NZRise

Supporting New Zealand Business in a COVID world

This article is an opinion piece by Breccan McLeod-Lundy, Co-Chair of NZRise and CEO of Ackama Limited. While the article is Breccan's opinion he endeavours to reflect the discussions of NZRise members during COVID lockdown in Aotearoa and as we navigate through this ever changing economic climate of the global COVID economy. One area of contention within the NZRise community is that of taxation.
The ideas proposed in this article are not necessarily the position of NZRise - instead are designed to stimulate discussion. This article has been released as a 4 part series or is available for download as a single PDF.
If you would like to join this kōrero please reply to this post or email chair@nzrise.org.nz .

After the initial shock of Covid-19, New Zealand can now focus on how we want our industries to develop and what the future holds. We can be purposeful in shaping the work and industries we want to have as a country, or we can just keep reacting to crises as they emerge. If we wait until the crisis has finished to think about changing our economy we will have lost the momentum to make changes and the opportunity to benefit from being ahead of the rest of the world on the recovery.

In any discussion like this, the first step is to discuss what a successful New Zealand economy looks like. I suggest the following basic outcomes:

- **Food Security** - Separately to any discussions of the productivity of our agricultural industry it is important that in situations like Covid-19 we can react quickly to produce enough food to keep the country running. Being at the end of supply chains makes this more important for us than many other countries.
- **Productivity** - That for every hour worked we should produce as much value as possible. We can achieve this by making work we're already doing more efficient or by favouring getting people involved in areas that are more productive. The exact measurement of productivity has some complex edge cases around the potential measurement of work that isn't captured within industry measures, but the historic case has been that higher measured productivity leads to additional capacity for non-billable activities.
- **Poverty Alleviation** - A high performing economy can ease poverty both by employing more people and having more funds available for social welfare. I think we should assume that as New Zealand grows, we will continue to tax top earners and look towards more company tax from NZ businesses, and then spend a portion of that tax on welfare in line with that growth.
- **Inclusiveness** - As we review industries, paths to employment, and paths to wealth, we should make sure we keep helping people up. We could meet the conditions of food security, productivity, and poverty alleviation by having a wealthy upper class that funded a generous welfare scheme for everyone else but that isn't an acceptable outcome in terms of the

long-term social consequences as work like Michael Marmot's research into the ongoing health effects of high social inequality shows.
- **Environment** - Environmental outcomes and protection are a key consideration in any policy we create. It makes sense to create and grow industries now that are better prepared for a future where environmental concerns have become even more important than they are today.
- **Long Term Planning** - Economic and social changes happen over decades. Many of the most impactful social programs (schooling, healthcare etc) take upwards of twenty years for New Zealand to fully benefit from improvements. China has a 100 year plan; Grant Robertson said that Covid-19 was a once in a 100 year shock - on a ten year plan we might say it's only a 10% risk and not think too hard about preparing, but on a hundred year plan we'd assume there'd be at least one and that might change our preparation.
- **Maintain and grow our international status** - New Zealand is well respected internationally and our strongest growth opportunities rely both on export and having uninterrupted access to offshore markets. This means signing healthy trade agreements that support all of our industries (both current and future) while maintaining our ability to take principled stances on social and political issues that matter to us.

With these goals in mind, there are plenty of changes we could make now to improve our position in the future. For now I'll focus on those around business in New Zealand but there is potential in every area.

What Does a Good Business Look Like?

Having outlined a general picture of what good looks like for New Zealand at a large scale I think it helps to also be clear on what good means in the case of business. By doing this we start to dig into a little more detail which can then lead to a conversation about the direct actions and approaches that the government should take with business.

There's been a lot of good thought in recent years about the future of business when it comes to concepts like the triple bottom line or corporate social responsibility. The focus for a country in setting policy around business is, however, a more complex puzzle as minor changes can dramatically change which industries grow and which shrink. There can be sudden pressures to favour certain industries whether that be roading under certain governments or a fixation on a shiny new technology as we see occasionally when ideas like blockchain or AI are at the peak of hype cycles. What is needed is a stronger theory of the kind of business the government should encourage based on the long term outcomes for New Zealand.

