



Hunkering down, but staying positive

Report of the findings of the Inaugural SAP/EMA Innovation for Growth Survey

November 4th 2008

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Executive Summary

Innovation is superseded by operational excellence and customer retention as the priority strategies that New Zealand businesses are planning to implement over the next one to three years, according to the inaugural SAP/EMA Innovation for Growth Survey.

The online survey conducted late September was undertaken to understand what initiatives New Zealand businesses would put in place to keep them viable and focused on growth in face of the uncertain business environment. The survey's special focus was on innovation, research and development (R&D) and investment including investment in IT.

The poll found innovation was the third in a list of eight factors respondents ranked in order of importance for business growth.

365 business owners/managers responded to the survey, with the largest proportion (30.4 per cent) from small businesses employing fewer than 10 full time staff.

Business challenges

Even at the time the survey was in the field a surprising 80 per cent of respondents were cautiously confident or very confident about the overall business and economic outlook for New Zealand over the next three to five years. Events largely offshore on October 3rd and 10th after the survey had closed may have modified this degree of optimism.

Not surprising was that the biggest hindrances to achieving business' goals in the next year will be economic volatility and unpredictability, followed by the challenge of attracting and retaining quality skilled staff.

The stability of energy supply and increased costs were the biggest energy concerns.

Sustainability

The businesses in our survey are not taking the sustainability challenge to heart yet. Over 55 per cent have not yet begun to define what sustainability means for their organizations, and just 29 per cent have plans underway to assess and address their carbon emissions. That means 70.3 per cent are not doing this yet. So do they plan to become carbon neutral at some time in the future? 75.4 per cent have no plans on the way to do so.

The news is much better on the 'feel good' social responsibility issue; 73.6 per cent of businesses are active in this area.

R&D

Annual expenditure on R&D amongst our survey respondents ranges from zero to 300 per cent of sales revenue (!) for one reported case. For most of the sample it's under 10 per cent.

21 per cent didn't know about the new 15 per cent tax credits available for R&D since April this year; the level of awareness of these was something we wanted to explore. Ironically, National's announcement subsequent to the survey that it would abandon these tax credits has possibly raised awareness of them!

Of those fully aware of them, just 15.5 per cent say the credits will encourage them to do more R&D, while 27.6 per cent say their introduction has changed the way they budget and/or account for their R&D expenditure.

Investment intentions

Likely business investments over the next 2-3 years is planned for major asset purchases such as plant and equipment for 29 per cent, with 26 per cent planning investment in major website development, and 25 percent looking at new premises or relocating.

Investing in IT received a strong endorsement as a contributor to business success: 65 percent of respondents see IT as supporting their business.

Upgrading ERP systems was the leading IT investment priority: 25 percent ranked it most important, with another 10 per cent ranking it second most important. IT security initiatives were ranked top priority for 19 percent, and second for a further 17 percent.

61 percent of respondents identified financial management software as important for meeting their business objectives with sales management software (45 percent), Business Intelligence/Business Performance Management (44 percent) and web services (44 percent) rating highly.

53 percent describe IT as essential for the smooth functioning of their business; 29 percent see it as essential to gaining and maintaining sustainable competitive advantage and 22 percent regard it as a primary plank in their growth strategy.

A. Demographics

A total of 365 business owners/managers responded to the survey conducted amongst the broad range of membership of the Employers & Manufacturers Association (Northern) including chief executives, financial controllers and managers responsible for R&D, science and IT. EMA has some 8000 corporate members including strong representation in the primary, manufacturing, construction, electricity and tourism sectors.

The largest proportion (30.4 per cent) of the sample was small businesses with fewer than 10 (full time) staff. For most, total revenue was less than \$10 million in 2007 (for 64.4 per cent; the biggest revenue group earned \$1-10m). 62.5 per cent of the sample were not exporting; but 12.8 per cent of firms were deriving more than half their revenue from exports.

B. Driving Growth

Over the next two to three years selling the business or merging with another overall are on the cards for 44.3 per cent of respondents. Mostly they will buy another business or merge with one (25.7 per cent), with another 18.6 per cent planning to sell to local or overseas interests. 11 per cent said they would raise equity capital but only two indicated plans to float the business on a stock exchange.

