



research  
NEW ZEALAND

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**Special report:  
Small Business in New Zealand:  
Myths and realities (Part 1)**

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## **Foreword**

Understanding small business owners' motivations and abilities is vital to improving the services and support for New Zealand businesses. Knowing why they went into business, what makes the difference between small and large business, and what they struggled with, adds to our understanding of how these businesses operate.

Small businesses should not be treated just as big businesses wanting to grow-up. Many small businesses, particularly following the IT revolution, are well-adapted to their environment. SMEs (small and medium-sized enterprises) are fully functioning businesses in their own right, operating successful business models, without necessarily having to get bigger or smaller, or more "mature".

This report gives us a valuable insight into the thoughts of small business owners and combines it with international perspectives and the views of groups like the New Zealand Small Business Advisory Group.

**Hon Maurice Williamson**

Minister for Small Business



## **Dispelling the myth: Small businesses are not little big businesses**

Small businesses<sup>1</sup> (enterprises employing 19 or fewer people) are a vital part of the New Zealand economy, and a key driver of growth, but successfully engaging with them can sometimes be difficult - especially for government and larger businesses.

It has been suggested that engaging with, or creating policy for, small business is being hampered by a myth that small businesses are little big businesses, with the same drivers and goals as much larger enterprises. This simplistic understanding of the motivation and complexity of the small business sector can lead to “flawed understandings”<sup>2</sup>, with any government interventions being blunt instruments when applied to the sector.

Internationally, and in New Zealand, it has been increasingly recognised that the issues facing small businesses can differ to those facing big business. Any policy interventions, therefore, need to account for the context in which small businesses operate.

Research can help to capture the complexity of the small business sector. To help move thinking about small business forward, we decided to conduct our own research project, investigating small businesses from the perspective of small business owners. By shedding light on the psyche of small business owners the project has deepened our understanding of how small businesses operate and how best to engage and assist them.

The project comprised three stages of research: an examination of the international literature on small businesses, a qualitative study that uncovered the drivers that motivated people to go into business for themselves (as well as the trials and tribulations that they experienced)<sup>3</sup>, and a survey of New Zealand small businesses<sup>4</sup>.

The following report brings together that research, profiling small businesses, exploring the motivations and expectations of small business owners when they establish their business, and considering some of the ways in which small businesses may differ from larger businesses. The words of small business owners from our qualitative group discussions are used to illustrate the findings of our research.

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<sup>1</sup> In this report, “small business” refers to small and medium-sized businesses (SMEs). Definitions differ on what size these SMEs may be, but they are defined as enterprises with 19 or fewer employees by the Ministry of Economic Development.

<sup>2</sup> Culkin & Smith (2000).

<sup>3</sup> Four group discussions (each with four respondents) were held with decision-makers from businesses in greater Wellington, between September and November 2006. Group membership was largely determined by business size and the length of time the business had been established. The sample also included a mix of respondents from blue and white collar industries. This research informed the development of a quantitative telephone survey of just over 500 small business owners.

<sup>4</sup> The final achieved sample of n=501 small business owners was selected, at random, to be nationally representative of businesses with up to 19 employees. An initial sample of n=5,000 businesses was selected, stratified by business size (businesses with more than five employees were over-sampled to ensure they were adequately represented in the final sample). Contact Research New Zealand for further information on survey methodology.



A second paper will consider the support networks available to small businesses, and how they view key relationships with government departments and corporate businesses.

## **Most New Zealand businesses are small businesses**

Small businesses contribute significantly to the New Zealand economy and, in particular, to provincial economies by creating and maintaining employment through the production of goods and services used by the local community, as well as stimulating further economic activity through their payrolls. Data on small businesses in New Zealand demonstrates the significance of this contribution<sup>5</sup>.

- ◆ Ninety-seven percent of enterprises employ 19 or fewer people<sup>6</sup>.
- ◆ Small businesses provide nearly one-third of total employment<sup>7</sup>.
- ◆ Small businesses account for 39 percent of the economy's total output<sup>8</sup>.

