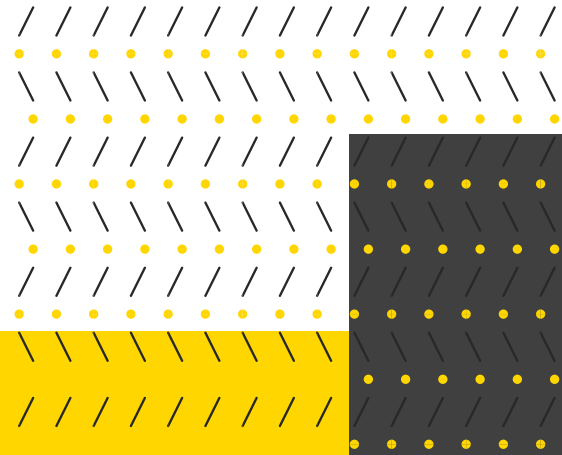
Report prepared for Xero

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About Astrolabe Group

Astrolabe Group are the recognised experts in urban growth and change management with a uniquely empathetic approach to client and community.

This report was prepared for Xero. In preparing the report, Astrolabe has made every effort to ensure the information included is reliable and accurate. Astrolabe is unable to accept responsibility or liability for the use of this report by third parties.

OVERVIEW

Next moves for strengthening small and medium businesses

New Zealand is a nation of entrepreneurs and business owners – with 97% of businesses being small businesses and employing around 30% of the total workforce

These businesses are crucial to the communities they serve through their products and services and are a massive driver of the national economy.

Owning and operating a business comes with unique challenges. The constant change we all experience through digital innovation is now something that owners and workers must also consider in maintaining sustainable and scalable businesses.

These next moves for government will address some of these challenges and support business:

1. Develop a Future Ready Skills and Training Strategy to support needs of the future workforce
2. Continue to invest and target initiatives that support training and upskilling support for small business owners
3. Explore a funded mentor and coaching program for SME owners
4. Extend workplace training grants and target groups based on user needs
5. Explore new targeted digital and technological support for business owners
6. Invest in support and awareness of cybersecurity vulnerabilities for small business operating in digital workflows
7. Implement recommendations to improve access to finance for SMEs.

A NATION OF SMALL AND MEDIUM BUSINESSES

Micro, small and medium businesses are critical to the local fabric of New Zealand – supporting the economy and delivering to the needs and wants of local communities. The sector contributes up to 30% of total employment and over 25% of New Zealand's Gross Domestic Product (GDP).

Vibrant and confident small businesses are a driver of productivity. The ability for smaller firms to try and scale new ideas, products and services offers the opportunity for innovation and agility which benefits spread across economic activity and community.

The next moves to supporting business and building the economy

While the diverse and localised characteristics of the small business sector offer tremendous benefit, it also presents challenges that government must help manage. The challenge to small firms of adequately resourcing digitalisation and digital transformation as well as ensuring business owners and their workforce have the right skills and capabilities. Improving access to finance will remove some of the hurdles in being able to sustain and scale. This paper explores some of the current pressures facing Small and Medium enterprises (SMEs) and calls out the opportunity to leverage existing work of government, adopt new technologies and support to respond to these pressures.

Government plays a crucial role

There is a crucial role for government to provide the systems, tools and support for small businesses experiencing challenges across digital technology and skills – allowing them to embrace technology faster to provide greater efficiency and effectiveness benefits, to more New Zealanders sooner.



SUPPORTING SMALL AND MEDIUM ENTERPRISES TO THRIVE

Approximately 97% of all corporations in New Zealand have fewer than 20 employees – and account for almost a third of all employment and over a quarter of Gross Domestic Product.¹ Only a third of SME in New Zealand grew in 2021, which was the second-lowest growth rate among 11 Asia-Pacific markets.² To maintain and grow productivity in changing times, SMEs need different and specialised support.

Primarily, the greatest gains will be seen if SMEs are able to efficiently sustain and/or scale their business. The three main areas of support focus on people, increased digitalisation and access to finance.

For SMEs – proportionately – a greater component of revenues and of owner/manager time is committed to overheads and compliance. Workforce demographics are changing rapidly and may disproportionately affect SMEs. They face a more limited ability to leverage any efficiencies through economies of scale (certainly relative to major/multi-national corporations) and have few workforce options available in a highly resource-constrained market.

Digitalisation and efficiencies are curtailed due to lack of skills, training and financial constraints and without government support, growth will continue to slow. SME specific policies can create a resilient sector, so SMEs are able to absorb external shocks such as changes to monetary policy, increases in regulation, rising input costs and a tight labour market.