Growing the domestic market and/or customer base is the activity most (42.4 per cent) said they would focus on to grow their business in the next one to three years, followed by expanding their export markets (19.1 per cent). But the least likely activity for the largest group of respondents (32 per cent) was expanding export markets.

Activities that others would focus on are:

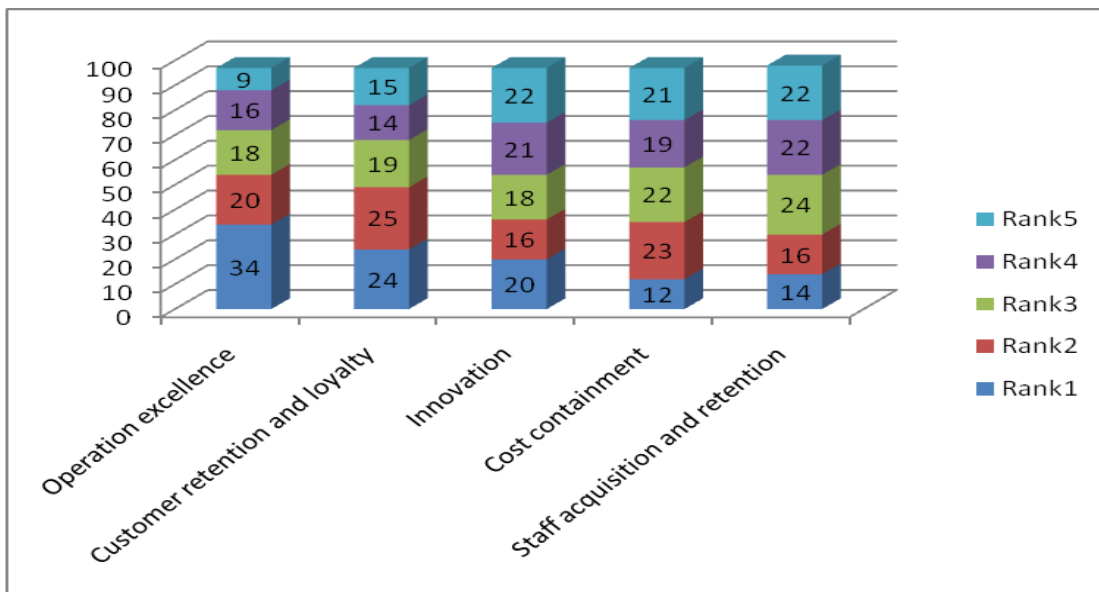
- Developing their product and service offerings - 11.7 per cent

- Collaborating with partners and suppliers through the supply chain - 6.3 per cent

The most important factors affecting growth goals over the next one to three years in their order of importance were:

1. operational excellence, ranked as most important by 26.3 per cent of respondents,
2. customer retention (16.9 per cent)
3. Innovation (11 per cent).
4. Cost containment
5. Staff acquisition and retention
6. Improving their business agility
7. Improving their marketing excellence, and
8. Capital investment

Business priority strategies



C. Current business challenges

Apparently bucking the trend of a number of other recent confidence surveys, 80 per cent of respondents were very or cautiously confident about the overall business and economic outlook in New Zealand over the next three to five years.

Subsequent events largely offshore on October 3rd and 10th after the survey had closed may have modified the extent of this level of optimism.

Not surprising was that the biggest hindrances to achieving business' goals in the next year will be economic volatility and business unpredictability followed by attracting and retaining quality skilled staff, wage and cost pressures close behind.

