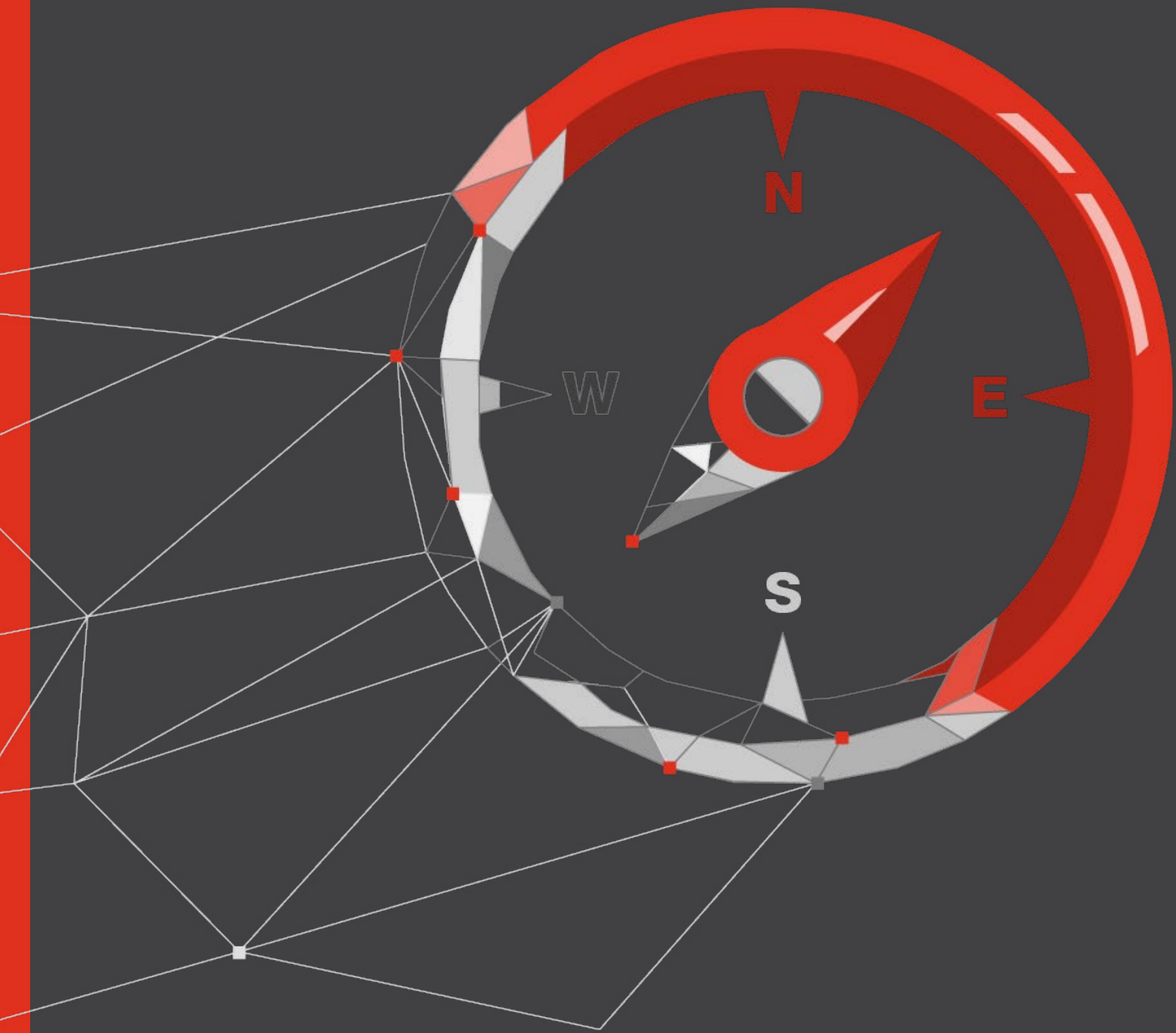

Rebuild New Zealand: planning guidance for mid sized businesses

pwc

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Introduction

Many months on from the first lockdown in New Zealand there remains continued uncertainty as to the business and economic outlook. We know that COVID-19 will not be a short-lived phenomenon, and we can expect to be dealing with it for the next two to three years, or longer.