I suggest the following criteria for judging whether a business is good for New Zealand (Or any country):
- **The creation of new high wage jobs** - This covers both that new jobs increase the productivity of New Zealand and also that they don't just hire people who are already earning well in the industry. To quantify, in 2018[1] the median salary in Aotearoa was $49,868 vs the median salary in the digital technology sector of $82,000.
- **There is a strategy to bring a diverse group of people into that business or industry -** This

is a joint responsibility with the government but even if an industry currently has a poor record on diversity there should be a plan to improve that situation.

- **That the business and industry around it will grow -** Many of our most successful growth stories are important not just because of the particular businesses that lead the way but because entire industry areas have sprung up around them. For example, Xero has directly lead to dozens of businesses being created and become a key channel for many New Zealand software businesses to sell internationally without having to grow to that scale. On the flipside of this Stretchsense and Rakon have both shown the risks of having some cutting edge tech but being in industries that have not achieved critical mass in New Zealand as sudden changes in other markets are both more difficult to react to and more likely to catch participants off guard.
- **That taxes are paid by the business appropriately and in the countries where the business trading -** There are some challenges here but the future of taxation must be cooperation with our key trading partners to divide taxes appropriately and jointly favour businesses that are good tax citizens of all the countries in which they trade.
- **Economic Sustainability -** We should encourage businesses that will exist for the long term if they succeed. This isn't to limit ourselves to sure bets but that businesses should have an intention to exist for the long term. While there are totally valid short term businesses such as entertainment joint ventures the focus of "business" policy should be on growing businesses that aim to exist for the long term.
- **Environmental Sustainability -** We should favour businesses with better environmental outcomes than not.
- **The broader community will see the benefits of success -** It is much better in the long run for New Zealand to grow businesses that continue to operate, create jobs, and pay taxes than for a single founder to see a sudden windfall and the business to disappear - some people suggest that big paydays still benefit the local community through investment, but I've yet to meet the wealth manager that recommends a locally focussed investment strategy over an internationally diversified one so while there can be a benefit I would argue it's not as big as some people would like to believe. This is particularly challenging as NZ entrepreneurs tend to sell or stop growing their business at a smaller size than some of our other trading partners.

1: Source "Digital Skills for a Digital Nation Report", Digital Skills Forum.

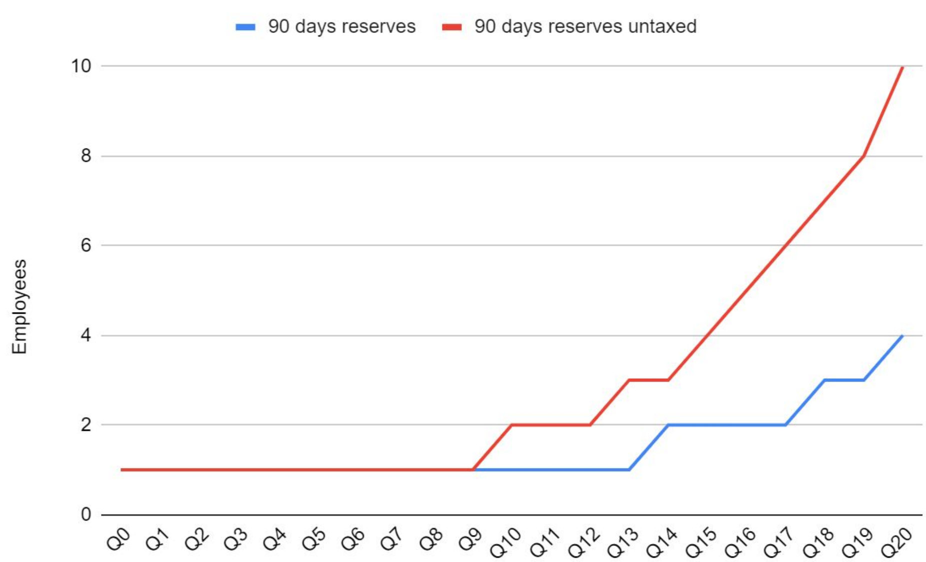
Supporting the Future of NZ Businesses

Tax Settings to Support Business Growth

Tax settings should support businesses that continue to invest in New Zealand and create New Zealand based jobs. That means favouring taxes that trigger when cash is removed from businesses rather than taxing the day to day running of a business. For example, favouring personal income taxes on high earners over company income taxes or wealth taxes.