The other challenges in order of the importance attributed to them were:

- Competitive pressures locally
- Business uncertainty
- Consumer confidence
- Business confidence
- Government policy
- Unfavourable New Zealand dollar
- The credit crunch
- Competitive pressures from overseas
- Access to credit
- Loss of access to capital

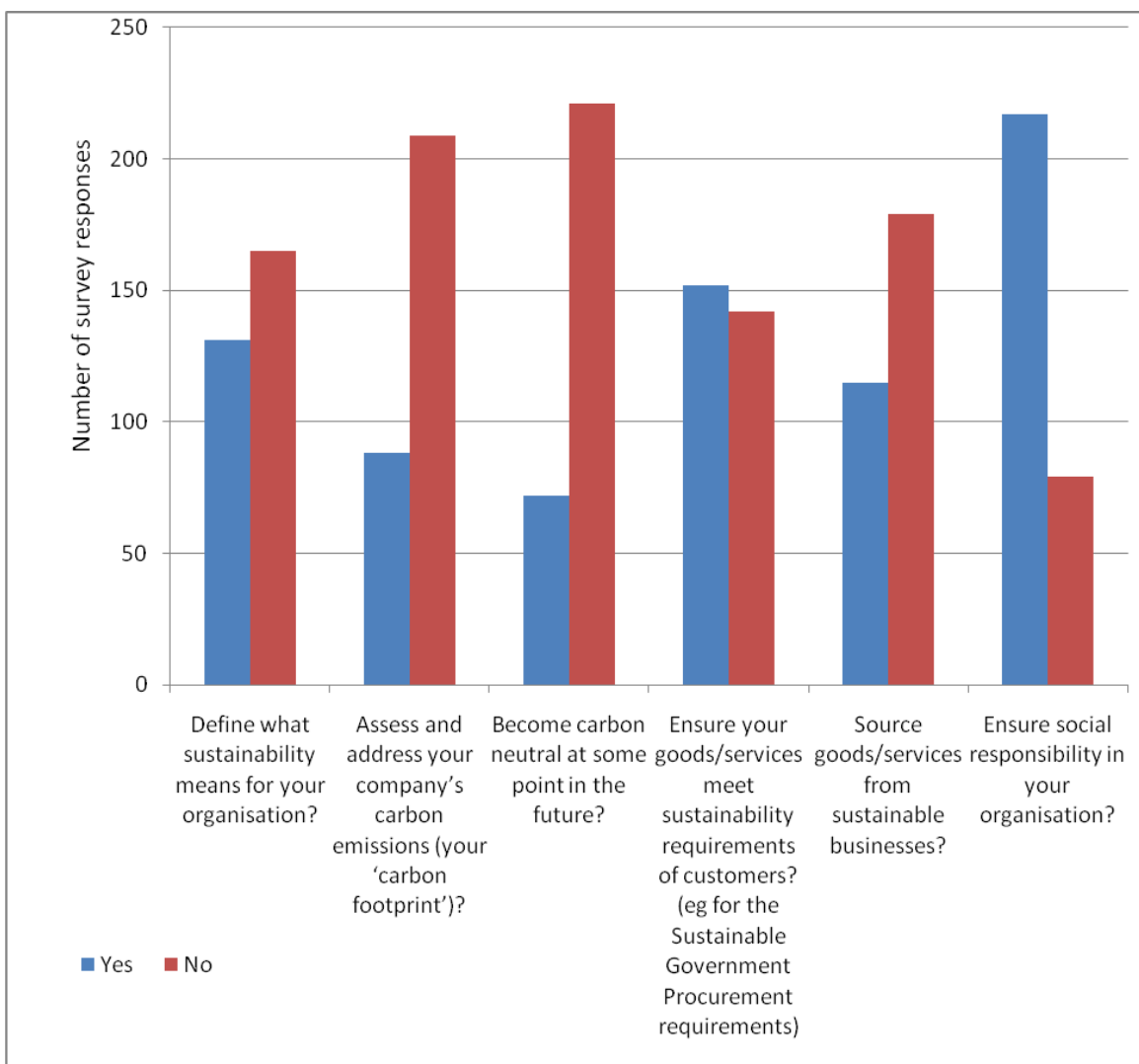
Furthermore, the stability of energy supply and its increasing costs were the biggest energy concerns, for 23 per cent and 21.9 per cent respectively.

The sustainability challenge is an issue most businesses have yet to really grapple with.

When it comes to defining the meaning of sustainability for their organizations, 55.7 are not doing this. When it comes to assessing and addressing their carbon emissions, 70.3 per cent have not yet begun to do this.

Do they plan to become carbon neutral at some time in the future? 75.4 per cent do not. 60.9 per cent were not planning to seek sustainable businesses from which to source goods and services. However customers' requirements are driving the demonstration of sustainability for 51.7 per cent of businesses.

