

→ 02. EXECUTIVE SUMMARY

The ANZ Privately-Owned Business Barometer seeks to investigate the issues confronting privately-owned, well established enterprises in New Zealand.

Typically these businesses have turnovers ranging from \$10 million to \$150 million and are strong contributors to economic growth.

Most of these firms are controlled and managed by their main shareholders, many of whom also founded the business. Their hallmark is that they have been successful and have established a platform with the potential to create further wealth for the benefit of shareholders, stakeholders and the country's economy. But realising their maximum growth potential, for some, appears to be elusive.

This is a significant issue for New Zealand and deserves more analysis to better understand potential impediments to substantial growth.

Recognising the importance of this, ANZ initiated a survey of privately-owned businesses and tested the findings with a panel of business experts as well as our own senior executives.

We are now publishing the results as the first ANZ Privately-Owned Business Barometer. This report has three key sections. Several key comments from the Barometer are listed on this page. The major issues arising from the Barometer are listed on pages 6 - 8. The full findings from the Barometer are listed from page 10 onwards.

“This survey raises a vital point – reminding us that owners of businesses are driven by many different motivators, and therefore require a much broader set of solutions than have traditionally been offered by the market. Our role as a bank is to truly understand an owner's needs then to design the solution most appropriate to their business and those needs.” Ross Verry, Head of Corporate Banking, ANZ

KEY THOUGHTS

Growth

Two thirds of businesses expect to grow this year by way of significant investment. We believe growth aspirations could be more easily realised by:

- › Better access to, or use of external expertise, including better use of truly independent directors on boards (a third are without a Board structure and only half have independent director(s))
- › More information and advice about alternative methods of growth (only 17% will seek to grow by acquisition in the short term)
- › More ready access to capital (half would make acquisitions or expand if capital was not a constraint)

Change

Nearly half of all owners expect to retire in the next five years and a third expect to be less involved in three years. But few have defined plans to effect this change. We believe change could be easier for owners to contemplate if:

- › They see succession as staggered change, rather than outright exit (perhaps releasing time and capital as a first step to a possible eventual exit)
- › External advice is sought in planning for change (nearly half say succession is an “issue”)
- › Existing management figured more highly in the change equation

→ 03. THE ISSUES

The Business Barometer identifies six significant issues confronting the privately-owned business sector.

1. THE ROLE OF BOARDS

- › Do our boards really cut the mustard?
- › Do owners understand the role that boards can play beyond governance?

The results in regard to boards at first glance were encouraging – two-thirds of companies have boards, most meet reasonably frequently and over half have non-executive directors in place. But when looking at the value a board could play – beyond a governance role, and in particular in driving growth – the question has to be asked, can we do better?

- › One in three companies had no board at all – a surprising statistic given the size of many businesses.
- › The fact that only half of boards hold ‘regular’ meetings (monthly or bi monthly) raises questions as to the involvement and hence effectiveness of many boards.
- › The lack of non executive directors raises questions as to the true independence and ‘value-add’ of some boards. 48% of respondents had no non-executives on their boards, and the true percentage could be much higher if other family members and / or the company’s accountant / lawyer were eliminated from the result.

The experience of ANZ is that high growth-potential companies of this size have much to gain from employing a truly independent director on the board, focused on the drivers for growth and the future direction of the company, rather than just governance. Such directors often bring international experience and a wealth of expertise to the table – and can make a real difference in driving both strategy and growth.

2. BARRIERS TO GROWTH

- › Is complacency stifling business growth? Or is a lack of knowledge, (about how to grow or how to fund growth) a factor?
- › Could greater access to advice and expertise help?

A commonly held perception – borne out by the experience of the panel, is that many owners get their businesses to a stage where they reach a position of comfort, then choose to settle back and enjoy life. This is often described as the three B’s syndrome – namely ‘Beach’, ‘Boat’ and BMW’ - not a hard position to relate to - but with the result perhaps being a natural glass-ceiling being set on business growth within those companies.

But, while some owners choose to adopt this view, the survey suggests that there are plenty of businesses in the market hungry for growth – raising a question about what other factors might affect their thinking in this regard?

So, what other reasons exist? Is it a lack of ambition – to take the business to the next level? Or a lack of knowledge – on how to grow or how to fund such growth? Is it risk aversion – of the owner towards taking on risk; or in borrowing the funds necessary to fund such growth? Or do owners simply not have the time to manage for growth? Is a lack of capital a real issue? Or, building on the previous point, perhaps it’s a lack of support / guidance / expertise that’s the more relevant barrier to success?

Our sense is that the reasons are widespread. The common assertions about complacency and the 3 Bs do exist, but there are many other factors playing a role. The bottom line is that there appear to be many companies out there with untapped growth potential, who could generate significant additional wealth for investors, stakeholders and be larger contributors to the overall economic well-being of New Zealand.