There are several factors which contribute to why these issues have become so acute in recent years. Understanding these can help government and those working with SMEs address challenges – supporting businesses to be resilient and thrive in ever-changing conditions.



UNDERSTANDING THE CHALLENGES FACING SMALL AND MEDIUM ENTERPRISES TODAY

WORKFORCE CHALLENGES

Labour shortage

There has been a significant shifting of the workforce over the past two decades, with significantly more young people now remaining in education/training for longer (both to completion of High School, and then on to Bachelors-level study).

Where SME have traditionally been reliant on seasonal/part-time labour, this sector has been shrinking in part because of greater tertiary education participation

rates – from 16% participation rate for 18-24 year olds in 2003 to over 22% for this cohort in 2022.³

Couple this with a reduction in the unemployment rate to 3.4% in 2023 (from 15.6% a decade prior), and it becomes more apparent the scale of the resource change challenge facing these small but critical employers.

Skills shortage

Around 40% of Australian and New Zealand employers report that skills shortages have intensified noticeably in the past 12 months, with 78% of all employers stating that they believe resource availability is currently impacting the effectiveness of their operations.⁴

While employers are looking to increase their staffing numbers (both permanent – 46% and temporary or contract – 22%), SMEs may lose out as they are often constrained by the salaries they can offer and are less competitive against their larger organisation counterparts.

In many cases, SME owner/managers have no option but to step into any resourcing gaps themselves which can lead to highly stressful and highly volatile workloads, and burnout.

While salaries may be a large incentive for recruiting and retaining staff, it isn't the only factor – 61% of employees reported valuing training as a key benefit. Providing training opportunities that are suitable and affordable for the SME workforce could make the competition for talent fairer.

While skilled migration has increased, skills shortages still prevail. Providing a domestic workforce that has the right set of skills for the workplace is essential to keep the SME sector thriving.

SME owners are overstretched and have under-developed business and management skills

An SME owner may be a specialist in their field but need to be a jack of all trades when it comes to running a business. It's often not cost-effective to outsource all the back-of-house aspects of the business, especially in start-up and establishment phases.

Businesses with less than 20 employees still need to maintain extensive corporate processes (such as safety) and compliance activities (such as payroll) as their larger competitors - and yet they don't necessarily have the revenue to support a dedicated back-office capability. For new participants to this critical market sector, the initial compliance and corporate administration hurdles can be significant, and accessing appropriate resources is an increasing challenge.

Coaching and mentoring can be an effective way of upskilling SME owners in the myriad of business-related tasks in growing a successful business. Australia and the UK have both implemented similar programs to assist SMEs in enhancing productivity and scaling their businesses.⁵ Astrolabe Group can personally attest to the benefits of coaching having participated in a Small Business coaching program and grew from five to 25 employees within three years. The coaching achieved this by covering how to run a business and manage the pressures of owning and operating a business.



Case Study: United Kingdom's Be the Business Mentoring

The UK mentoring initiative, pairs executives from top-tier companies with SME leaders (mentees) in an effort to improve management and leadership practices in SMEs and increase productivity.⁶

It was reported in a 2022 evaluation, that the program has led to improved knowledge, skills, and management practices, resulting in increased productivity and business growth for SMEs.

Specifically, the mentees sought guidance in decision-making and handling employee issues and the mentorship provided expert advice and helped build confidence in decision-making.

However, there are challenges due to the diversity of participating firms and improvements such as program promotion, the mentor-mentee matching process, and guidance support could be made.⁷

Case Study: New Zealand's Digital Boost

Digital Boost is a government-backed, free, self-directed online learning platform. It contains over 1,000 short videos, live events and expert advice to help SMEs grow their business and thrive in today's fast-paced digital world.

While Digital Boost has reduced some barriers to uptake of digital technologies this could be more likely to be used by those who are comfortable with technology, those that have the time to invest in the program and those that see value in digital upskilling.⁸



Younger SME owners appear to have the most difficulty remaining cash flow positive and therefore targeted financial training could be helpful. While digital literacy training and education would be best targeted to owners over the age of 60 who have the least developed technological skills in the SME sector.

SKILLS AND TRAINING OPPORTUNITIES

The government plays a crucial role in addressing the workforce challenges facing SME. Supporting both general upskilling and targeted upskilling will improve the skills available to small and medium businesses and the SME owners (and sole traders) themselves.

