

# Exploring the impact of adverse events on SME tax compliance behaviour: A longitudinal study on Inland Revenue's response to, and learnings from, the Christchurch earthquakes

Findings from Year 2 - Qualitative research with stakeholders and Inland Revenue staff



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Te Wāhanga ā-motu mo te Rangahau me Aromātai

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## Preface

In 2010 and 2011, a series of major earthquakes hit Canterbury, with one particular earthquake on 22 February 2011 resulting in 185 deaths. The earthquakes caused major economic and social disruptions to everyday activities and social life, and this prompted Inland Revenue to look at how it responds to sudden large-scale adverse events.

A large proportion of tax debt is owed by small businesses, and a disaster makes small and medium enterprises (SMEs) from certain industry sectors more exposed to incurring tax debt. Furthermore, there is a risk that tax debt could increase during the reconstruction phase as some SMEs grow faster than their ability to meet their new tax filing and payment demands.<sup>1</sup> Disasters can also make people change their attitudes towards tax compliance. This could impact on SMEs in certain industries as they become exposed to hidden economy opportunities during the various recovery and rebuild phases.

Following an adverse event, a well-working tax system and its administration are key to helping the economic and social recovery of the affected region and country. This is why Inland Revenue (IR) wants to better understand how an adverse event can affect long-term debt, and if social norms and attitudes change leading to increased hidden economy activity during recovery. As the tax administrator, IR also wants to know what impact its actions may have in mitigating these risks so that learnings can be applied to respond appropriately to future adverse events.

IR is carrying out a longitudinal research project over three to five years. The first year of this study (completed in 2012) consisted of a desktop review of literature, analysis of IR's administrative data, survey and qualitative research with SMEs and tax agents.

The Year 1 findings showed that, as expected but with some exceptions, overall business incomes were down and tax debt levels had increased. Interestingly, there had been little or no perceived worsening in attitudes regarding tax and participation in the hidden economy.

The Construction and 'Rental/Hiring/Real Estate' sectors were the exceptions as they had experienced strong growth in the 2011-2012 year. Also, while many businesses in the 'Accommodation/ Foodservices' sector had closed, many of the remaining businesses appeared to be doing better than before the earthquakes. Notably, concerns were raised about whether businesses have the time and expertise to maintain their tax compliance while they are growing.

The overall expectation for IR was to be lenient and provide tailored assistance for businesses that are still struggling, but to return to 'business as usual' monitoring and enforcement of tax compliance for businesses that have recovered.

This research forms part of a suite of research that the government, universities and other organisations are undertaking on the impact of the Canterbury earthquakes on New Zealand's social and economic wellbeing. Findings from the longitudinal study will feed into this bigger pool of information which will help other agencies in their decision and policy making. It will also help the government develop a collective view of the key issues facing Canterbury.

This report presents findings from the Year 2 qualitative research undertaken with stakeholders and IR staff.

<sup>1</sup> Research has found that while most SMEs are aware there are financial penalties for late payment of business tax, there is a lack of detailed knowledge and understanding of how they are applied (Poppelwell, Kelly and Wang, 'Intervening to reduce risk: Identifying sanction thresholds among SME tax debtors.' *eJournal of Tax Research*. Vol 10, No. 2. October 2012). This lack of detailed knowledge did not impact on the compliance behaviour of SMEs who have never been in debt, but did for those who were in debt or had been in debt.

## Executive summary

This report presents the findings of the Year 2 longitudinal research aimed at exploring the impacts of a large-scale adverse event on New Zealand's small and medium enterprises (SMEs). Qualitative research was conducted with stakeholders and Inland Revenue staff. This report builds on the findings of the Year 1 benchmark research conducted with SMEs and tax agents in 2012. This section summarises the key findings from the research.

## Research methodology

In-depth individual interviews were conducted with 39 stakeholders from a range of business sectors, government agencies and professional bodies, as well as 11 with Inland Revenue (IR) staff identified by the project advisory group and research team. The participants were all Christchurch-based, and were knowledgeable and experienced in their respective sector of activity. They have a good understanding of SMEs within the sector and give their opinions on SMEs' situations throughout the report. Please note that the views, opinions, findings, and conclusions expressed in this report do not necessarily reflect the views of IR.

IR's National Research and Evaluation Unit (R&E) commissioned Colmar Brunton to conduct the interviews during February and March 2013. The interviews were conducted face-to-face in Christchurch and over the telephone. Their duration was up to one hour in length, and a semi-structured discussion guide was used to elicit viewpoints.

## Research findings

Key findings related to each of the research objectives are provided below.

**Objective 1: what do stakeholders and IR staff think the recovery times are before business as usual (BAU) is restored?**

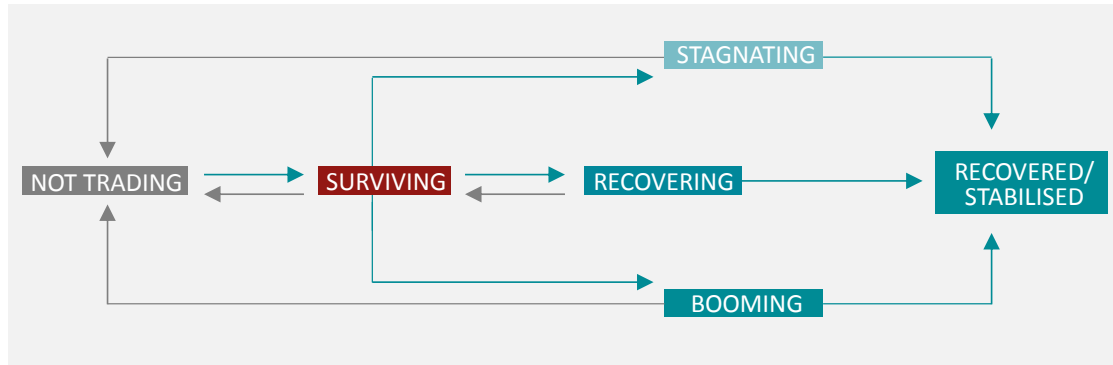
Stakeholders and IR staff are divided about SME recovery times and when SMEs reach BAU. Since the earthquakes, SMEs have experienced some enabling and hindering factors that have influenced their recovery.

They are summarised in the table below.

Factors	Characteristics
Enabling	<ul style="list-style-type: none"> <li>External assistance (e.g. wage subsidy)</li> <li>SMEs' proactivity</li> <li>Having a business branch outside of Canterbury</li> <li>Business resilience</li> <li>Personal resilience of business owners</li> </ul>
Hindering	<ul style="list-style-type: none"> <li>Lack of clarity around the roles and responsibilities of the parties involved in the rebuild</li> <li>SMEs' insurance and financial difficulties</li> </ul>

SMEs' speed and level of recovery varies. While stakeholders and IR staff expect SMEs to have resumed trading or closed down their business, they also acknowledge that some SMEs are still struggling (e.g. relocation and insurance issues).