Grappling with sustainability



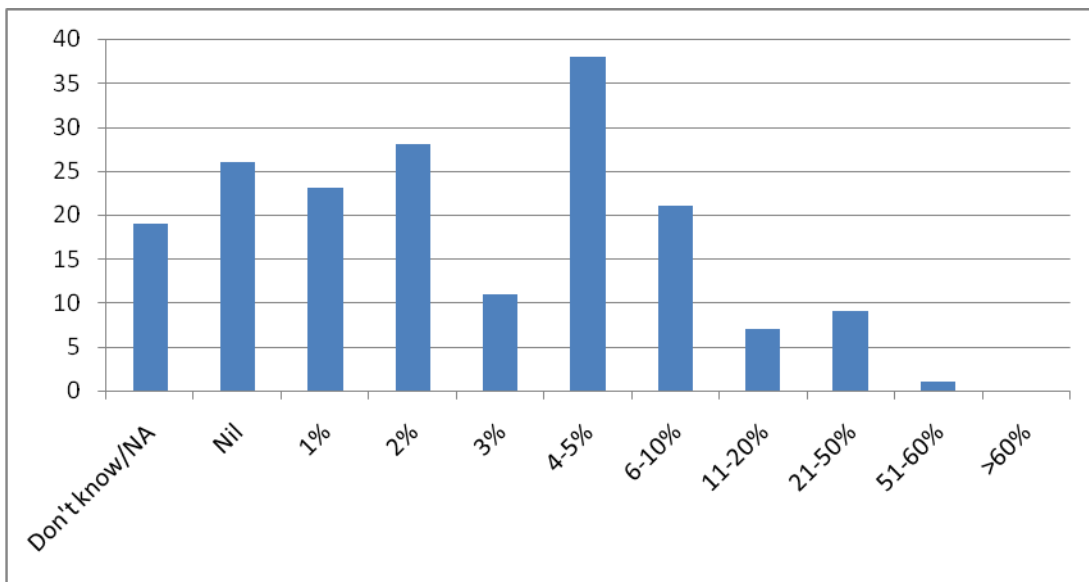
The news on those addressing their social responsibilities is far better - 73.6 per cent of respondents are applying themselves to this.

D. R&D

Looking at investment in R&D, 62.8 per cent reported they do not budget or account for R&D separately from other business activities.

Annual expenditure on R&D ranges from zero to 300 per cent of sales in one reported case, doubtless a venture capital funded start up. Mostly the level was under 10 per cent. Some appear uncertain how their R&D budget is accounted for, or say for example: "R&D is melded into other work systems so it would be very difficult to measure - at a guess about 3-5%". Several others said their head office overseas controlled it.

R&D as % of sales



21 per cent of respondents said they didn't know about the new 15 per cent tax credit available for R&D since April this year. Ironically, the National Party's announcement subsequent to the survey that it would abandon these tax credits has possibly raised awareness of them.

Of those fully aware of the tax credit, just 15.5 per cent say they will encourage them to do more R&D. And 27.6 per cent say the new tax credits has changed the way they budget and/or account for their R&D expenditure.

However, less than half said they are able to make use of the credit or plan to do so.

Amongst those expecting to increase their budget for R&D in the next 3-5 years, 23.7 per cent expect to increase it by more than five per cent; most would do so by 5-10 per cent.

73.3 per cent indicated the increase would be by less than 5 per cent.

The most common activity classified as R&D is to make ongoing developments to products or processes. This was the case for 43 per cent of respondents.

R&D for originating or developing new products applied to 36.4 per cent of respondents, with 35.3 per cent undertaking research on extra features for existing products or services. Only 9.8 per cent of our sample undertook fundamental scientific inquiry.

In applying for the tax credit slightly more than half (52.5 per cent) said the additional costs in doing so were difficult but manageable; a quarter considered the extra costs straightforward; 21.8 per cent found them extremely complex.