Next moves

1. Develop a Future Ready Skills and Training Strategy to support needs of the future workforce.
2. Continue to invest and target initiatives that support training and upskilling support for small business owners – for example, through extending programs such as Digital Boost
3. Explore a funded mentor and coaching program for SME owners
4. Extend workplace training grants and target groups based on user needs

TECHNOLOGICAL CHALLENGES

Lack of digital literacy

Technological efficiencies are a powerful factor in addressing some of these resource constraints but require a high degree of digital literacy to leverage – in 2021, more than 35% of SMEs in New Zealand earned no revenue at all from online sale, and New Zealand continues to lag behind its peers in terms of volume of eCommerce by vendors.⁹

New Zealand currently trails in digital competitiveness (impacting on overall competitiveness), dropping from 19th to 27th out of 63 countries since 2019.¹⁰ Digital knowledge, encompassing talent and training and education was the lowest

ranking out of the three criteria.¹¹

Lowering skills barriers, and addressing (often age-based) digital exclusion, must therefore be key priorities for SMEs to move forward in a context of increasing reliance on eCommerce and digital marketing/ analytics.

Simply having a robust business plan is no longer enough for a SME – they must ensure they remain abreast of rapidly changing trends in technology, which requires both ongoing professional education, and an investment in relevant IT systems.

Lack of investment in digital technologies

Linked to the lack of digital literacy, SMEs investment in digital technologies is low. According to NZIER report (2023), a 20% increase in the number of businesses adopting cloud-based business tools would result in a GDP increase of up to \$7.8 billion. For SMEs, digitalisation can deliver routine low-value tasks allowing them to redirect labour to higher-value pursuits improving productivity and improving wellbeing.

To increase take up, there is a need to lower the time and cost barriers to digitalisation.¹² SMEs face high upfront investment costs for technology despite the evidence of their benefits – in 2021, 30% of surveyed businesses made no investment at all in technology.¹³

Utilising digitalisation grants can help reduce the barriers for SMEs in investing in new digital technologies and productivity enhancing technology. Without well considered support, SMEs risk being left behind in a rapidly digitalised economy.

Advanced digital technologies and Artificial Intelligence (AI) are sometimes similarly seen less as an opportunity and more as a major cause for concern. “78% of New Zealand small business owners are concerned AI development and adoption is outpacing regulation, as generative AI tools permeate various industries and the workforce.”¹⁴

It is revealing that New Zealand SME owner/managers’ report that sensitive information disclosure (51%) and data privacy violations (50%) are the biggest ethical challenges relating to AI use in their business, closely followed by worker displacement (with 44% citing this as the biggest ethical challenge).¹⁵ Not only are SMEs not keeping pace in digital economy reforms, but large parts of the sector are actively opposed to any investment whatsoever. SME owners need supportive regulation, education and access to tools to keep pace and not be left behind.

Providing a multi-faceted program modelled on Singapore’s Go Digital program would work well in the New Zealand context based on the population size and proximity of SME owners and the lower levels of digital literacy. A program like this removes the barriers of uncertainty and cost and promotes action. The key to success would be ensuring the CTO-as-a-Service, the sector specific IDPs, a Start Digital programme and Productivity Solutions Grants were implemented as a cohesive suite of measures to build the digitalisation of the SME sector.

see case study on the following page

Case Study: Singapore's Go Digital program

SMEs Go Digital program was launched by the Infocomm Media Development Authority (IMDA) in Singapore. The program aims to help SMEs adopt digital solutions to thrive and seize growth opportunities. The key elements of the Go Digital program are the Chief Technology Officer-as-a-Service (CTO-as-a-Service) platform, the sector-specific Industry Digital Plans (IDPs), the Start Digital programme and the Productivity Solutions Grant (PSG).

The CTO-as-a-Service platform provides a self-assessment of digital readiness, digital solutions recommendations, and relevant grant support available (including the PSG). It provides SMEs access to a shared pool of digital consultants for digital advisory and project management services. "The digital advisory service covers digital needs analysis, digital solutions recommendations, basic cybersecurity risk advisory and training roadmap, among others. The project management service includes establishing project implementation plan, managing the progress of the project, supporting solution 'Go-Live' and conducting project closure, among others."¹⁶

The sector-specific IDPs provide SMEs with a step-by-step guide on the digital solutions to adopt and relevant training for their employees at different stages of their growth. It is another way to provide SMEs a guide on how to improve productivity through digitalisation.

The Start Digital programme aids newly incorporated SMEs and those that have not yet adopted digital solutions in getting started. SMEs can select a digital solution from the approved list for six months of free use. After the fee waiver period, SMEs pay for the solutions at market rates.

