



Human Capital Risk – SME Trends in New Zealand

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Where are we going....

- Demographics
- Key research findings
- Implications
- Opportunities

Human Capital Risk Defined

- Risk of loss arising from the loss of key people in organisations
- Implications
 - financial losses
 - intellectual capital
 - labour resources
- Succession Planning
- Systematisation and Documentation
- Labour shortages



Demographics



Market Size

- 340000 private sector enterprises
- Equals 99% of all enterprise in NZ
- Estimated another 100000 farms
- 64% - owner is sole employee
- 23% employ 1-5 people
- 11% employ 6-49 people
- Net result 96% employ less than 19

Source Ministry of Economic Development, SME's in New Zealand: Structure and Dynamics

Economic Contribution

- 40% of total economic output
- 29% of total employment
- 59% net new jobs came from the SME sector
- New businesses with 1-5 people created greatest number of new jobs = 95320 from 2001-2006
- Greatest employer of part time employees

Source: Ministry of Economic Development SME's in New Zealand: Structure and Dynamics

About the Owners

- 67% of owners aged 41-60
- 22% 60+
- Twice as many males as females
- Owners predominantly European- 80%
- 86% married or cohabiting
- 49% 'family businesses'

Source: New Zealand Center for Small and Medium Enterprise Research: Succession Perspectives from New Zealand Small Enterprises

Other Characteristics

- 2/3rds of businesses are home based
- 83% opportunity entrepreneurs v necessity entrepreneurs
- 44% OE have tertiary qualifications compared to 25% of NE
- Motivation – be own boss and lifestyle

Source Unitec NZ's Centre for Innovation and Entrepreneurship: The Unitec Global Entrepreneurship Monitor

Research



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Global Research Findings

- Human Capital Risk 2nd greatest concern for CEO's
 - Skill Shortages
 - Succession planning
 - Loss of Key Personnel
- No Metrics to measure or manage
- Limited awareness of risk is a significant barrier

Sources: Economist Intelligence Unit, Best Practice in Risk Management

KPMG: The evolution of risk and controls

New Zealand Research Findings

- 70% of businesses 3 or fewer shareholders
- 62% of business owners believe the enterprise is too dependent on their involvement
- Non-business events had a substantial impact on the future outcomes of the business
- Owners do not regard their business and personal lives as separate
- 70% of self-employed businesses that close down do so in part because of serious injury
- 1800 businesses folded because of injury to the owner in 2003
- 43% of the businesses were more than 10 years old

Sources: NZ Centre for Small & Medium Enterprise Research, Speaking up: Stories of Growth in SME's in NZ 2004

The ANZ Privately Owned Business Barometer 2008

ACC New Zealand - NZPA

New Zealand Research Findings

- 20% of small businesses will be forced to close within 3 months if an event happens to the owner
- There is an increase in the % of Principal Shareholders who are actively engaged in their business
- Business Owners wish to release capital out of their business for retirement
- 60% rate this as of relatively high importance
- 63% of Business Owners cite succession as an issue
- 45% aspire to retire in 5 years
- Finding a suitable successor, determining the value and the businesses dependence on the owner are the key barriers to succession

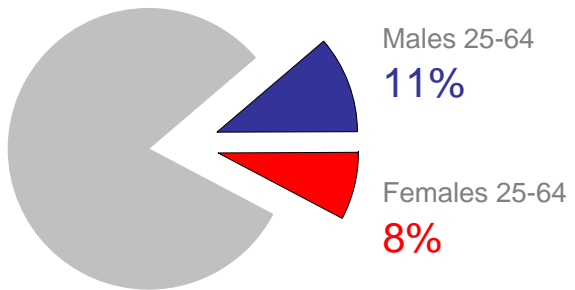
Source: The ANZ Privately-Owned Business Barometer 2008 and NZ Centre for SME Research, Succession Perspectives from NZ Small Enterprises Nov 2007

Why are SME's so vulnerable?

- Under capitalised
- Over draw on cash
- Low financial literacy
- Low appreciation of the impact of risk
- Technicians v Managers
- Don't want to pay for advice
- Personal attitudes and culture

Death...