We don't know whether we will experience another community outbreak, whether there will be further regional or national lockdowns, or when our borders might open with Australia, or the rest of the world. Nor do we know what the effect of the pandemic will be on the global economy, and therefore how demand might be impacted for many of our traditional exports, especially the all important primary sector which has held up strongly to date.

However we are becoming more accustomed to dealing with continual change and the faster pace of transformation in the current environment. The news of a number of vaccines for COVID-19 is also promising.

This report is aimed at New Zealand mid-sized businesses (defined as those with turnover between $5 million and $200 million). These businesses are the engine room of our economy.

Business needs to remain agile and be prepared for this continued uncertainty. These are the themes for this report as businesses adapt their futures over the next 12-36 months given these ongoing challenges. The report covers the following topics:

- Scenario based strategy to plan effectively amidst uncertainty
- Responding to changing consumer preferences and behaviours
- Building a financial budget
- Dynamic cash flow forecasting
- Managing bank and key stakeholder relationships

Scenario based strategy to plan effectively amidst uncertainty

In a very fluid and challenging operating environment, a business that can readily adapt its plans based on a range of defined variables and plausible assumptions will be much better placed to respond to whatever the future brings.

To date, we have seen that the immediate economic impacts for many sectors in the economy stemming from COVID-19 have been somewhat muted. This is due to the Government's stimulatory interventions and the success of our border control policies that have effectively eliminated the spread of COVID-19 within the domestic community. However, we expect the eventual ramifications of these policies to be profound and widespread, encompassing market access, trading environments, access to skilled labour, technology usage, competitor actions and lasting changes to consumer behaviours.

(For more on how consumer behaviours have changed since COVID-19 and how they plan to spend in the future, see our recent report, Rebuild New Zealand:consumer insights).

If you have already implemented the necessary measures to ensure your business will survive this immediate disruption, then you might begin to think about how to revive in the near term and thrive over the medium to longer term.

There are many models to build your strategy from. A simple framework for resetting your strategy is WWH (why, what, how). This will provide you a straightforward basis to work from:

- **Why do we exist**: Start with why you exist as an organisation? What is the purpose of your organisation? What are the market needs you fulfill better than anyone else? Who are the stakeholders that benefit from your continued success?
- **What do we want to be**: Where are you now (current state performance, customer base and market position)? Where are you heading to in two or three years? In defining your future state, get very specific on what your competitive differentiation is - what are your key measures of success and how will you know when you have achieved them?
- **How do we get there**: Knowing your direction, how will you get there? What are the key activities and investments you need to undertake to get you there? What are the material risks or inhibitors to your ambitions.

We consistently see that those businesses that have a clear purpose and vision, which can articulate a robust strategy based on a differentiated proposition and strong understanding of what their customers want will be able to maintain a strategic focus that enables them to revive quickly and eventually thrive in this uncertain environment.

Base your strategy on multiple scenarios to test resilience

A scenario based strategy, supported by tools such as cash flow scenario models (discussed below) allows leaders to manage effectively, and understand the likely decision points and trigger events.

Taking a scenario based view of the future allows you to think through the implications of a range of key variables. In the current environment predictability is a rarity, which means that a flexible approach to strategic planning is essential. With a scenario based strategy you can think through two or three likely key scenarios, and understand in some detail the different decisions you will need to take depending on which scenario eventuates. This means that when you understand the trajectory you are on, you will already have made some of the hard decisions required.

Make sure you are clear on the assumptions supporting your base case, and ensure you explore downside scenarios more thoroughly than upside scenarios. Downside risk is especially dangerous when combined with increased uncertainty.