For an illustration of why this is important, look at the surprise from many commentators when it came to how quickly small businesses found themselves short of cash under Covid-19. Part of the reason for this is if you have a growing business you could either build up your cash reserve and then hire additional staff or just hire additional staff immediately. High company income tax is a disincentive to building up healthy cash reserves as you'll have to pay tax immediately on the "profits" while pouring the money immediately back into more staff won't be realised as a profit.

This graph shows the difference in employee count after 20 quarters or 5 years between a small services business that decides to only hire employees once it has 90 days of cash reserves to meet in a company tax versus no company tax environment (assuming that an employee costs about $100,000 a year and generates $120,000 revenue and the business starts with $10,000 and a founder that works until there is enough cash to start hiring).



This means that the effect of paying company tax is the difference between a small business with 4 employees and a business with 10 - a sizable difference in overall business and tax take. While the smaller business will have generated an extra $43,000 in company profit tax, the company that could accrue capital without paying it out in tax will have created jobs with a minimum income tax component $217,000 higher than the smaller business. These are also both good businesses in that they're holding responsible amounts of cash to cover downturns and providing high-paying jobs. For an even more extreme example a business modeled on the same assumptions that keeps winning work but decides to hire as soon as it can cover the next salary rather than holding a cash reserve could theoretically reach 400 employees in the same time frame, although a stiff breeze would put it at risk of falling over. (Note: Singapore achieves a similar outcome by issuing a plethora of tax credits to growth businesses rather than a blanket allowance.)

This isn't an argument against tax but an argument that we should target taxes at money moving out of the business(whether to a shareholder or to an offshore parent) rather than at cash being used to grow the business. Better taxes include: personal income tax, fringe benefit taxes, dividend taxes, and capital gains taxes. All of which time the taxation to the point that the funds are being taken out of the business and no longer being used for growth.

Making early phases of starting a business more efficient is also a key component of making business more equitable. As those from more privileged backgrounds are more likely to receive an early investment of "friends and family" capital while those from less privileged backgrounds must slog it out until they reach the investment criteria of external investors or qualify for debt finance.

Employee Share Schemes

Employee share schemes are great for spreading the eventual benefits of success in a business around more people as well as giving employees some extra insight into the business through shareholder rights. In cases where a business becomes extremely successful, they also help create a community of people who become active in supporting other businesses and investing. A very successful business making one person a billionaire seems a lot worse for New Zealand than the same business making 100 people have 10 million dollars as the second one will lead to a much more diverse set of follow on investments and choices being made.

Unfortunately, New Zealand has done a disappointing job of employee share schemes as apart from a small $5,000 dollar a year carve out employees will be taxed on an employee share scheme when they are issued shares. Which might sound okay except that startup shares are generally illiquid (no one will actually buy them from you) and extremely volatile in value (they could go up a lot but they also have a greater than 50% chance of being worth $0). By taxing at issue we disincentivise using stock as a significant portion of employee compensation which misses a splendid opportunity to spread risk and reward across businesses. In comparison, in the US, where people talk about the high salaries of software engineers, companies like google are often paying 40% of those packages in company stock rather than cash.

Government Procurement

Government is a key client of many NZ businesses and a careful approach to procurement can deliver better outcomes for all of New Zealand in terms of both better outcomes and secondary economic effects of funneling money back into the local economy. Unfortunately, New Zealand has traditionally feared being seen to favour bids from New Zealand businesses on the basis that it might run afoul of trade deals. This is cowardice and contrary to what most countries do, in terms of local purchasing preferences.

The Labour Government has introduced minor changes to the rules of sourcing in this term, many lack teeth and as a sector we are yet to see the resulting changes in capability or behaviour from government agencies as buyers.