Percentage of deaths in New Zealand

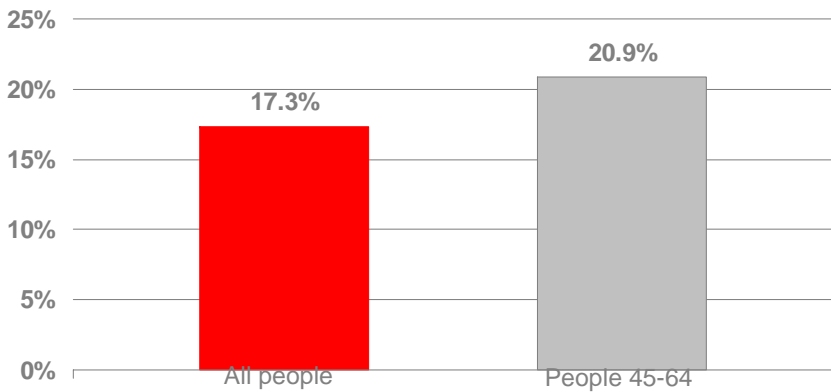


Source: Ministry of Health, Mortality and Demographic data, 2004

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Disability...

Percentage of people with a disability



Source: Statistics New Zealand 2006 Disability Survey

Implications



Economic Risks

- Loss of economic output
- Loss of employment opportunities
 - EU 30000 SME's and 300000 employees
- Social welfare costs
 - pre-retirement
 - post retirement

Source: NZ Centre for Small & Medium Enterprise Research, Succession Perspectives from NZ Small Enterprises

Business Owner Risks

- Loss of personal income
- Loss of personal assets
- Reduced income in retirement
 - business owners typically get 35% of what they think the business is worth in a fire sale
- Loss of family inheritances
- Self esteem

Going concern...



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Case Study

- ARH Limited supply and service equipment to dentists within New Zealand
- The sole SH purchased the business in 2003 as a going concern and is the sole director. The family Trust now has 99% shareholding of the company and 1% is owned by the director. ARH Limited has one part time employee working 30 hours per week whose main duties are administration and marketing
- The owner has full responsibility for generating sales revenue and managing the customer relationships
- The gross revenue for ARH Limited is consistently between \$300,000 - \$350,000 pa
 - \$380,000 to year end 2006
 - \$290,000 to year end 2007
- Revenue from April 2007 – November 2007 has been \$280,000 with the forecast being approximately \$320,000 for March 2008
- The business has a term loan to the bank of \$170,000 and \$50,000 OD facility secured by a PG and over the owners personal home
- The owner also has a current account owing to the coy of \$73,000
- The owner receives a salary of \$55,000 with PAYE deductions

Key Person Exposure

1. Revenue

- Cessation of all Unit sales leading to a potential loss of at least 50% of total revenue
- New opportunities for growth would be stymied until the owner returned to work

2. Cost of Goods Sold

- Increase costs of servicing existing rental contracts as the work would have to be outsourced at a cost of \$6,000 pa

3. Operating Expenses

- Increase the administrator wages from \$ 24 to \$ 30 per hour to compensate for the extra responsibilities she would take on to maintain rental income and consumable sales – additional cost \$7,488pa
- Obtain additional support on the accounts and financials from the accountant. Assuming 4 hours per week at \$30 per hour, expenses would increase by \$5,760 pa

4. Profit

- The business is forecast to make a loss of \$46,000 assuming the owner stops taking income

5. Liabilities and Personal Guarantees

- To avoid foreclosure on the loan the business would also need to make capital repayments of \$18,000 on the debt
- If the company had to be wound up all bank debt would need to be repaid to avoid mortgagee sale

Possible Outcomes

- Business makes a loss
- No income to owner
- Trading while insolvent – personal liability for business debts
- Bank cancels facilities and enforces security (receivership) including personal guarantee
- Receiver will require repayment of current account
- Mortgage over owner's house enforced by bank

Opportunities

- Develop your expertise in Human Capital Risk consulting and solutions
- Ensure you have protected your business from HCR
- Build effective relationships with Centres of Influence
- Grow the wealth of your practice – higher average premium and leveraged relationships
- Increase the value of your business on exit

Parting Thoughts

- SME's are the backbone of New Zealand's economy
- Exposure to Human Capital Risk is statistically the risk with the greatest probability facing SME's
- The potential impact has far reaching effects on the personal lives of the business owners
- Most business owners are unaware and inattentive to HCR
- If you thought randomness was bad try ignorance!

Questions?



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