The SME recovery model (from the Year 1 research) has been reviewed and reflects the variety of situations experienced by SMEs today. The diagram below illustrates the revised recovery model.



The model shows the different stages of SME recovery after an adverse event:

- **Not trading:** this stage *immediately* results from the earthquakes. A variety of SMEs in different sectors of activity found themselves unable to trade as a consequence of the earthquakes. Today, stakeholders and IR staff believe that SMEs should not be in this stage anymore: they should have resumed trading or closed down. If SMEs are not trading today, stakeholders and IR staff believe it is more likely due to other issues than the earthquakes themselves (e.g. cashflow and insurance problems).
- **Surviving:** some SMEs are still in this stage and struggle to resume regular business patterns (e.g. business disruption through unexpected roadworks). They face financial difficulty (e.g. irregular income, tax debt). This stage comprises SMEs in a range of sectors.
- **Stagnating:** SMEs have resumed trading, but are unable to grow their business (e.g. due to limited foot traffic and online presence). Although their financial situation is better than in the Surviving stage, Stagnating SMEs still need to monitor their situation carefully. Their struggles result from dealing with the earthquakes' consequences (e.g. insurance problems, roadworks and building assessment).
- **Recovering:** these SMEs have re-established regular business patterns and are in a better financial position to grow their business sustainably.
- **Booming:** a number of SMEs are experiencing exponential growth and feel financially secure. These SMEs need to ensure they have appropriate systems and processes in place to manage their rapid growth. In addition, this level of growth is unsustainable and these SMEs may face financial difficulty when the 'bubble bursts'. These SMEs are likely to be found in the building/construction sector, because of the rebuild, as well as in the

hospitality sector (e.g. café, bars and restaurants), because of the lack of competition.

- **Recovered/Stabilised:** very few SMEs are in this stage, which is characterised by a solid business foundation and practices leading to sustainable business growth.

Stakeholders and IR staff believe that some SMEs have reached BAU, while others have not. Those who have reached BAU have re-established their business and seem to be doing well (e.g. earning an income). These SMEs are in the Recovering and Booming stages, and in future in the Recovered/Stabilised stage. However, the SMEs that have not reached BAU are still struggling to reach a business activity level that would give them financial security. These SMEs are in the Surviving and Stagnating stages. Stakeholders and IR staff think that it will take three to four years for these SMEs to reach BAU.

Stakeholders and IR staff discuss BAU at the industry level or Christchurch city level. In these cases, it would take even longer for industries and the city to reach BAU (five years and at least 10 years respectively). Stakeholders and IR staff expect that BAU for Christchurch city will be reached when the CBD is functional.

#### Objective 2: how can we recognise signs of 'normality' (pre-quake activity) or identify a new 'post-quake normality'?

Stakeholders and IR staff explain that today is "a new normal" in Canterbury. The earthquakes have changed Christchurch and its people significantly (e.g. layout of the city and social connections). The outcomes of the earthquakes have been felt at different levels and are both positive and negative.

The table below summarises the key outcomes of the earthquakes, which have resulted in creating a sense of new normality in Canterbury.

Levels	Outcomes
Christchurch city	Positive: <ul style="list-style-type: none"> <li>Greater sense of community spirit and resilience.</li> <li>More certainty about the CBD provided by the Blueprint.</li> </ul>
	Negative: <ul style="list-style-type: none"> <li>High levels of destruction.</li> <li>Loss of a central business district (CBD).</li> <li>Slow rebuild.</li> <li>Multiple relocations.</li> <li>Skilled labour shortage.</li> <li>Strengthening of the 'old boys' network'.</li> </ul>
SMEs	Positive: <ul style="list-style-type: none"> <li>More cooperation between SMEs.</li> <li>SMEs' increased creativity and innovation.</li> <li>Decreased competition for some SMEs.</li> </ul>
	Negative: <ul style="list-style-type: none"> <li>Extensive changes in the business environment</li> <li>Ongoing insurance issues</li> </ul>
Personal	Positive: <ul style="list-style-type: none"> <li>Better work-life balance</li> </ul>
	Negative: <ul style="list-style-type: none"> <li>Poor health and wellbeing</li> </ul>

### Objective 3: to what extent have the Canterbury earthquakes changed SMEs' attitudes and behaviours with regards to tax compliance?

Stakeholders and IR staff believe that attitudes have not fundamentally changed following the earthquakes. They explain that tax compliance is a mindset or a moral attitude, and as such is difficult to shift one way or the other.

Stakeholders and IR staff explain that compliant taxpayers' fundamental attitude to tax compliance is unlikely to change, i.e. they believe that everyone needs to contribute their fair share of tax. With signs of the rebuild, people and SMEs are more optimistic about economic growth for the region and feel more strongly about contributing to tax.

However, slight attitudinal shifts may occur in terms of relative priority for compliant taxpayers, for example if they are forced to change from a long-term strategic business plan to a more short-term, functional approach to business. In addition, if people and businesses do not perceive much progress in the rebuild, they may lose

confidence about the purpose of paying tax and contributing to the rebuild.

With regards to tax compliance behaviour, stakeholders and IR staff note that it has changed following the earthquakes. Initially, SMEs were unable to file their returns and pay their tax because of the high levels of destruction (e.g. buildings and records destroyed) and also personal injury and trauma.

In the months following the destructive earthquakes, some SMEs resumed filing their returns and paying their tax. For some, this involved setting up payment arrangements with IR. However, some SMEs have continued deprioritising their tax obligations, either intentionally or accidentally.

SMEs at different stages of recovery may face more or less difficulty meeting their tax obligations. For example, Surviving SMEs are likely to have an irregular income, thus making it difficult to pay their tax. Recovering SMEs, however, earn a regular income and are more likely and able to meet their tax payments.

### Objective 4: do they think IR's presence and actions are helping SMEs, who are recovering or recovered from the earthquakes, return to making tax compliance a priority? Also, do they think IR is using appropriate actions for SMEs not trading or still in the Surviving stage?

Stakeholders and IR staff are generally very positive about the diverse assistance IR provided to SMEs. They believe it has been helpful to SMEs' recovery. IR has been approachable, flexible and friendly, thus enabling SMEs to address their tax issues. This has also resulted in IR's profile and reputation being lifted in the community.

However, stakeholders and IR staff explain that struggling SMEs may have found it difficult to remain compliant because of the problems faced by their business (e.g. irregular income and insurance issues). These SMEs need to reprioritise their tax obligations as soon as possible with IR's personalised assistance. Stakeholders and IR staff believe that non-compliance is unacceptable, but IR's needs to use its discretion to help SMEs address their tax obligations.