3. GROWTH BY ACQUISITION

- › Is a lack of capital a constraint to growth?
- › Why aren't more companies growing via acquisition?

Only a third of those surveyed felt that access to capital was a constraint to growth – yet when offered more capital, half the businesses in the total sample said they would accelerate their growth by making acquisitions.

Acquisition is a very common form of growth internationally. New Zealand is also in a phase of increased business consolidation - particularly given an ageing ownership base and growing sector consolidation. Yet despite this, only 17% currently envisage growth via acquisition in the short term.

As with previous points, many reasons contribute to such decisions. We suspect these include limited knowledge as to how to make acquisitions, as well as access to advice, in particular in regards to funding acquisition. Perhaps this is another area where professional advisors and boards can do more.

Understanding such anomalies is a key to unlocking value in the future.

“The Business Barometer gives us invaluable clues to the aspirations of companies driving future economic growth. It reminds us forcefully that governance really does matter, and more importantly, of the value a board can play in championing growth,” Sandy Maier, professional director

4. MOTIVATORS FOR CHANGE

- › What are the real motivators for change? Do owners want more options?
- › Forget succession – if anything, it's staggered exits that many owners are really after.

‘Succession’ for many means ‘when am I going to sell my business?’ But it needn't be that black and white. Nor is it, with the survey suggesting that business owners have a plethora of different motivators that influence their decision to enact or plan for change.

‘Succession’ is a concern – whether understood or ignored. Half of all respondents identified it as an issue; half want to retire within 5 years; and a third want to be less active in 3 years.

However, 76% of owners are still actively running their business and only 10% have a formal plan for change in place – whatever form that change might take.

In regards motivators, the survey highlights two main drivers – the desire to release time (to spend with family or to pursue other interests); and the desire to release capital (to de-risk ownership or to spend on other things).

Despite the common view that it's either all-in or all-out, ANZ's experience matches survey findings – suggesting that owners can stay involved, can stay invested – but at the same time can achieve their other goals on the way to an eventual exit – if and when desired.

So, can owners have their cake and eat it too? Absolutely! The message is clear, owners need to consider their position, understand their options, then seek advice in preparing for whatever objective it is that they wish to achieve.

5. IS VALUE BEING DESTROYED?

› Are shareholders holding onto the reins too tightly or for too long?

The desire of principal shareholders to be less active as managers in the next 3 years suggests significant on-coming change in ownership.

But are business owners preparing for this? Will they let go of the reins – in stages or at once? Or will we see an aging ownership demographic unsure as to what is needed or unwilling to move forward. The result? Businesses failing to pursue opportunities or invest in maintaining competitiveness. The loss of a frustrated next generation of middle managers and even a significant decline in the prospects for the business and the value of that business over time?

A clear danger suggested by the survey is that owners may be holding onto the reins too tightly or for too long. This natural reluctance to dilute an owner's shareholding, or to share management responsibilities, may be causing damage to the very asset that owners seek to protect. Business owners should start considering early what change might be necessary and who might be involved in that change, over what timeframe.

The decision needn't be black and white. A variety of options exist – including staggered succession, which enables owners to release cash and time, but to remain as owners, engaged in their business going forward. Bottom line, owners need to think like investors and decisions need to be made before value is destroyed.

6. THE ROLE OF MANAGEMENT & FAMILY

› Why is management seemingly being ignored?

› Is handing down to family becoming an increasingly unrealistic goal?

Given the high level of change of ownership expected in the next few years, and the international experience that families and in particular management play a key role in such activity, it's surprising to see family and management figure low in vendors' preferences for exit. The transition to family or management is generally considered to be the least complicated of all exit mechanisms, (in terms of preference, interest and capability), and is often preferred by many vendors for a range of other reasons.

On the management front, only 15% nominate management as their preferred exit mechanism – despite international evidence suggesting that in many markets management is the vendor's preferred form of exit. This seems to be in conflict with the fact that 58% of owners feel management are capable of taking over, and 57% say management are interested in taking over. This raises serious questions. Why are owners discounting management? Is it because they feel managers can't afford to buy such businesses? Or do they feel that they will get a better price elsewhere?

ANZ's experience of many transactions suggests that not only can managers afford to buy businesses – albeit often with the assistance of their bankers or private equity backers, but also that the price they are prepared to pay commonly matches other offers and sometimes exceeds them. In our view – utilising existing management in some form of succession plan is to be encouraged.

In regards families – while 22% see family as preferred exit mechanism, is this realistic? ANZ's experience has found that many children are less enamoured by the prospect of taking over the reins than their parents anticipate. We suspect the actual rate of change to families is lower than the anticipated 22% reported.

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