Small businesses make up over 90 percent of enterprises in most industries, and are particularly predominant in the finance and insurance sector, accounting for 99.2 percent of all enterprises<sup>9</sup>. They are also dominant in property and business services, agriculture, forestry and fishing, and communications services, making up over 98 percent of businesses in each of these industry groups.

### **The small business sector is turbulent**

Small businesses create many new jobs. Between March and December 2006, the largest single contributing group to employment growth was businesses with 1-5 employees, creating on average 32,369 new jobs per quarter. Conversely, they were also (over the same period) the greatest contributors to employment *reduction*.

Fewer very small firms survive than larger firms. This further reflects the dynamic nature of these enterprises. In a UK government paper describing the evidence-base on small business growth and development, the Small Business Service describes small businesses as making an important contribution to "the process of productive churn". That is, new businesses replace less efficient existing businesses, "... leading to increased productivity in the economy as a whole"<sup>10</sup>.

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<sup>5</sup> The data for this section was sourced from Ministry of Economic Development (2008).

<sup>6</sup> At February 2007.

<sup>7</sup> *Ibid.*

<sup>8</sup> See Ministry of Economic Development (2008) for information on how value-added output is calculated.

<sup>9</sup> At February 2007.

<sup>10</sup> Small Business Service (2003), p.36.



## Getting started in small business

Just over one-half of small business owners in our survey identified themselves as ‘first-time’ business owners. Two-thirds (68 percent) reported that they had established the business themselves, with most of the others stating they had bought it from someone else (28 percent). Just three percent had inherited the business.

Over one-third of respondents reported they had owned their current business for less than five years (37 percent). This was just as likely to be the case for ‘first-time’ business owners (35 percent) as it was for respondents who had previously owned businesses (41 percent).

At the other extreme, 15 percent reported they had owned their business for more than 20 years, with more ‘first-time’ business owners claiming this to be the case (19 percent) than respondents who had previously owned businesses (10 percent).

Our research shows one of a number of drivers impacting on people’s decisions to start small businesses.

- ◆ Wanting the freedom and rewards associated with being your own boss

*“I want to be master of my own destiny”*

- ◆ Practical reasons (such as not being able to find a suitable job, or as an investment)

*“I moved here with money to invest and saw the opportunity in this business”*

- ◆ Lifestyle choices (to fit around family and/or other interests)

*“I started my business so that I could be home with my son”*

- ◆ A desire to make their mark (the entrepreneur)

*“It’s formidable to put yourself out there. It’s the risk factor. You see an opportunity and go for it”*

Whatever their reason for establishing their own business, the small business owners in our research were united – they started with a vision (sometimes rose-tinted) and a belief that they can make it work.

*“It comes back to the certainty about where you are heading, and that expression that says, ‘if you don’t know where you going, you will never get there’. So you have to have a vision”.*



## The expectations of small business owners

Most small business owners anticipated that becoming a business owner would be hard work, but most also expected it to be enjoyable.

In addition to work being hard, but enjoyable, eighty-two percent also expected customers to love their product or service. Three quarters expected to be able to work the hours they wanted, and the same number anticipated a better work-life balance. Sixty-one percent expected to make their mark and become well-known/recognised.

Less than half of those surveyed expected to make a lot of money, or even make a profit in the short-term.

### Were their expectations met?

Having established what the respondents' expectations were, we asked them to tell us to what extent they felt their expectations had been met. Four of the six most frequently identified expectations were noted as having been 'met' or 'exceeded' by 50 percent or more of the respondents who identified these as expectations in the first place:

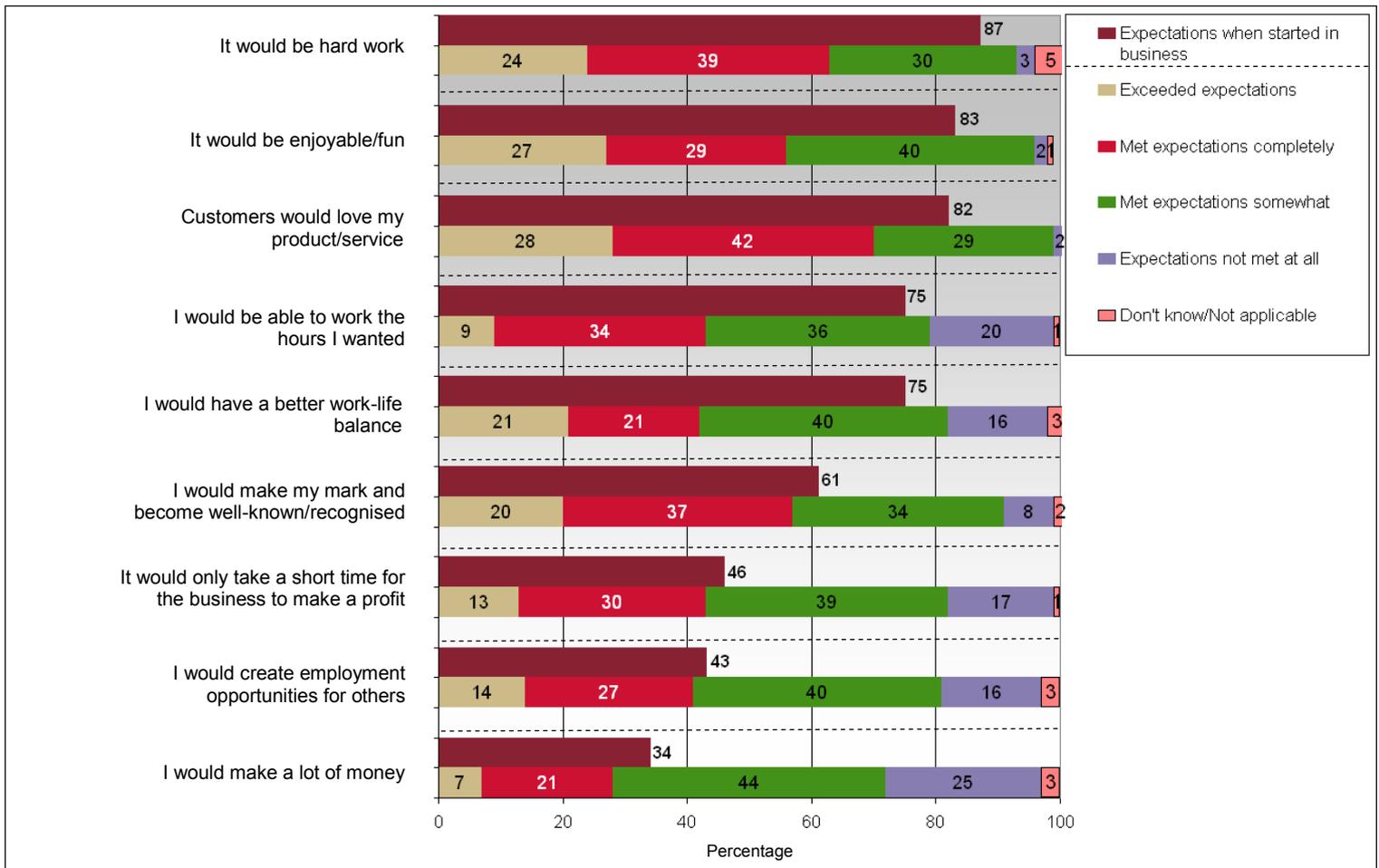
- ◆ 'It would be hard work' (identified by 87 percent as an expectation and 63 percent of these respondents reported this expectation had been 'met' or 'exceeded').
- ◆ 'It would be enjoyable/fun' (identified by 83 percent as an expectation and 56 percent of these respondents reported this expectation had been 'met' or 'exceeded').
- ◆ 'Customers would love my product/service' (identified by 82 percent as an expectation and 70 percent of these respondents reported this expectation had been 'met' or 'exceeded').
- ◆ 'I would make my mark and become well-known/recognised' (identified by 61 percent as an expectation and 57 percent of these respondents reported this expectation had been 'met' or 'exceeded').