Surviving SMEs still require some specialised assistance from IR to move to the Recovering stage. Stakeholders believe that IR needs to assess each struggling SME's situation on an individual basis. Both stakeholders and IR staff believe that a thorough evaluation of SMEs' viability is key to understanding if these SMEs can recover and what type of assistance they require.

A few stakeholders and IR staff recognise that IR's leniency was helpful to SMEs during the earthquakes. However, they believe that, today, IR's leniency has

become unhelpful to those SMEs that do not feel a sense of urgency to become compliant. These stakeholders and IR staff believe a 'deadline on leniency', which can be revisited, is required.

**Objective 5: how can IR influence SME post-quake behaviour to return to pre-quake tax compliance acceptable levels? And Objective 6: what is the level of acceptability on SME tax compliance behaviour and can IR mitigate the effect of non-compliant behaviour to reduce the 'acceptability' of committing cash economy activity and restore pre-disaster compliance levels?**

Many stakeholders and IR staff believe that IR needs to return to BAU now and apply its practices of educating, investigating, following up, auditing and prosecuting. This will not only help SMEs return to better compliance levels, but also help decrease hidden economy activities.

To mitigate the hidden economy, some stakeholders and IR staff suggest that IR develop social marketing campaigns to increase people's and SMEs' understanding of their tax obligations, and 'goodwill' about contributing to the rebuild.

They expect that these campaigns would increase compliance and reduce participation in the hidden economy. Stakeholders and IR staff feel that, today, non-compliance has become even more unacceptable, as the destructive earthquakes were over two years ago, and SMEs should now be able to meet at least some of their obligations (e.g. filing returns).

Should SMEs remain non-compliant or take part in the hidden economy, stakeholders and IR staff want IR to make an example of these SMEs to show that IR applies the rules and to deter SMEs from non-compliance and hidden economy activities.

However, stakeholders and IR staff also emphasise that IR needs to be flexible and use its discretion with SMEs that are still struggling and require assistance. This needs to be evaluated on a case-by-case basis. The key is that IR needs to be consistent.

## Contractors' views of their industry post the earthquakes

In early 2013, the Southern Regional Manager for the New Zealand Contractors' Federation was informed of the longitudinal research IR was undertaking on the impact of adverse events on tax compliance behaviour. This led to an offer to shoulder-tap members of the

Federation to provide IR with their experiences of working in Christchurch following the earthquakes.

The key findings from this additional piece of work are presented in the Appendix. The key themes that emerged from discussions are:

- Cashflow
- Staff
- Compliance costs
- Contracting agencies
- Growth of business
- Retentions.

The views of the participating contractors will augment and add depth to the information that was collected from the stakeholder interviews.

## Next steps

In 2014, we will follow-up with the SMEs and tax agents who participated in the 2012 benchmark research.<sup>2</sup> We will revisit how the prolonged nature of recovery has impacted on SME compliance behaviour, how IR tried to mitigate it, and how we can learn from this.

In addition to identifying the long-term implications for Canterbury and the rest of New Zealand, findings from the study will form a body of information that will help IR and other government agencies inform future strategies, and develop a framework for managing compliance behaviour following an adverse event.

<sup>2</sup> <http://www.ird.govt.nz/aboutir/reports/research/adverse-events-report-1/>



## Background and objectives

On 4 September 2010, the first of a series of destructive earthquakes struck the Canterbury region. The next destructive earthquake on 22 February 2011 resulted in deaths and serious injuries, as well as much property and material destruction. Two other powerful earthquakes struck the region on 13 June and 23 December 2011. Tremors have occurred since the first earthquake. From the start of this crisis, people and businesses received a range of assistance through different organisations including Inland Revenue (IR).

International and New Zealand research is available about exploring the impacts of large-scale adverse events on SMEs. However, there is no research investigating such impacts on SMEs from a financial and tax perspective. This research is all the more important, as it is a longitudinal study that will provide a deep and rich understanding of what the impacts have been on SMEs since the earthquakes and how these impacts have changed over time.

In 2012, IR's Research and Evaluation Unit (R&E) commissioned Colmar Brunton to conduct benchmark research with SMEs and tax agents about the impacts of the earthquakes on Cantabrian SMEs. This research is the next stage in the longitudinal study of the earthquakes' impacts on SMEs. It reports on the findings from the perspective of stakeholders and IR staff about the impact of the earthquakes on SMEs in Canterbury.

## Research objectives

This research aims to investigate the earthquakes' impacts on SMEs over the past two and a half years from the perspective of stakeholders and IR staff. More specifically, the objectives of the research are:

1. What do stakeholders and IR staff think the recovery times are before 'business as usual' (BAU) is restored?
2. How can we recognise signs of 'normality' (pre-quake activity) or identify a new 'post-quake normality'?
3. To what extent have the Canterbury earthquakes changed SMEs' attitudes and behaviours with regards to tax compliance?
4. Do they think IR's presence and actions are helping SMEs, who are recovering or recovered from the earthquakes, return to making tax compliance a priority? Also, do they think IR is using appropriate actions for SMEs not trading or still in the surviving stage?
5. How can IR influence SME post-quake behaviour to return to pre-quake tax compliance acceptable levels?
6. What is the level of acceptability on SME tax compliance behaviour and can IR mitigate the effect of non-compliant behaviour to reduce the 'acceptability' of committing cash economy activity and restore pre-disaster compliance levels?

## Research method

This research project used a qualitative methodology to explore the views and opinions of stakeholders and IR staff.

### Qualitative methodology

This research project consisted of 50 in-depth individual interviews conducted face-to-face in Christchurch and over the telephone. One of these interviews was paired, i.e. it involved two respondents.

### Sample

The project advisory group and research team identified 39 stakeholders and 11 IR staff as instrumental to this project. These respondents are knowledgeable and experienced in their respective sector of activity. They have a good understanding of SMEs within the sector and give their views on SMEs' situations throughout the report. Please note that the views, opinions, findings, and conclusions expressed in this report do not necessarily reflect the views of IR.

All respondents are based in Christchurch. The table below provides a breakdown of the organisations who took part in this project

Sector of activity	Organisations
<b>Building/construction and manufacturing</b>	Interviews 1-8 (eight interviews involving six organisations)
<b>Design and architecture</b> (consultancy and project management)	Interviews 9-15 (seven interviews involving seven organisations)
<b>Finance</b> (investment and tax)	Interviews 16-19 (four interviews involving four organisations)
<b>Hospitality and tourism</b>	Interviews 20-23 (four interviews involving four organisations)
<b>Retail and services</b>	Interviews 24-28 (five interviews involving five organisations)
<b>Government organisations and infrastructure</b>	Interviews 29-43 (15 interviews involving five organisations, including IR)
<b>Business and professional organisations</b>	Interviews 44-50 (seven interviews involving seven organisations)

*Note: some stakeholders and IR staff do not want to be identified, therefore we have provided minimal identifier details.*

### Fieldwork

IR's R&E Unit commissioned Colmar Brunton to conduct the interviews during February and March 2013. The interviews were up to one hour in length. Most interviews (34) were conducted face-to-face at the respondent's business premises in Christchurch, the remaining 16 were conducted over the telephone.