Many countries have succeeded with strategies to make sure work paid for by the government benefits the local economy as much as possible without running afoul of trade laws. Common provisions in other countries provisions include:

- Weighting economic benefits, particularly local employment, as an outcome of a project.
- Structuring projects in a way appealing to local businesses. Such as building a smaller solution that is exactly what the problem needs rather than buying a large generic solution, or breaking a problem up into smaller pieces that suit local providers but multinationals might consider “too small”.
- Requirements for involvement with local indigenous peoples.
- Requiring high levels of staff availability both during the project and for support afterwards.
- Tax compliance and regulation so that businesses are incentivized to employ locally or have to payout a larger portion of their earnings back to the government in tax.
- Encouraging the capture or sharing of new intellectual property generated through a project either through open source licensing or by requiring local ownership (this can include a multinational’s local office owning the IP but making it clear that in that case they’re expected to pay tax in the country where the IP was developed based on fees it might generate or the revenue generated by “selling” it back to the parent).

Create a more cohesive approach to long term investment in New Zealand

Whenever decisions are made about investment by the government there is a key challenge in comparing different projects and investment opportunities. One of our challenges is that we don’t do a good job of comparing investment in different areas and really focussing on the long-term outcomes and potential for a changing world to materially change which investments will be the most valuable.

To give an example, the government views investment in roads and software differently. But, as we have seen during lockdown, working from home reduces the load on core infrastructure dramatically. A key question we should ask is “What needs to happen for more remote working to happen across the country?”. This includes both working from home and incentives towards regional offices to take the load off Auckland.

I believe a change in the government approach to view many large technology projects as more in line with roads and less in line with building a website will better reflect both the longevity of many of these systems and the costs in maintaining them. To give an idea of the kinds of projects I imagine in this space (some of which are already in train):

- Completing work on bringing digital identity standards and capabilities up to both an appropriate level of access and ease of use for all New Zealanders to interact directly with government services.

- Eradicate paper forms and replace them with appropriate digital approaches across all levels of government. This especially is a needed step for many government functions we would like to improve with technology in the future - the latest newfangled AI system is not much use if big chunks of information don't exist in a machine-readable format.
- Make interaction with government through online systems easier and better than working with them in person. For instance, someone on a benefit should be able to complete all of their required activities online including everything from signing up for a benefit through to job seeking and training. This experience should be so much better than going to an MSD office that it serves as a motivation to sign up for the required digital identification.
- Business intelligence and analysis should be flexible and easy to manage across departments. Over time the approach to storing both data about government actions and the rules and regulations it follows should allow for not just easy interoperability but also a complete programmatic simulation of as much of the overall economy as possible. For instance, if the government were considering a change in benefits, that change should not just be modelled in a spreadsheet but simulated against the actual data of earning levels in New Zealand at the time. This is especially important as we become more aware of the negative effects of inequality - with a simulation we are much more likely to detect when a suggested change will create outliers (either people unfairly harmed by a policy or people given too much advantage) than with a distribution based model.
- Key service areas should have cohesive overarching digital strategies. For instance, health should have a single easily connected patient record database with data controls, and inefficiencies, such as ongoing reliance on faxes, must be eradicated.
- Technology and digital record keeping should be empowered to become a key part of tracking and managing the results of long term social investment in areas like education and healthcare.
- Investment should enhance digital systems for maintaining privacy, limiting the impacts of data breaches and providing dynamic controls over personally identifiable information.

Support R&D and commercialisation more broadly and systematically

New R&D and product development is one of the best ways for New Zealand as the returns and growth in jobs can be large (consider how many high-wage jobs one Xero adds to the economy let alone any of the benefits from the success of the business for shareholders). Unfortunately, at the moment, many of our policy settings don't support the long view of R&D that could lead to really capturing the benefits.

The current R&D tax credit still refers to novelty or "newness" as part of the test of whether something counts as true R&D which effectively reads as excluding most software based innovation. This thin view of R&D raises several issues and possible responses:

- **Many excellent ideas are the application of existing approaches to different problems -** Xero was not a technically difficult idea. It was a great idea at the right time, but if you'd found a good developer and described what Xero needed to do, they wouldn't have told you it was pushing the boundaries of human knowledge which seems to be what the current tax credit suggests should be the case. We should absolutely be supporting businesses to not just

research, but also apply that research into services and thriving industry.
- **Without ongoing support of research through to commercialisation, New Zealand is unlikely to see the bulk of the returns on R&D -** Any piece of research is a long drawn-out process, but even more difficult is the next step of market research and commercialisation. Because we define the research phase so narrowly, we too often see good early stage ideas or businesses being sold to larger players at a cheap price rather than the potentially larger businesses accruing their benefits to New Zealand.
- **By incentivising complexity rather than results we don't "fail fast" -** In startups it has become standard to fail-fast. Or in plainer terms to stop doing things that aren't working sooner rather than later. When our main categorisation for R&D is being globally "new", we reward complexity rather than results. Bad early stage ideas receive ongoing R&D funding because no one involved in reviewing them understands them well enough to say they aren't good R&D. A good example of this in recent years has been the propensity of startups that really didn't need a blockchain adding a mention of blockchain to their R&D programs because it made it seem more "novel".
- **Create clearer educational pathways to R&D -** One of the challenges with universities responding to a focus on preparing people for the workforce is that R&D as a capability doesn't match up nicely to a career path and is generally better served by the more traditional academic pathways. This is another benefit to reinforcing the role of vocational learning for those who do want clear career paths so that those who want to be on a research path are not so heavily tied to courses within universities that are steadily trending towards job readiness.
- **Without broad access to funding and support, entrepreneurship will exacerbate rather than close social divides -** One of the key challenges when looking at entrepreneurship as a social level is that starting a company is a really really terrible idea for the founder. Anyone who has the skills to found a business could competently do a much more stable job that produces a stable income, so entrepreneurs (and particularly "growth" entrepreneurs) will disproportionately be from backgrounds that are already well-off. R&D funding comes into this as well since a simpler and more broadly applicable fund is more likely to support people at the right time.

Growing capital in New Zealand

Wealth is security. While it is commonly noted that money doesn't buy happiness it's nearly always followed up with the note that the lack of it surely brings unhappiness. New Zealand needs a wealth strategy for the long term. While we have strong individual wealth in New Zealand a disturbingly large proportion of that is based on our eye-wateringly high property prices (39% of household net worth currently being property).

We have been very lucky that the NZ Super Fund has performed as well as it has over the last few years and Kiwisaver is building up the balances of many New Zealanders to help mitigate the challenges of an aging population. But that's only one of the many challenges we can expect over the next 100 years, whether it's global warming, changes in agriculture, disease, or sudden shocks in the global economy - we should expect constant change, and we should expect at least some of those shocks to be worse than any we've experienced so far - A resilient New Zealand is not just one with a functioning economy but one that can handle a non-functional economy for as long as possible.

We need to have a plan for there to be enough capital in New Zealand to allow us to maintain our position globally and not become a dependent state. That doesn't mean it all has to be private wealth, state owned capital counts, but if successive governments alternate between selling off state assets and discentivising private wealth, then the end result will be no one in New Zealand having any money while states that can leverage their wealth slowly pressure us either financially or politically. Consider the current challenge between the fact that of our major trading partners only China has managed to hold steady financially during Covid while the US is pressuring us to ban Huawei as a supplier. Protecting our independence requires that we maintain relatively high levels of wealth, especially as aggressive financial pressure becomes more accepted as a modern approach to diplomacy.

In 2013, Piketty's[2] book about the growth of wealth inequality outlined the challenges presented by the wealthiest people reaching the point that their wealth generates income at a pace that will steadily increase wealth inequality. This same pattern of wealth inequality will also apply between countries as much as it does between individuals. If New Zealand does not act to encourage the accumulation of wealth inside of New Zealand then for all our good intentions we are at serious risk of creating a country where everyone is more equal internally but we have fallen behind the rest of the world.

Piketty's suggestion of a global wealth tax might work if there were ever the global motivation to do so. But a national wealth tax as suggested by the Greens without alignment with the rest of the world would create another disincentive to the local accumulation of wealth. In some countries that might not be such a problem, but in New Zealand we already have difficulty incentivising and building the businesses that will make New Zealand wealthier in the long run.

2 Source: "Capital in the Twenty-First Century" by Thomas Piketty.

Education

Financial Literacy

Many would expect digital literacy to go first in a list of challenges in this list. But I have been consistently shocked by how weak the level of financial knowledge in New Zealand is across the board. This ranges from people's ability to understand investment or long term effects of their choices through to business owners with weak understanding of their own balance sheets.