*"Money can deliver success, the bottom line is survival. But success is when your clients are happy... when they come back for more. At the end of the day, that's what makes you happy and fulfilled".*

Control over hours of work and work-life balance are the two expectations that were *least* likely to be met. Indeed, 20 percent of respondents reported that the expectation they would be able to work the hours they wanted had "not been met at all".



**Graph 1: Expectations when started in business and the extent to which they were met**





## What makes small business different to big business?

*“Larger organisations are inherently more complex in their structure, their organisation and the level of departmentalisation and specialisation within the company. This leads to, on the surface, increasingly complex decision making criteria. However, although small firms may be regarded in one very valid sense as relatively ‘simple’ units in terms of their attitude, behaviour and decision-making, they have complexities of their own”<sup>11</sup>.*

Once established in a small business, owners face a number of pressures, many of which are different to those experienced by larger businesses. Small businesses usually have fewer resources, fewer in-house specialists and less “capacity to deal economically with change, when compared with larger firms”<sup>12</sup>.

### The core role of the business owner

Although small businesses may appear to have a much simpler structure than big businesses, they can also exhibit complex behaviours, particularly where they are personality driven. In these cases, understanding the context, attitudes and behaviour of the individual small businessperson becomes equally as important as understanding their business<sup>13</sup>.

*“It’s my chance to shine. It’s all about me. My company’s called X, but really it’s me. It has to stop with me, as my credibility is on the line. If I’m not performing, the whole thing’s doomed”.*

All the small business owners interviewed in our survey identified themselves as being ‘hands-on’ – that is, they are mainly responsible for the day-to-day running of the business. In many cases, they will be required to be Jacks-of-all-trades, turning their hands to all aspects of running the business, as well as producing the products or services that their business provides.

Small business owners need to be flexible and may even need to re-invent themselves (more than once) in order to survive.

*“Everything’s new. You can never really be prepared. The old way of planning was to have a business plan. I think its organic. You can’t really think it out. Plans are more in your head than on paper. As soon as you write a plan it changes and moves. It’s natural planning”.*

However, the Auckland Chamber of Commerce stresses that the importance of a comprehensive business plan cannot be over-emphasised.

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<sup>11</sup> Culkin & Smith (2000), p.8.

<sup>12</sup> Small Business Advisory Group (2006), p.2.

<sup>13</sup> Culkin & Smith (2000).



*“The business plan is a necessity. If the person who wants to start a small business can’t put a business plan together, he or she is in trouble”<sup>14</sup>.*

A business plan can be important in a number of areas of a small business, including applying for outside funding, management of finances, promotion and marketing, and achievement of goals and objectives<sup>15</sup>. Nevertheless, not all small businesses will have a formal plan for growth or change, and figures from the UK show that less than half of small and medium-size businesses have a business plan<sup>16</sup>.

### **Personal commitment**

Without the buffers and supports inherent in corporate and government department structures, small business owners have to work hard to keep things going.

*“It’s ambition that drives you. When you start, you have nothing. It’s your own determination and perseverance”.*

For small business owners, work subsists at the boundary between their business and their personal life. This can result in the boundary between ‘work time’ and ‘personal time’ becoming blurred<sup>17</sup>. In many cases, their personal finances may be linked to the success of the business, leading to additional pressures.

Seven of every ten small business owners, in our survey, work (significantly) more than the average working week of 40 hours. This was particularly the case for respondents who owned and managed businesses with six or more employees (89 percent), compared to those respondents with no employees (60 percent).