A semi-structured discussion guide was used to elicit stakeholders' and IR staff's perceptions while providing them with the freedom to explore the topic from their own distinct perspectives.

## Section 1. Ongoing impacts of the earthquakes – contextual findings

This section discusses the outcomes resulting from the earthquakes and then details how these outcomes have played a role in enabling or hindering SMEs' recovery.

### Outcomes of the earthquakes

The Canterbury earthquakes have had positive and negative outcomes at three key levels. Stakeholders and IR staff discuss the outcomes for Christchurch city, for SMEs and for individual Cantabrians<sup>3</sup>.



#### 1. Mixed outcomes of the earthquakes for Christchurch city

The earthquakes have changed the city of Christchurch. Negative outcomes include:

- High levels of destruction
- Loss of a central business district (CBD)
- Slow rebuild
- SMEs' multiple relocations
- Skilled labour shortage
- Strengthening of the 'old boys' network'.

However, Christchurch has also seen some positive outcomes, such as a greater sense of community spirit and resilience and the Blueprint providing more certainty about the CBD.

These outcomes have resulted in a new sense of normality for Christchurch today.

These outcomes are explored in depth on the following pages.

#### Negative outcomes

##### High levels of destruction

The level and extent of destruction in Christchurch is significant. Business and residential premises were destroyed, as well as business records and equipment. The CBD was cordoned off after the 22 February 2011 earthquake, and SMEs had to relocate. Today, the city centre is mostly unpopulated by businesses, despite the opening of the Re:START mall in Cashel Street about eight weeks after the February 2011 earthquake. Ongoing roadworks in and around the city makes it difficult to do business. Today, the physical layout of Christchurch is vastly different in that there is still no CBD.

##### New suburban business centres and uncertainty about returning to the CBD

Many people and SMEs have relocated following the earthquakes, thus changing the traditional living and business patterns of the city. Some suburbs have become thriving business centres, while others have been depleted of their local businesses (e.g. takeaway shops and hairdressers).

<sup>3</sup> It is likely that the earthquakes have had a wider impact than these three levels, e.g. the outcomes for New Zealand as a nation. However, stakeholders and IR staff contained their discussion to these three levels.

*“Particularly in the eastern suburbs of Christchurch, many of the general practices that were vibrant businesses before the earthquake are going to be non-viable going forward. And part of that is a result of populations that have moved and displaced, and therefore the previous funding models and the way that health services work are needing a radical rethink. Because they’re not those sort of businesses, general practice and community pharmacies are not going to be viable on a long-term basis. On the western parts of Christchurch, they’ve got a totally different issue. With the population shifts there, the practices are not geared up to deal with the level of population that they’re now having to deal with. So, they’re quite different business issues, but both very real and for quite different reasons. One in terms of the population is not there and the second bit is actually the rapid increase in population means that the ability for those practices to expand or to accommodate the additional pressures is also not there. So, that is particularly relevant for general practice and pharmacies.”*

**(Interview 43)**

There is also a lack of certainty that when the CBD is rebuilt, previous living and business patterns will return. For example, successful suburban SMEs may be reluctant to return to the CBD once it is rebuilt.

*“Some other [business] people are saying they’ve actually found it a good move [to go to the suburbs]. They’ve realised they can get good facilities in a suburb, cheaper rental than they were paying when they were in town. So, you are getting some [business people] that are saying ‘well, actually, we don’t know if we will move back into town, we’re happy to stay out here’.”*

**(Interview 4)**

Stakeholders and IR staff believe that too many question marks still surround the future shape and structure of the city. Some of these concerns are:

- When are the 14 anchor projects in the CBD going to be implemented and completed?
- What are the ‘feeder projects’ aimed at sustaining the rebuild, and when are they going to be implemented?
- What is the duration of the business leases and can these contractual obligations be broken?
- What will be the future location of competitors (e.g. are they returning to the CBD or staying in the suburbs?)

- What other businesses will be in the CBD?
- What will be the levels of foot traffic and demographic characteristics of customers in the suburbs and the new CBD?
- What will be the impact of roadworks on business activity level throughout the rebuild?
- What will happen to businesses run from residential premises when it becomes illegal to do so (i.e. the bylaw expires)?

*“There are residential conversions, from a house to a shop. The Council gave agreement for five years.”*

**(Interview 30)**

As the rebuild gets underway, it is likely that the geographical spread of SMEs in Christchurch will evolve. However, the future locations of business centres in Christchurch are difficult to assess. SMEs have to make the tough decision about whether to relocate their business or stay put. This will have implications for their future activity levels and financial viability.

#### Christchurch’s slow rebuild

As a result of the high levels of destruction, the Christchurch physical environment has vastly changed and will continue changing throughout the rebuild. Given the extent of the earthquakes, stakeholders and IR staff understand that the rebuild will take time. They believe that the slow rebuild process creates much uncertainty for SMEs. It makes SMEs’ decision-making process more difficult in this ‘unstable’ environment.

*“I don’t know whether many SMEs would actually go back to the centre to be honest, and until they decide what the centre is going to look like [SMEs may not make a decision]... For some SMEs, that might be an issue at the moment – not knowing what the future of Christchurch actually is going to be from a business sector environment.”*

**(Interview 34, IR)**

Today, emergency repairs are finished and the horizontal rebuild is well underway (i.e. infrastructure such as fresh water, storm water, wastewater and roads). However, the vertical rebuild (e.g. high-rises), which is key to recreating the CBD, has not started yet. Stakeholders and IR staff feel that the longer it takes for the vertical rebuild to get underway, the more people’s and SMEs’ enthusiasm is likely to drop. As a result, people and SMEs are likely to stay in their current location and keep to their newly established business routine/habits.

*“The effect of reconstruction, and it’s not a criticism, it just takes a long time to sort that out. Insurances have to be sorted out. Geotechnical advice on central city land has to be sought. Design, urban planning has to be met. Funding, viability studies, leasing studies have to be undertaken and reviewed, and tested. So there is a lot of measuring, designing, retesting, recalculating, re-cost estimation going on.”*  
(Interview 10)

The building industry has suffered from the ‘stop-start’ aspect of the rebuild. Many SMEs have invested in staff and equipment after obtaining building contracts. However, lengthy administrative processes have sometimes put a halt to the contract’s progress. Some SMEs have had to make staff redundant while waiting for the contract to resume. For example, building and home repairs agreed by an insurance company are now revisited, thus leaving SMEs unable to start work and earn an income. This means that SMEs in this industry can experience highly uncertainty and fluctuating incomes, which can make their business finances and taxes challenging.