The PSG supports businesses in the adoption of pre-scoped IT Solutions and/or Equipment that improve productivity. These solutions have been evaluated to be market-proven, cost-effective, and backed by reputable vendors.



Inadequate cyber-security

The increasing expansion into eCommerce and online sales means that data privacy and cyber security are both business threats, and potential financial liabilities. Cybersecurity is a significant issue with New Zealand with attacks increasing year on year – in some cases, twice as often in 2021 relative to 2018, and with over half of those surveyed indicating a critical systems breach had occurred in the past 12 months.¹⁷ While medium sized businesses appear to be making increasing levels of investment, small businesses are only investing an average of 4.2 percent or \$41,000 in security and risk management and placing it low on their priority lists (12th).¹⁸ Cyber security is not just a threat to SME because of potential malicious attacks (such as malware/ransomware attacks) or due to potential loss of Intellectual property, but

because of the potential financial liabilities which may be involved if personal data information of customers is compromised in an attack.¹⁹ Although the recently passed Digital Identity Services Trust Framework legislation will contribute to the protection of personal data, it adds another technological challenge for SMEs to overcome.

Failure to take “adequate” steps to secure customers’ personal information may result in legal, compliance, and ultimately financial consequences which may not be covered under many SME insurance policies.

While increasing awareness of cybersecurity threats to supply chains is a positive, there is still far too little action across the sector to address these risks.

TECHNOLOGY EDUCATION AND SUPPORT OPPORTUNITIES

The opportunities for improving productivity through the use of technology are great and with government support, can improve the SME sector’s ability to grow.

Next moves

5. Explore new targeted digital and technological support for business owners such as a Go Digital program, with a Chief Technology Officer-as-a-Service platform, sector-specific Industry Digital Plans, a Start Digital programme and a Productivity Solutions Grant.
6. Invest in support and awareness of cybersecurity vulnerabilities for small business operating in digital workflows

FINANCIAL CHALLENGES

Deteriorating cashflows

New Zealand SMEs are (on average) cash flow negative four months of the year, with 95% of SMEs cash flow negative for at least one month in 2021.²⁰ As a result of this, almost 52% of SMEs required a degree of Government support in 2021, including via grants, incentives, or deferral of payments.²¹ While many of the COVID related financial supports have been retired, SMEs are still under financial pressure based on global interest rate rises and cost-of-living pressures.

This cashflow management challenge for SMEs has continued to trend negatively over recent decades, and makes proactive investment in new systems, processes, and equipment an almost insurmountable barrier. Inability to demonstrate a sustained positive cashflow has longer-term implications from SME seeking to scale, by impairing their ability to demonstrate a lower-risk investment to institutional lenders and investors.

Impaired access to finance

The large number of SMEs in New Zealand means that banks risk being heavily leveraged towards this market segment, and often require property as collateral. Where this involves the owner/managers' personal place of residence, this only further heightens anxieties associated with financial performance – as patterns of house ownership change and new Reserve Bank capital requirements for banks potentially come into force, small business owners may find it increasingly difficult to get loans at affordable interest rates.²²

Rising interest rates only further dampen SMEs ability to access affordable debt to invest in expansion/upgrades. Conversely, where SMEs are forced to rely on non-traditional lenders, there is greater scope for predatory commercial terms, justified under the argument of SME being a higher-risk investment.



Case Study: Australia's Better Business Loan²³

Australia has a government backed private sector led business loan that is geared towards SMEs. As an example, one medium sized business applied for this loan with no specific use in mind. When an external shock arose causing a sudden significant reduction in cashflow, the business was able to continue to pay salaries, pay tax and super obligations and pay contractors while waiting for the market to improve. While there was significant stress during this period, it was lessened by the access to the loan which was paid off as soon as the business was cashflow positive.