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<sup>14</sup> From the Auckland Chamber of Commerce website: <http://www.aucklandchamber.co.nz/biztools2/mgmt-planning.htm>

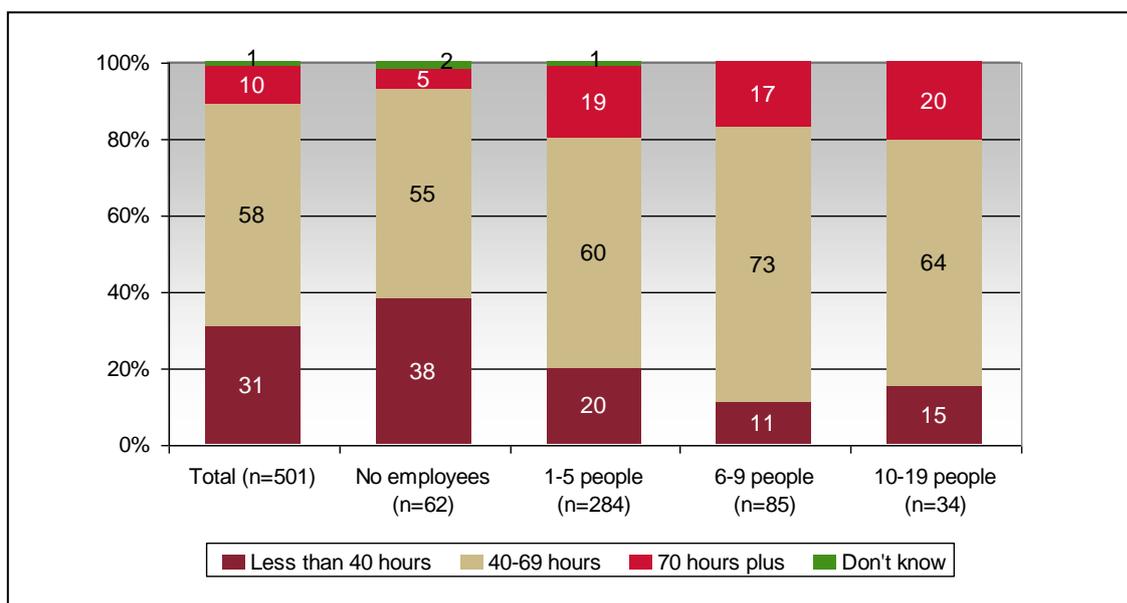
<sup>15</sup> *Ibid.*

<sup>16</sup> Cosh & Hughes (2003), cited in Small Business Service (2003).

<sup>17</sup> Culkin & Smith (2000).



**Average hours per week spent running business**



## Building business capabilities

Small businesses have more need of assistance in building business capability than larger businesses<sup>18</sup>.

A number of areas in particular can cause difficulties to the small business owner. They may feel particular vulnerable in these areas compared to larger businesses. In our survey, two-thirds of respondents experienced some type of difficulty establishing their business. Five specific aspects were frequently mentioned by respondents as being difficult:

- ◆ Dealing with or setting up health and safety systems (39 percent reported this was difficult).
- ◆ Dealing with government departments other than IRD and ACC (33 percent reported this was difficult).
- ◆ Setting up your human resources systems and dealing with other staff matters (31 percent reported this was difficult).
- ◆ Setting up your financial systems to manage your costs and invoice clients (23 percent reported this was difficult).

Not surprisingly, owners of businesses with six or more employees were more likely to state they experienced difficulties with their human resources and health and safety systems. They were also more likely to state this was the case in terms of their marketing and promotion, and in their dealings with government departments other than ACC and IRD. In contrast, difficulties with

<sup>18</sup> Small Business Advisory Group (2004).



computer systems were more likely to be mentioned by sole operators. Difficulties with financial systems tended to be an across the board issue.

### **Recruitment**

Recruitment is an area of business that can present particular challenges for small business owners. Nearly one-third of respondents in our survey experienced difficulty when setting up their human resources systems and dealing with other staff matters. This was particularly the case for businesses (with six or more employees). The New Zealand Small Business Advisory Group acknowledges that, for small businesses in particular, “selecting and managing employees is a major undertaking”<sup>19</sup>.

*“Lying awake worrying every night. Having to do all the work myself, because the staff are so unreliable”.*

In a small business, employers and employees usually work side by side. As the Small Business Advisory Group notes, each employee can be crucial to the business and will often have a unique skill set. This makes it hard for someone else to do the work if they are not performing. Indeed, in many cases, there may simply be no one to delegate to! Staff turnover can also present problems, particularly as small businesses can only offer limited scope for career progression.