#### Multiple relocations and trading from suboptimal premises

As a result of building closure and demolition, many SMEs have had to relocate several times. This means an increased cost to the business (e.g. new lease and refurbishment). Time and money are diverted from the core business activity to similar recurring purposes (e.g. re-establishing a client base and advertising a new location). These SMEs are more likely to struggle to breakeven and/or make a profit.

Some SMEs waited a long time before moving premises and are now paying premium rents where they are. If their business activity level is reduced or stagnates, this is likely to impact on their cashflow and ability to keep trading.

Some SMEs have managed to keep trading from their original premises, but when the safety of their business premises is assessed as part of the rebuild, the premises may have to be closed down. With increased rents in Christchurch today, these SMEs may be unable to relocate and may have to close down too.

Currently, many SMEs trade from suboptimal premises, which can influence the quality of their business (e.g. not enough storage space for stock and limited foot traffic). Today it is difficult to find and move to suitable business premises because of a shortage of such premises and sharply increased rents.

#### Skilled labour shortage today

Following the earthquakes, skilled employees left Canterbury. Stakeholders and IR staff observe that there is now a labour shortage and SMEs have trouble recruiting suitable staff. This not only puts an inflationary pressure on wages, but SME owners also have to spend more time on recruitment matters than on their core business activity. This situation impacts on SMEs’ recovery, as more pressure is put on the business to perform but there is no guarantee of an increased return on investment. This influences SMEs’ viability and cashflow.

*“There is a high demand for skilled staff, it’s very hard to find... There’s a lot of graduates and overseas architects and engineers coming, and we have employed from overseas. So, we have quite a mixed number of nationalities in the office, and so it’s been quite a mission, or quite an effort, to find experienced and skilled staff. [We] interviewed a lot of people.”* (Interview 10)

*“I think the supply and demand is going to be an issue, because getting good staff [is difficult]. At the moment there’s no shortage of good architectural people, but that’s going to change and that will drive up wages. We’ve given all our staff at least a 10% increase late last year just to make sure we keep them. I’m hearing that from others as well and also from builders. So from a tax point of view and business point of view, I think there’s going to be some inflationary effects on the wages, and therefore people are going to be earning more, going to be paying more tax.”* (Interview 9)

#### The ‘old boys’ network’ is more active today

Today’s business world in Christchurch is complex and difficult, and some SMEs have resorted to using their personal and business networks even more to stay in business. The traditional ‘old boys’ network’ that Christchurch is known for seems to be even more at play today than prior to the earthquakes. While this may be a positive outcome for those SMEs that belong to this network, SMEs not part of it may be struggling to find work and staff, and grow their business.

*“Christchurch is one of those closed cities too. It’s all about what school you went to, and unless you’re in the in, then you’ll struggle for work.”*  
(Interview 35, IR)

### Positive outcomes

#### The earthquakes have built a stronger community spirit and sense of resilience

Throughout the ordeal, people and businesses have become a lot more supportive of each other. They have come together to restore the city and their business. Stakeholders and IR staff believe that this sense of ‘togetherness’ will help rebuild a better and stronger Christchurch. They want the city to thrive again and grow economically.

Since the earthquakes, people and businesses that are outside of the ‘old boys’ network’ have had to become less insular and more open to professional advice and business connections outside of Christchurch/ Canterbury. For example, SMEs recruit skilled and experienced staff from outside of Canterbury and overseas. This may help people and businesses get back in ‘business mode’ more rapidly with this new external support.

#### The Blueprint provides more certainty

After the destruction of the CBD, a consultation process started to design a new CBD and lasted for several months. The resulting Blueprint was published on 30 July, 2012. This Blueprint has provided more certainty and confidence about the shape and structure of the new CBD. It identifies 14 anchor projects that will kickstart and support the rebuild. The first of these projects is the Convention Centre that people and businesses await with anticipation. They believe that once this project is completed, other services, facilities and amenities will be attracted to the city centre, which will indicate the reopening of the CBD.

### These outcomes mean a new sense of normality in Christchurch

Today is “a new normal”, which is vastly different from ‘the normal’ that people and businesses knew prior to the earthquakes. The following factors explain what has changed in Christchurch to create this new sense of normality:

- The rebuild is about recreating a place and a sense of place from scratch rather than renovating.
- The rebuild is a journey rather than a point in time and the new sense of normality is achieved gradually through this journey. It is an incremental process of change and stakeholders and IR staff are unable to pinpoint a specific point in time when it started.

- Underlying anxiety about more earthquakes.

*“I think it was a bigger adaptation required than normal across the whole wide spectrum of business. Change is constant and businesses are always having to adapt, [but] not to the degree that they’ve had to. So, I think the scale of change has been bigger and has certainly caused more stress.”*

(Interview 44)

Over time, this new sense of normality has been strengthened, because:

- The earthquakes have subsided
- Many SMEs have resumed trading
- Some level of disruption is tolerated (e.g. roadworks)
- It feels like a long time since the earthquakes. People and SMEs have to “get on with their life”
- Today the rate of business creation and de-establishment is similar to what it was prior to the earthquakes.

*“The place won’t ever recover if we continue to treat it as broken.”*

(Interview 33, IR)

*“Throughout [the earthquakes and after], they [births and deaths of SMEs] dropped away a little bit to begin with, but actually they came back quite quickly, and now births and deaths and failures are very similar to where they were [prior to the earthquakes]. Obviously, there’s been some loss of retail, permanent loss of retail, tourism and accommodation in particular, and those will come back over time. But that’s been offset by booms in construction, procurement, you know, supply chain kind of markets as the rebuild really kicks in.”*

(Interview 44)

## 2. Mixed outcomes of the earthquakes for SMEs

The earthquakes have had unexpected positive outcomes for SMEs (cooperation, creativity and innovation, and less competition), but also some significant negative impacts (extensive changes in the business environment and ongoing insurance issues).

These are discussed in turn overleaf.

## Positive outcomes

### More cooperation between SMEs

Stakeholders and IR staff observe that SMEs in Canterbury tend to collaborate more today. For example, hairdressers and architects whose salon and office were destroyed now share the same business premises. Business people, through professional organisations and business networks, help each other despite being competitors. SMEs have created a new 'business dynamic' unique to Christchurch and are more reliant on each other.

*"I know from my association with the local Institute of Architects that we formed a little committee to find out who needed help... There's a real professional bond, I suppose. Different practices took in other firms. I mean, we made an offer for other firms that they could come and use our space here, use our facilities, and a lot of firms went and worked from home on a temporary basis. Some firms did join ranks and work together. So no, there's no professional jealousy. It was basically a lot of collaboration and professional help and guidance. Some of that was coordinated by the Institute of Architects' head office in Auckland. From a professional perspective we have got quite a good, close-knit Institute, so that helped."*  
(Interview 9)

More collaboration also exists between government agencies and other organisations. For example, IR and the Ministry of Social Development (MSD) shared work premises and have provided more coordinated assistance and information to SMEs. IR's and MSD's collaboration has been more effective and productive for assisting SMEs.