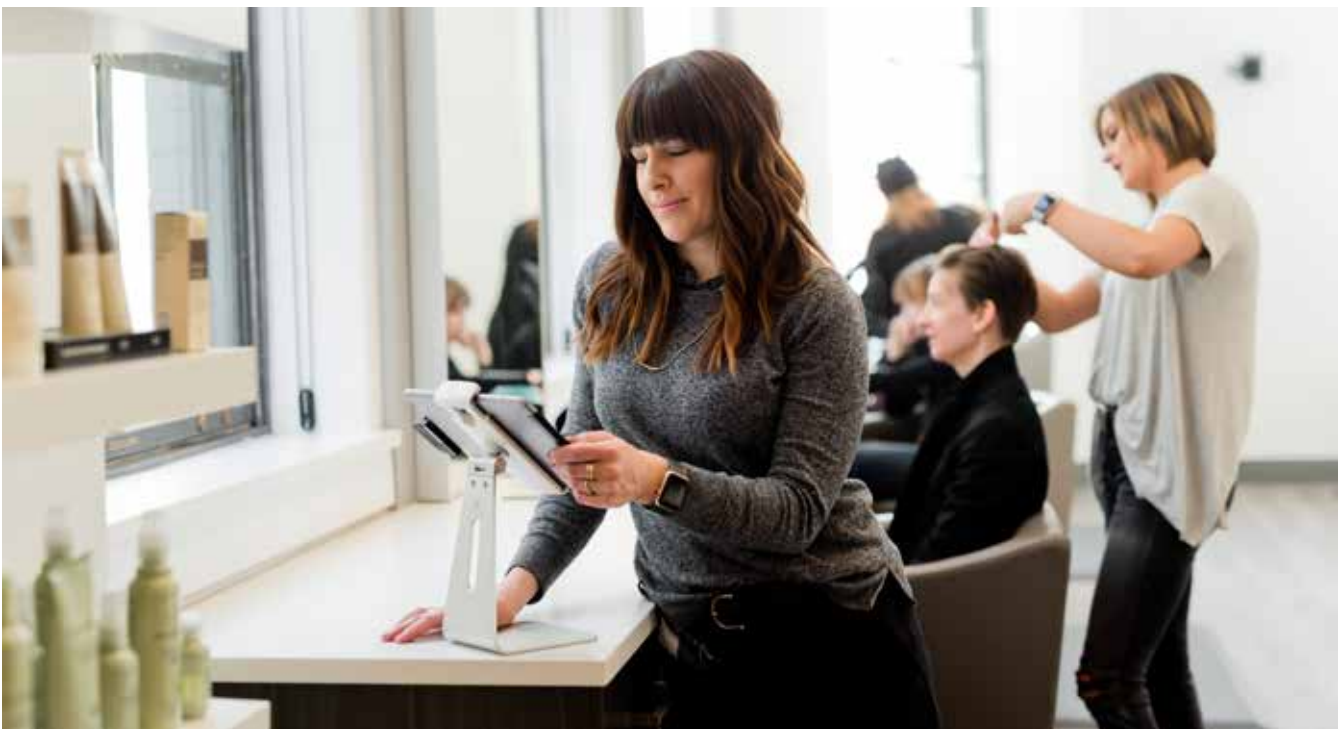


ACCESS TO CAPITAL AND FINANCE OPPORTUNITIES

Small businesses need access to money to both invest in improvements to sustain and scale as well as provide a buffer for any irregular cashflow. The ability to easily access credit, grants and tax offsets allows SMEs to remain agile and innovative.

Next moves

7. Implement key recommendations of the Government's New Zealand Small Business Strategy relating to finance:
 - a. Recommendation 3: Government introduce a Credit Guarantee Scheme to facilitate lending to small businesses.
 - b. Recommendation 4: Government facilitate the establishment of a private sector led digital lending and capital marketplace platform to quickly and efficiently match small businesses with appropriate lenders and capital providers.
 - c. Recommendation 5: Government facilitate the establishment of a private sector led Small Business Growth Fund to provide long-term funding in the form of debt and non-controlling equity investment.



OPPORTUNITIES FOR THE SMALL AND MEDIUM ENTERPRISE SECTOR IN NEW ZEALAND

The vitality of small and medium-sized businesses in New Zealand cannot be overstated. These enterprises constitute a significant portion of the country's economy, contributing up to 30% of total employment and over 25% of the GDP. Their role in supporting local communities, fostering innovation, and driving productivity is indispensable.

However, this sector faces multiple and changing challenges, including workforce issues, digitalisation hurdles, and financial constraints. The evolving workforce demographics, coupled with skill shortages, have placed SMEs in a resource-constrained environment, where recruitment and retention have become major concerns. Many SME owners find themselves wearing multiple hats, struggling with business management tasks beyond their capacity. Digitalisation offers promising avenues for improving efficiency and competitiveness, but the lack of digital literacy and

investment in technology remains a significant impediment. Furthermore, inadequate cybersecurity measures expose SMEs to potential risks and liabilities, particularly in the realm of data privacy.

Financial challenges, such as cashflow management and access to finance, compound the difficulties faced by SMEs. These issues have become more pronounced over the years, hindering their ability to invest in growth and secure favourable lending terms.

There is an opportunity for the New Zealand Government to extend strategies that are working to support SMEs and to do more. When SMEs prosper these benefits spread across economic activity and as well as the wider community.



APPENDIX A - ENDNOTES

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