### **Information**

Information can play a key role in the creation, development and growth of businesses. However, small businesses, with their time and capacity constraints, may not be able to access the full range of available sources to answer their specific questions regarding the day-to-day management of a small business<sup>20</sup>. They may also not have the experience to assess the quality of the information available to them. External information and advice is often needed when setting up computer systems. Nearly one-half (45 percent) of respondents in our survey reported they had difficulties setting up computer systems when establishing their business. This was particularly the case for sole operators. At the time of the survey, 20 percent were still experiencing difficulties with computer systems.

### **Finance**

A range of financial issues can provide challenges for small business owners. Setting up financial systems to manage costs and invoice clients in a new business was identified as difficult by 23 percent of respondents in our survey. Eleven percent of respondents were still experiencing difficulties at the time of the survey.

Small businesses may also have trouble accessing capital investment and debt finance, as they have little to offer as collateral, and small business owners may not have the knowledge and skills needed to prepare formal business plans to access finance<sup>21</sup>. Without enough information to fully assess risks and returns, potential lenders and investors may impose additional requirements for

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<sup>19</sup> Small Business Advisory Group (2008), p. 5.

<sup>20</sup> Small Business Forum (2006).

<sup>21</sup> Small Business Advisory Group (2004), p. 6.



mitigating risk, such as requiring security for loans. Such requirements can be particularly costly (both in time and financially) for small businesses<sup>22</sup>.

The financial position of a business can also affect its ability to innovate. Innovation in a small business is likely to involve a higher level of risk than in a large business, as it will involve a higher proportion of the assets of the business, and could mean the success or failure of the business (Small Business Service, 2004).

## **External pressures**

Small businesses are particularly vulnerable to external pressures that can create disproportionate costs.

*“You have road works outside your business for two years, and there’s nothing you can do about it, and every business around you goes under, and you think, ‘what’s going to happen?’ Things that are beyond your control can really affect your business. You hear about other people and the things that happen, and you think, ‘we’re OK’, and then something happens, and it can be devastating”.*

The fixed costs associated with compliance can create a higher relative burden for small businesses. In small firms, it is business owners who are like to deal with regulatory responsibilities. This has been estimated as costing two to three times as much as if they were able to delegate to a staff member. In addition, business owners are unlikely to be regulatory experts, so may take longer than average to understand regulatory documents and assess the implications for their business<sup>23</sup>. Small businesses may also lack the resources to keep up to date with new regulations and with amendments to existing regulations. These factors may mean that small businesses do not reach their full potential.

*‘If you are trying to run a business, and going out there to get more business to keep the doors open and feed your staff, you can’t afford to be spending the whole time doing compliance work with ACC and IRD”.*

Our survey supports this, finding that compliance issues and the paperwork involved in running a business were two of the four reasons most frequently identified by respondents as being the main reason that they found it difficult to stay in business (the other two were financial issues and “how hard you have to work”).

An OECD report notes that OECD countries have generally adopted the view that small businesses are of particular importance in the economy, and that burdensome red tape can undermine their competitiveness<sup>24</sup>. However, the OECD also concludes that little is known about the effectiveness of measures introduced by different countries to address this issue<sup>25</sup>.

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<sup>22</sup> Small Business Service (2004).

<sup>23</sup> Department for Business Enterprise & Regulatory Reform (2008).

<sup>24</sup> OECD (2003b).

<sup>25</sup> OECD (2003a).



It is important to note that, in addition to the difficulties experienced by small business owners when establishing a business (described in this paper), our survey also identified a number of administrative aspects that most small business owners found easy to manage when establishing their new business. This included registering for GST with Inland Revenue (94 percent reported this was easy), setting up and dealing with power and telephone suppliers etc (87 percent reported this was easy), setting up insurances (87 percent reported this was easy), and registering with ACC (84 percent reported this was easy).

The next paper in this series will consider the organisations and networks that are available to support small businesses. It will focus on how small business owners view key relationships with government departments and corporate businesses, and small business owners' perceptions of the support they provide.



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