While there is plenty of support for business owners on the entrepreneurship front it constantly surprises me how modern tools like Xero mixed with accountants that happily take care of the day to day financial reporting of a business have made it possible for people to not have a firm grasp on the financial position of their business while mostly being able to carry on trading. Improving financial literacy across the board is to my mind a key part of improving the proportion of attempts at entrepreneurship that are actually successful.

Separately, growing businesses depend on their staff having strong financial literacy. To take an earlier example employee share schemes are only valuable if the people you'll offer shares to understand what shares are and how they work. Even more importantly, growing businesses rely on being able to hire staff into management roles, from my experience one of the key challenges to hiring for these roles in New Zealand is a relatively low level of base financial acumen even among professionals within New Zealand.

Digital Literacy

Digital Literacy is much more lacking in New Zealand than most people realise. I include in this topic everything from basic usage of computers and the internet through to an understanding of how systems work in whatever industry someone is part of. Separate strategies are needed across multiple fronts to improve digital literacy across society. Some key groups include:

- **Those Suffering from the Digital Divide -** There's a lot of work happening here which I won't relitigate in a bullet point but it remains deeply important.
- **Government Officials -** Many government officials still need additional training to become confident around technology to the degree that is necessary in their roles. This often leads to risk averse choices that have worse long term consequences than a risk aware choice would have led to.
- **Governance Professionals -** Boards in New Zealand still frequently lack technology expertise or have only a single "tech-savvy" board member. It's my view that future boards should treat digital literacy more like finance in that all board members should be expected to have basic capabilities and one or more specialists may also be on the board if necessary. The technology sector changes so fast that there is never a single "correct" answer so enough people around the board table need to be confident enough about technology to create discussion.
- **Older Generations -** A key part of getting the greatest savings from moving to digital solutions across government is in slowly turning off non-digital solutions. That means we need to provide the right training and access to take people who've got used to those processes along with us to the newer approaches.
- **Younger Generations -** Many people assume that younger generations are automatically tech savvy; however, this is steadily becoming less true as modern devices hide more of their internal workings and the algorithms behind them become less intuitive so young people now have less opportunities to understand how the systems they use work. This becomes even more critical as they become more politically active while not able to make strong judgements about what's actually happening around them versus what's projected to them by the systems they use.

Vocational education pathways into high-wage industries

At the moment there are plenty of careers where the default study path is university but vocational approaches would also be suitable. For example, at Ackama we've hired a mixture of people that have done everything from 3 month programming bootcamps to PhD's in computer science. On balance, we need some people with deep computer science backgrounds when we hit tricky problems but a good chunk of our work is just not that complex. Most modern startups should focus on delivering the simplest solution to a particular customer problem before investing time in making that solution particularly efficient.

There's a lot of discussion currently going on in this front for tech. I believe there are three key components:

- **Short Entry Courses -** Enspiral Dev Academy for instance provide an excellent 3-6 month course that get people up to the skill level necessary to start as a developer.
- **Employer Incentives -** In any vocational model there is a longer period when someone first joins the industry that they are a net cost to the employer, potential answers here include: training wages, government subsidies, and minimum contract lengths.
- **Ongoing Training and Microcredentials -** One of our observations of developers coming through Dev Academy or other shorter courses is that some of the content that is left out in comparison to a university course becomes needed later on in their career. A new web developer doesn't really need to know advanced algorithms and data structures when they join the industry but they would really benefit from that knowledge once they're trying to become a senior developer and run their own projects. The most motivated people can pick it up over time from books and other training sources but a more complete pathway would be immensely helpful.

Where next?

The tricky thing is to decide what to do next. This post is already long and in no way an exhaustive list. So you might ask, "What should we do first?" Unfortunately, the answer is *everything* all at once and as fast as possible.

All of these areas I've talked about depend on each other. Employers need customers like the government to grow, people need employers to employ them, employers need those people to have the skills to do the work in front of them, and everyone needs the country they're a part of to be secure and stable.

It would be easy to place this in the "too hard basket" but the reality is the global and domestic impacts of COVID require the private sector and government to work together. We need to break this down into a series of intertwined and interdependent parts, establish a working group to focus on changing the NZ economy so we can adapt rapidly, leveraging our strengths in this new world.