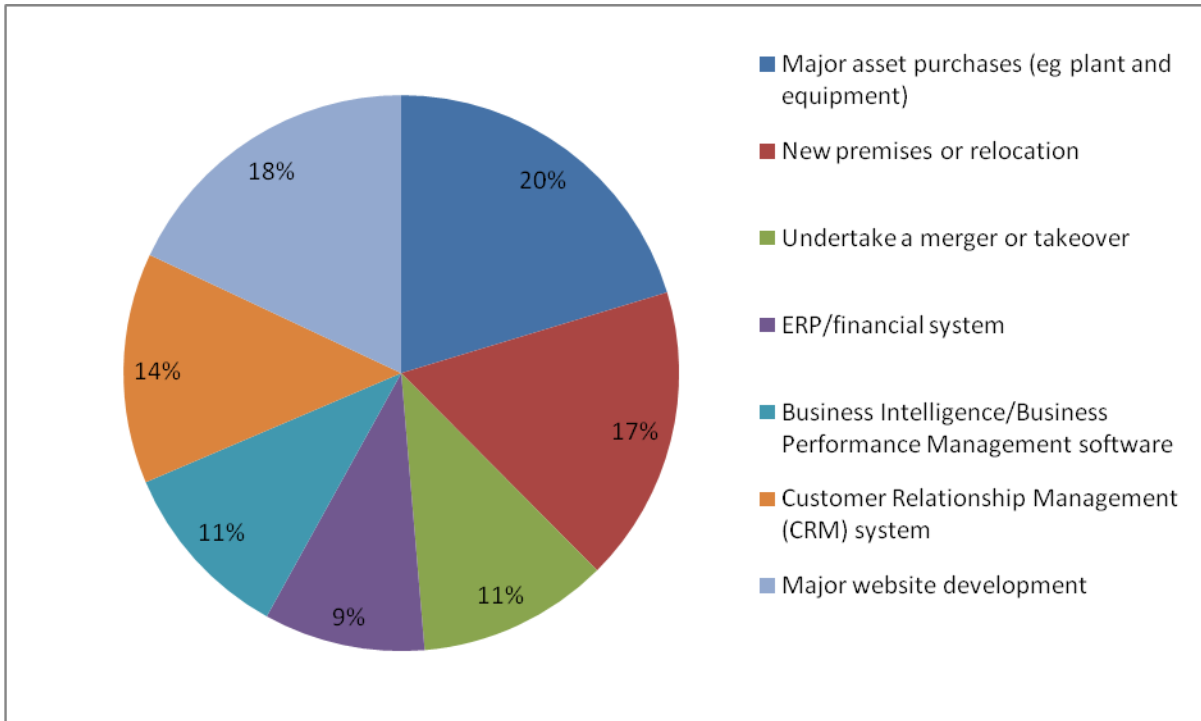
Representative comments about the scheme which we consider highly pertinent included:

- “The tax credits are not available for what most companies consider R&D to be. Upgrading models is R&D but not considered to be so by this regime.”
- “We are below the threshold.”
- “Returns and reports make it not worthwhile to bother.”
- “They seem to be encouraging scientific enquiry rather than commercial product development.”
- “It’s a good start.”
- “There is very limited ability to make use of the R&D credits scheme.”

E. Investment

The most likely business investments over the next 2-3 years are planned for major asset purchases such as plant and equipment by nearly a third of respondents (29 per cent), and 25 percent planning to relocate or invest in new premises.