Scenario planning model

Business Response Based on actions that are within your control	**Scenarios** Based on operating conditions outside of your control: **Good**	**Bad**	**Ugly**
Plan A: Do nothing	Profit and revenue neutral	Profit and revenue unsustainable	Profit and revenue unsustainable
Plan B: Modest Action	Profit and revenue favourable	Profit and revenue neutral	Profit and revenue unsustainable
Plan C: Aggressive Action	Profit and revenue favourable	Profit and revenue favourable	Profit and revenue neutral

Profit and revenue favourable | Profit and revenue neutral | Profit and revenue unsustainable

Responding to changing consumer preferences and behaviours

The current global pandemic has presented enormous problems for businesses across the globe and has required rapid responses, focussing immediately on survival and cash flow. Customers should always be at the centre of any strategic decisions made over different recovery timeframes.

In this changing consumer and competitive environment, businesses may need to reassess who their target market and intended customers are. Your business may need to revisit it's value proposition, to understand your product's point of difference. Customers need to easily find you, find out about you and transact across carefully selected channels.

There has been an accelerated demand for e-commerce and e-services. Businesses that have, or are rapidly able to build robust digital capabilities will be in an enviable position as technology is at the forefront of change. Web analytics and search engine optimisation (SEO) can be invaluable in driving incremental traffic to these digital platforms.

Companies do not need the best of breed technology across the business, but they do need to know what customers value and what tools to focus on that enable better customer outcomes. The digital tools and processes that support them could be customer facing channels or anywhere throughout the value chain including production, marketing, supply chain, fulfilment / 'last mile' delivery and the provision of after-sales service.

Considerations include:

Will you be trading in the same market?

What could a global recession mean to your market and how should you respond? Are you in danger of losing a big chunk of your clientele? Will your current customers be engaging with you in the same way? Are there unexpected restrictions or constraints on how you engage with your customers? What about new customers? Will they have different expectations? If your model is currently "business to business" (B2B) does it need to evolve to include "business to consumer" (B2C)? Can you identify and access new markets?

Will you be selling the same products and services?

What do changes in consumer behaviour and a transformed environment mean for your products and services? Will your pricing need to change? What about your profitability and overheads? Have consumer expectations changed? Are there companion products, services or contiguous categories that you could explore?

Will you be managing the same business?

Many businesses will be making significant structural changes. What will your organisation look like in 2021 and beyond and what is the best way to transform your business? What does that mean for you and what resources do you need? Who "owns" the customer? How can you scale your business (up or down) to respond to material changes in sales volumes or activity levels? Are there partnerships that could enhance your business?

How will you recognise and respond to market changes?

With a fast changing market you may need more real time information on business performance and activity. How will you monitor your markets for recovery? What do you need to do to respond to changing market conditions? How can you navigate with constant uncertainty? Do you need better market insights and what can the business provide you in the way of information so you can make decisions quickly?

Assessing your channel health for breaks and opportunities

2020 has seen a marked impact on the way the consumer searches, selects and engages with goods and services providers. With this in mind, businesses can quite easily take stock of their own channel health to make sure they are directing their resources in the right area.

You don't need to be good at everything when you look at your channels, but you do need to be clear on the areas that support your business ambition, whether it be attracting new customers in new markets or retaining current customers in current markets. The first step in this is to take a quick look at whether your channels are good (tick), bad (cross) or neutral (tick/cross) across a simple transaction pathway (from awareness through fulfillment to advocacy).

The digital channels you may want to assess include:

- **Direct web**: The web sites and properties you directly control
- **Mobile web**: How your websites function on a mobile device
- **Social media**: The social media channels you control
- **Distributed web**: Where your brand or proposition appears on other websites (intermediaries, distributors, affiliates, partners)
- **App**: If you have your own stand alone app
- **Marcomms**: Marketing and communications including adwords, campaigns and advertorial

When you undertake this exercise, consider:

- Are your current customers looking for you in the same way they used to?
- How do new customers look for you and find you?
- Do you need to change the messaging or offering via current channels?
- Do you need to de-power old channels and networks?
- Do you need to build new channels and networks?
- What experiments can you perform to test your thinking?

Once you've completed this exercise you should be in a better position to decide how best to invest in messaging, media, networks and technology to create enhanced customer experiences and drive improved business performance.