*"I sense a really good collaboration. Across government and the business sector people are willing to share and open together. If you look at us, this is Corrections, so they're with us as well. There's willingness for people to give it a go and share things that traditionally they won't, and I think that's good for business."*  
(Interview 29)

### SMEs' creativity and innovation have flourished

Stakeholders and IR staff believe that creativity and innovation have flourished since the earthquakes. People and SMEs have had to rethink how to do things and come up with solutions, for example, how to reopen a business that has been destroyed. Some restaurants that were destroyed have reopened in shipping containers, and some SMEs have set up an online

presence instead of relying solely on foot traffic. This may be underpinned by the Kiwi culture of 'giving it a go'.

*"We've been able to do things that we weren't really good at ordinarily, like live music. We've had a lot of live music going on in the evenings, just because there was nowhere. So, we were really busy with that. And now we still are busy, we still do it, we still spend a lot of money on musicians but I wouldn't say it's our forte."*  
(Interview 22)

*"It has provided a springboard for smart, innovative people to create their own companies. So, we've got quite a lot of individuals who might have been working for, say, Fulton Hogan or some of the bigger companies, who've gone out and created, started up their own company and are doing well out of it: minimal overheads, [they] have some good skills, and so there's a great opportunity for companies like that. There'll only be a handful of employees, but they're maximising the benefits that they can get out of it, because of their knowledge of the local industry, plus contacts as well, I guess."*  
(Interview 45)

### Decreased competition for some SMEs

In different industries, SMEs have seen competition levels change due to the earthquakes. Some SMEs have benefited from the demise of their competitors and have thrived, regardless of how much the earthquakes have affected them. For some SMEs, business growth has been incremental while for others it has been exponential.

*"I think the survivors did really well, most businesses, because there were fewer of them. There's less restaurants, there's less hotels, there's less accommodation, so everyone that is up and standing is doing really well and they still are. Rental properties, the only way you're going to bring that back is when you start building new restaurants and new things, get back into all the competition, but I think competition's gone."*  
(Interview 3)

## Negative outcomes

### Extensive changes in the business environment

It is widely accepted among business people that the business world is constantly changing, and successful SMEs have to keep adapting to their environment. However, today's business environment evolves more rapidly and significantly than prior to the earthquakes. For example, cafés share premises with florists and hairdressers.

### Insurance issues are ongoing and complex for SMEs

Stakeholders and IR staff observe that insurance claims are relatively difficult to settle today as a result of the earthquakes. They take time to settle due to their complexity and volume. This makes it difficult for SMEs to resume trading and/or focus on business management and growth. SMEs are affected in different ways:

- Business owners spend time, effort and resources on settling their insurance claims rather than concentrating on their core business activity.
- Insurance payouts can be smaller than expected for some SMEs, leaving the business with an unexpected financial gap to address.
- The settlement process is protracted, as insurance companies work in collaboration with other organisations (e.g. CERA and City Council). The process duration tends to increase business owners' stress levels.
- Insurance problems have changed over time, which makes dealings with claims difficult for SMEs:
  - Initially, some SMEs experienced challenges with their business interruption insurance. They did not fully understand the terms and conditions of their insurance for such an adverse event and have not received what they expected from their insurance company.
  - Then some SMEs had issues with their commercial property insurance and have been struggling to receive the expected insurance pay out.
  - And now some SMEs are experiencing issues with reinsurance, where the cost of reinsuring building and property has increased severely. Land and building owners have to assess if they can afford it, and if not, what alternatives exist.

*“Insurance. It just seems it's been such a nightmare. Delay, deny, defend is what they seem to be doing. Then there's reinsuring, which is so much more expensive.”*

**(Interview 48)**

## Specific issues mentioned by sector

Stakeholders and IR staff identify issues specific to each sector – these issues affect SMEs' recovery. The table overleaf lists these key issues.