Investment priorities



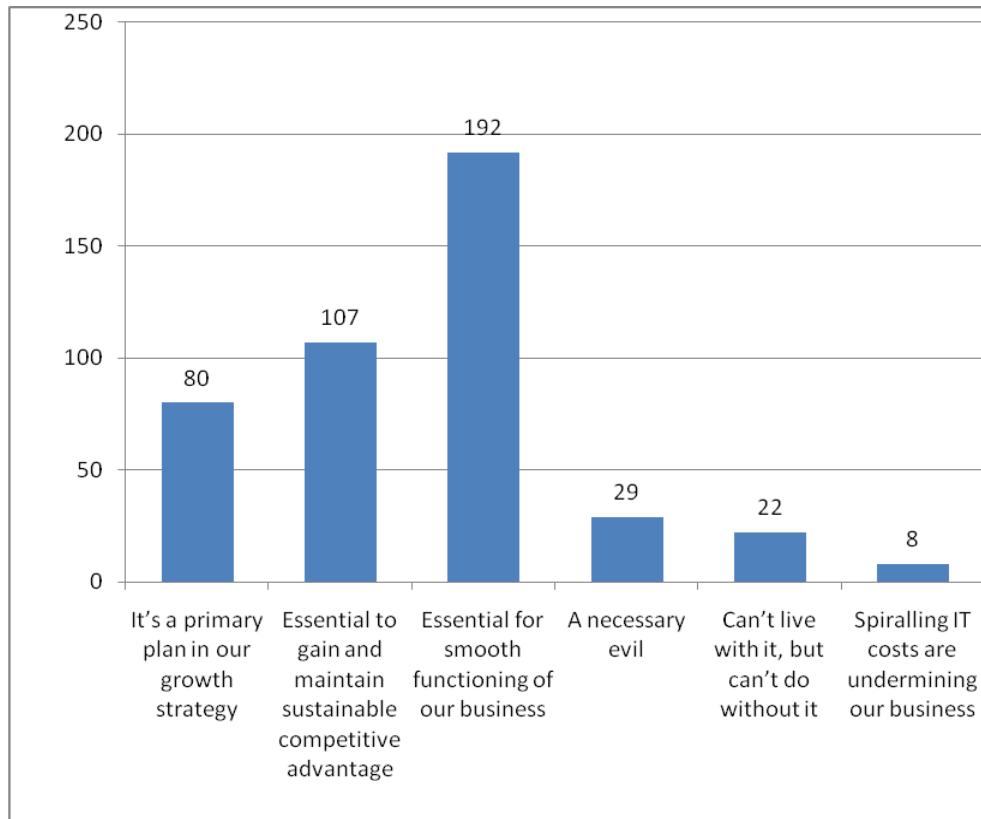
26 per cent of the sample are looking to invest in major website development, with a strong interest expressed in new customer relationship management (CRM) systems (19 per cent).

Investing in IT overall received a strong endorsement as a contributor to business success: 65 percent of respondents see IT as supporting their business.

When asked to be more specific on the types of IT investment they considered the most important, upgrading ERP systems was the clear leader: 25 percent of those surveyed ranked investment in ERP system upgrades the highest IT priority. A further 10 percent ranked it second most important.

49 percent of all respondents, the highest, rated IT security initiatives amongst their top 3 priorities. IT security ranked most important by 19 percent, and second most important by a further 17 percent.

How business views IT investment



Hardware upgrades were the top priority for only 8 percent although 40 percent rated hardware investment amongst their top three priorities. RFID, outsourcing and Vista migration were accorded the lowest priority.

When asked about the software and IT services important for meeting their organisation's objectives over the next one to three years, the focus fell clearly on core financial management capability. 61 percent of respondents identified software to achieve this as important, significantly more than the next most important category.

Other IT services and software rated highly included sales management software (45 percent), Business Intelligence/Business Performance Management (44 percent), web services (44 percent).

These responses are clearly consistent with business attitudes to how IT is considered to supports the business:

- 53 percent described IT as essential for the smooth functioning of their business;
- 29 percent see it as essential to gaining and maintaining competitive advantage,
- 22 percent regarded it as a primary plank in their growth strategy.

Few were IT averse, though some did say it was “a necessary evil,” and six percent said they can’t live with it, but can’t do without it. Several people thought spiralling IT costs were undermining their business: (NB: respondents were able to agree with more than one statement.)

Contrary to a perception in some quarters that IT systems oblige businesses to change the way they operate, 22 percent of respondents said their IT systems had enabled them to formalise their existing business processes with 13 percent saying they simply automated their existing processes.

A further 11 percent said that though they did have to change their processes significantly, doing so ultimately benefitted the way they operated. Only three percent said that though they had been forced to change their processes, they were not convinced of the benefits.

The survey’s respondents on IT technology were clear about whose advice they followed when investing in IT. Forty-one percent said they were influenced by their customers, and 32 percent by their business partners. Only 23 percent admitted to being influenced by their suppliers.

Who influences business IT decisions