Channel Assessment example

	Awareness / education		Engagement		Transaction		Fulfillment		Advocacy	
	EXISTS	WORKS	EXISTS	WORKS	EXISTS	WORKS	EXISTS	WORKS	EXISTS	WORKS
Direct web	Good	Good	Good	Good	Good	Good	Neutral	Neutral	Good	Good
Mobile	Neutral	Neutral	Neutral	Neutral	Neutral	Neutral	Neutral	Neutral	Neutral	Neutral
Social	Good	Neutral	Good	Neutral	Not good	Not good	-	-	Good	Good
Distributed web	Neutral	Neutral	Good	Good	Good	Good	-	-		
App	Not good	Not good	Not good	Not good	Not good	Not good	-	-	Not good	Not good
Marcomms	Good	Not good	Good	Not good	Good	Not good	-	-	Not good	Not good

Good Neutral Not good

Building a financial budget

Forward looking financial information is absolutely critical to making good decisions for any business.

When building your budget or financial forecasts, the following principles should be front of mind:

- Have a base-case, worst-case and best-case scenario in your mind as you work through the various income streams and expenses.
- Be realistic, do not sugar coat assumptions. What do you honestly think you will sell or spend during the period?
- Resist the all too easy tendency when working with spreadsheet tools to simply tweak assumptions, even by seemingly minor amounts, in order to produce the results you would like to see. The changed outcome can be materially different and potentially unrealistic.
- Don't underestimate the costs of things such as expenditure on replacement fixed assets and repairs and maintenance.
- It's almost always better to be prudent and err on the conservative side when making predictions. Invariably some assumptions will work out well but it is highly unlikely that this will be the case across all assumptions.

To start building a financial budget you will need to think about:

Revenue streams: what drives the revenue in your business, does this change depending on time of year and what is the easiest way to forecast this over the next 12 to 36 months? For example: is your revenue based on units sold at certain price levels? Do you have multiple income streams? Do you have seasonal revenue?

Other income streams: do you have any other significant income streams that are not part of your normal course of business but need to be included? Examples of other income include interest, dividends, royalties and grant funding (including any Government grants or subsidies).

Direct or variable costs: are there any costs in your business that are directly associated or fluctuate with sales revenue/volumes and what is the best way to forecast what these will be? Examples of direct costs include purchases, freight, packaging and direct labour/wages. There are various ways you can look at forecasting direct costs depending on your business. Some examples include using a percentage of sales approach or to calculate backwards if you have a standard Gross Profit percentage you want to maintain.

Operating expenses: what are the key operating expenses you have in your business and how are these incurred? Examples of operating expenses include salaries/wages, rents, office expenses, utilities, professional fees such as accounting and legal, advertising/marketing, insurance and repairs and maintenance.

Financial expenses: what are the key financial expenses you have in your business or plan to incur? Examples of financial expenses include bank fees, interest on bank loans, overdrafts and any other borrowings, leasing costs, or foreign exchange hedging costs.

Any other significant expenditure: what other significant costs do you expect to incur over the next 12 to 36 months? For example expenditure on replacement or new fixed assets or other capital investments.

Common mistakes to avoid when building your budget:

- Assuming that as your revenue grows, your gross and net margins will remain the same. It is unlikely that revenue will increase significantly without impacting gross and net margins to some degree.
- Being unrealistic about your receivables collection cycle. Do not budget 45 days if you never get the average below 55.
- Relying on the prior year revenue trend only and not looking at current market conditions locally and overseas (if you have overseas exports), and the stability of your current customer base. The flow-on effects of these factors could affect your revenue quite significantly.
- Relying too much on cost levels from previous years rather than current supply chain pressures.

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Dynamic cash flow forecasting

In today's world, managing a business without a cashflow forecast is like driving a car with your eyes closed. In a highly uncertain and volatile environment, the cash flow forecast is an essential day to day management tool that helps to ensure the business' survival providing it is used to guide each and every decision.

Some key building blocks for having a robust business cash flow forecast were discussed in our previous COVID-19 Update, Effective liquidity management techniques in uncertain times. The article was published during the first lockdown and focused on short-term crisis management, investigating the levers that could be pulled to immediately understand and manage cash and liquidity requirements.