Sector of activity	Key issues
<b>Building/ construction and manufacturing</b>	<ul style="list-style-type: none"> <li>• <u>Increasing diversity within this sector</u>: some SMEs are struggling to earn an income, while others are growing exponentially.</li> <li>• <u>Vertical rebuild not yet underway two years on</u>: SMEs have no or limited income, but they have employed new staff and purchased equipment.</li> <li>• <u>SMEs in the residential and horizontal rebuild are growing rapidly</u>: they earn and spend large amounts of money, without always having suitable administrative processes in place to handle these amounts.</li> <li>• <u>Slow decision-making for the rebuild</u>: the 'start-stop' rebuild process affects SMEs' income streams and their ability to plan and manage workflow.</li> <li>• <u>Recruiting experienced employees</u>: demand for experienced staff is larger than supply, which puts an inflationary pressure on wages to attract and retain staff.</li> </ul>
<b>Design and architecture</b> (consultancy and project management)	<ul style="list-style-type: none"> <li>• <u>Increased number of parties to deal with</u>: PMOs, insurance companies, EQC, CERA and the City Council are involved in building projects, which makes it difficult to find consensus</li> <li>• <u>Slow decision-making process</u>: planning and executing projects takes longer due to increased bureaucracy and the number of parties involved.</li> <li>• <u>Being from outside Canterbury</u>: SMEs that have not built a loyal client base and networks in Canterbury and Christchurch find it hard to obtain contracts.</li> <li>• <u>Recruiting experienced employees</u>: demand for experienced staff is larger than supply, which puts an inflationary pressure on wages to attract and retain staff.</li> </ul>
<b>Finance</b> (investment and tax)	<ul style="list-style-type: none"> <li>• <u>Slow decision-making about land use and building repairs or demolition</u>: property owners are running out of their two-year business interruption insurance, yet no decision has been made about land and buildings.</li> <li>• <u>Increased costs of repairing/rebuilding and reinsuring</u>: property owners need to increase their financial investments to repair/rebuild, but there is no indication that high-value tenants will rent these new premises.</li> <li>• <u>Future legislation</u>: new laws, bylaws and regulations may be enacted in future and tighten the current financial and tax leniency accorded to property owners (e.g. tightening of depreciation).</li> </ul>
<b>Hospitality and tourism</b>	<ul style="list-style-type: none"> <li>• <u>Cyclical industry and lack of tourism</u>: the accommodation sector is returning to its cyclical pattern of occupancy, but some accommodations are struggling because the tourist market is very small and they cannot rely solely on business customers.</li> <li>• <u>Waiting for a decision on building demolition or repair</u>: some SMEs are still waiting to hear if their business premises will have to close down temporarily or permanently.</li> <li>• <u>Recruiting experienced employees</u>: demand for experienced staff is larger than supply, which puts an inflationary pressure on wages to attract and retain staff.</li> </ul> <p><i>Note: cafés, restaurants, bars and entertainment places are doing well, which is mostly due to a lack of competition at the moment.</i></p>
<b>Retail and services</b>	<ul style="list-style-type: none"> <li>• <u>Lack of foot traffic and/or road traffic disruption</u>: some SMEs are struggling to earn a regular income due to their location in poorly visited areas and/or roadworks preventing customer access.</li> <li>• <u>Waiting for a decision on building demolition or repair</u>: some SMEs are still waiting to hear if their business premises will have to close down temporarily or permanently.</li> <li>• <u>Necessity to adapt rapidly</u>: the business environment changes and SMEs have to adapt or exit the marketplace.</li> <li>• <u>Recruiting and retaining experienced employees</u>: demand for experienced staff is larger than supply, which puts an inflationary pressure on wages to attract and retain staff. Retaining staff is also subject to monetary incentives.</li> </ul>
<b>Government organisations and infrastructure</b>	<p><b><u>Government organisations (excluding IR) and infrastructure:</u></b></p> <ul style="list-style-type: none"> <li>• <u>Poor health and wellbeing</u>: the earthquakes have strongly affected Cantabrians who still struggle with stress and anxiety. Some of the consequences are alcohol abuse and domestic violence.</li> <li>• <u>Geography and types of crimes have changed</u>: crimes need to be identified and addressed appropriately.</li> <li>• <u>Uncertain structure of Christchurch in the future</u>: the horizontal and vertical rebuilds occur slowly and leave question marks about the future shape and size of the city throughout the rebuild and upon its completion.</li> </ul> <p><b><u>Government organisation – IR only:</u></b></p> <ul style="list-style-type: none"> <li>• <u>Increased data sharing and collaboration required</u>: doing so, between IR's departments and also between IR and other government agencies, would enable IR to gain a wider understanding of SMEs' situations and help them address SMEs' tax issues in a more timely manner.</li> <li>• <u>Need for continuous Canterbury-based assistance</u>: SMEs require locally-based assistance, as local IR staff know issues SMEs are going through and have specific assistance packages for them.</li> <li>• <u>Return to BAU</u>: today IR needs to enforce the rules like it did prior to the earthquakes while maintaining flexibility for struggling SMEs. This will help address the hidden economy issues.</li> <li>• <u>Implement communications campaign</u>: IR needs to show people and SMEs how tax payments and the hidden economy affect the rebuild. This will help capitalise on people's and SMEs' current goodwill to get the vertical rebuild underway.</li> </ul>
<b>Business and professional organisations</b>	<ul style="list-style-type: none"> <li>• <u>Today's business environment is different from prior to the earthquakes</u>: SMEs in all sectors of activity have to be able to understand and adapt to their new environment to survive and grow. Some SMEs still require IR's assistance to do so.</li> <li>• <u>Insurance claims and reinsurance</u>: delays in insurance payouts hinder SMEs recovery, and re-insurance costs for some SMEs are beyond what they can afford.</li> <li>• <u>Relocation of business premises</u>: multiple relocations affect SMEs, especially in the customer service industry, because they lose customers. Multiple relocations also distract business people from focusing on the SME's core business.</li> <li>• <u>Increased bureaucracy and administration</u>: many SMEs are focused on survival and recovery – the administrative burden needs to be minimised to help them focus on the core activity of the business.</li> </ul>

### 3. Mixed outcomes of the earthquakes for individuals

This section discusses the positive changes (work patterns) and negative changes (poor wellbeing) that people have experienced since the earthquakes.

#### Positive outcomes

##### Aiming for a better work-life balance

Stakeholders and IR staff observe that work patterns have changed for many employers and their staff since the earthquakes. Many want more stability in their work life, and as such have made changes. For example, they work in a more efficient and productive way and avoid or minimise working overtime.

The concept of work-life balance has become more important after the earthquakes: for many, a shift has occurred from being mostly career focused to enjoying more quality time with family and friends. As a result, some business people may be less interested in setting up new ventures or growing their business.

However, for SMEs currently experiencing a rapid growth in their activity level, some overtime is a necessity to address customer demand.

#### Negative outcomes

##### Poor health and wellbeing outcomes

Stakeholders and IR staff recognise that the impacts of the earthquakes have taken a toll on Cantabrians' health and wellbeing. Since the earthquakes, people have experienced stress and fear. Although the earthquakes have subsided, people are still on alert and concerned about "the next big one". Two years on, recurring tremors still make people anxious and tired of being constantly stressed.

*"With social and other issues, things like relationship breakups, domestic violence, underlying anxiety-related issues, drug and alcohol, those sorts of elements are quite a major part of what we're starting to see ... what will be an ongoing journey for quite a number of people that is just really beginning or getting to a crisis point."*

(Interview 43)

Employers have used workplace flexibility as an active strategy for staff wellbeing and retention. However, continuous stress may lead business people to make unsound business decisions or lose focus on their business. Some SME owners find it difficult to adequately manage the intensity of the work (e.g. large contracts to be honoured) and the workflow (e.g. seasonal peaks and troughs of the hospitality industry).

*"Reassure them [employees] that their job's there, that there's enough work. Reassure them that where they're working is safe. Reassure them that we're not rushing back into an old building somewhere, that the firm is keeping on. And just doing some team building and trying to build more of a social atmosphere. Just trying to, I guess, demonstrate that they are valued, and that we'd look after them. We're concerned for their safety, their families etc."*

(Interview 10)

## SME recovery varies significantly

As discussed in the previous section, the earthquakes have changed the city physically and socially; they have forced SMEs to adapt to survive; and they have also had a serious impact on people. SMEs have limited control over these outcomes.

This section discusses the factors that have enabled SMEs' recovery. However, some ongoing issues have also hindered their recovery. To some degree, SMEs can influence these enabling and hindering factors, unlike the outcomes of the earthquakes. This discussion then leads to the review of an SME recovery model<sup>4</sup> and an explanation of the different recovery stages.

### Factors instrumental to SMEs' recovery

Stakeholders and IR staff identify several factors that have helped SMEs to recover from the impacts of the earthquakes (external assistance, SME's proactivity, the existence of a business branch outside of Canterbury, business resilience, and personal resilience). Each of these factors is discussed below.

#### External assistance a 'lifesaver'

The wage subsidy has been key to SMEs' survival. It has enabled a large proportion of SMEs to pay their staff for several weeks while being closed for business.

Some stakeholders identify this intervention as being a Government measure, while others refer to it as one of IR's interventions. Some time has elapsed since the wage subsidy's implementation, and stakeholders are unable to remember the details about this assistance package.

Receiving advice and information from various organisations, including government agencies, has also enabled SMEs to understand what they needed to do during the critical time of the earthquakes.

<sup>4</sup> In the 2012 research with SMEs and tax agents, Colmar Brunton identified a model that identified four stages of SME business recovery.