Many of these building blocks and levers remain equally relevant today when considering the medium term business planning horizon. Cash flow forecasting should be ingrained within any business (irrespective of size) so that when needed it can be relied upon. But in order to do this properly, the cash flow forecast must be a dynamic tool, meaning it needs to be updated regularly, sometimes on a daily basis. Management must therefore own the cash flow forecasting process.

Some key "tips" to help make your cash flow forecast a more dynamic and accurate tool include:

- Design a forecast tracker that visually charts actual results against forecast figures with variances explained and openly interrogate what went well and what didn't.
- Investigate cash conversion assumptions and actual performance, particularly the timeliness of debtor receipts and doubtful/bad debts.
- Think through how the business will operate over the next 36 months given your current understanding of the market and lead indicators, update assumptions and continue to seek timely information from the wider business.
- Scrutinise the status of negotiations with suppliers and customers using regular catch-ups with sales and procurement personnel to ensure assumptions remain realistic.

Managing bank and other key stakeholder relationships

Where a bank is a key stakeholder in your business, it's vital to maintain regular updates with your relationship manager, even when the news may not be all good. The most important thing is to be proactive around this communication, because this helps to build trust which is essential to the relationship. Conversely banks tend to become wary of customers who are not forthcoming with key developments affecting their business, especially where it's bad news.

Banks will want updated business forecasts and will be seeking assurance that your assumptions remain realistic given the highly uncertain business outlook. Greater focus will be applied to those sectors that are more vulnerable to the economic slowdown.

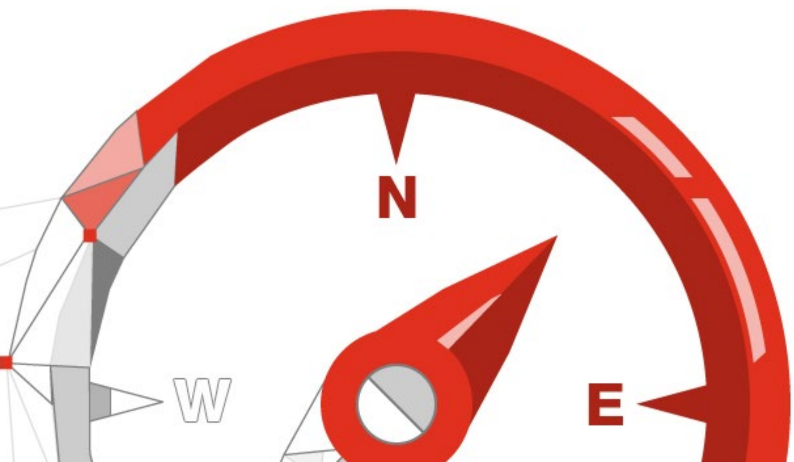
Banks are continuing to work closely with their existing customers and are still responding positively, albeit with a greater degree of caution, to new lending requests providing they are consistent with their lending strategy and pricing parameters.

What information does your bank need?

Most banks will require your latest financial reports to understand how your business is going, as well as a financial forecast going out at least 12 months and ideally longer, showing your projected financial performance, financial position and cash flow.

As part of these financial forecasts, banks will be particularly interested in the assumptions you have made when developing your forecasts so you will need to ensure these are clearly outlined and accurately reflected in your forecasts.

Ideally the forecasts should be supported by a succinct annual business plan which narrates your key actions for the coming year as well as an overarching strategic plan showing where you want to take your business over the next three or more years.



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Many months on from the first lockdown in New Zealand, there remains continued uncertainty as to the business and economic outlook. Businesses needs to remain agile and be prepared.

How we can help

Businesses can navigate a commercial environment where there are a lot of unknowns if they focus on scenario based strategy and responding to changing consumer preferences, alongside building budgets and cash flow planning for the next 12-36 months.

Working closely with business owners and operators across New Zealand, we provide independent tailored strategy and financial advisory services. We offer market insights and fresh thinking, as well as guidance on managing your risks and overcoming challenges to help businesses grow, innovate and plan for the future.

Please contact us to discuss how we can help your business navigate the changing commercial environment ahead.

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