### SMEs' proactivity is key to recovery

SMEs' speed of reaction to disruption is paramount. Stakeholders and IR staff perceive that the sooner the SME adapts to its new environment, the better it is for its recovery. For example, SMEs that relocated shortly after their premises were destroyed have been able to re-establish their business more easily. Compared with later movers, these SMEs had a larger supply of rental premises to choose from and the rents had not yet increased significantly.

*[What helped SMEs?] "They were quick to recognise what services were doing well. For example, temporary fencing material. There's a huge demand for that."*

**(Interview 1)**

### Business branch outside of Canterbury an asset

Some SMEs that have a business branch outside of Canterbury can use them to partially subsidise their Christchurch branch. This buffers the Christchurch branch from a steep financial decline. Although this situation is not sustainable in the long-term, SMEs have found this helpful. For example, Christchurch staff were paid or employed on projects outside of Christchurch, instead of being made redundant.

### Business resilience fundamental to recovery

Stakeholders and IR staff identify business resilience as a fundamental factor helping SME recovery. Resilient SMEs are able to re-establish their business more rapidly after an adverse event. They believe that the following factors assist SMEs to be resilient:

- SMEs with solid business systems and practices in place prior to the earthquakes (e.g. built cash reserves and invested in insurance).
- SMEs' use of technology (e.g. data storage on cloud) and disaster preparedness (e.g. offsite stock storage).
- SMEs that belong to professional bodies and build their networks.

### Business owners' personal resilience important to recovery

Stakeholders and IR staff believe that business owners who are organised and manage their own stress levels, and that of their staff, are able to focus their energy and resources on their business. For example, some employers provide counselling services to their staff and are flexible around work-life balance.

*"I think, what I found is I really had to paint a picture of what I believed. Firstly I had to convince the staff that I was staying... I had to convince them I was staying, but equally I asked*

*them as well to commit. I said I'm not going to spend another minute and dollar on this business if you tell me you can't work. The building is going to be held up by props and tons of spare scrap metal. And once we've got past that hiatus, it was really a matter of staying positive, about setting the scene and then just encouraging people. And, I put counsellors in here, all sorts of things just to get people's spirits up."*

**(Interview 8)**

Business acumen is also important: business owners who can adapt their current products or services, or develop new ones, to meet customer needs are more likely to stay in business. Loyal customers and committed staff also play a key role.

### Factors hindering SMEs' recovery

Stakeholders and IR staff identify two key factors that inhibit SMEs' recovery. These are a lack of clarity around roles and responsibilities and SMEs' insurance and financial difficulties. They are discussed in turn below.

#### Lack of clarity around the roles and responsibilities of key parties involved in the rebuild

For some SMEs, the roles and responsibilities of the central and local governments, as well as CERA and EQC, in the rebuild process are unclear. This affects SMEs' productivity, as time is spent dealing with multiple agencies to sort out land and property issues.

*"There is a lot of 'in-fighting' at the moment between various areas... You've got CERA, you've got EQC, you've got the City Council, you've got the Central Development Unit, you've got so many different people all wanting to have a bit of a play."*

**(Interview 34, IR)**

SMEs also have to deal with more organisations today (CERA and EQC), which means more bureaucracy and "red tape". Some stakeholders feel the decision-making process is not as effective as it should be, because of the politics and slow decisions (at times they conflict). Stakeholders appreciate that making the right decisions takes time, and the wider implications of decisions also need to be carefully considered. However, this situation leads to a protracted decision-making process with a high level of uncertainty for all parties involved (e.g. insurance companies, land developers, shop owners). This means that SMEs cannot be as responsive to the demands of their business, which is required in an ever-changing business world.

*“PMO [Project Management Office]. Those are the firms that drive the repairs. But they had a very distorted view on realism and relativity in what was fair and reasonable, and so you had the homeowner who wanted something more than perhaps the PMOs thought they were entitled to. So, nothing happened for well over a year and even two years on. We’re still battling with that. If you had to put something down, as far as large consequences of this earthquake, is the control of the PMOs and underskilled and inexperienced project managers. In other words, you have professionals like architects and engineers and builders who are subservient to project managers who really don’t know what they’re doing.”*  
**(Interview 9)**

**Insurance and financial difficulties**

Some SMEs were underinsured and/or did not have business interruption insurance. This has affected their financial and cashflow situation. If they were unable to access enough funds to keep the business afloat, they are now likely to have accumulated debt, including tax debt, or have closed down their business.

*[What has been the biggest inhibitor of SME recovery?] “Insurance. Insurance. Insurance. Business interruption insurance: if it takes six months to pay out, it is not useful.”*  
**(Interview 44)**

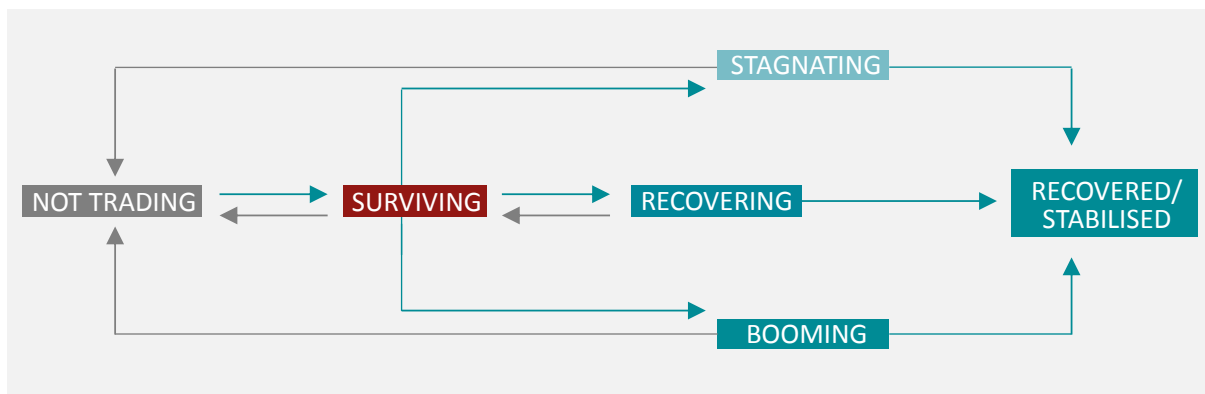
**Revised SME recovery model**

The 2012 research identified a recovery model of four stages (Not trading, Surviving, Recovering and Recovered). This model identified that, in 2012, SMEs were in different stages of recovery. Today, with the addition of new perspectives from stakeholders and IR staff, and given more time has elapsed since the earthquakes, Colmar Brunton has reviewed this model. Now the recovery model comprises six stages: two stages (Booming and Stagnating) are added to the original four stages, and the fourth stage is now called Recovered/Stabilised.

The recovery model is dynamic and SMEs move between the stages. Moving to another stage in the model is influenced by the outcomes of the earthquakes, as well as the enabling and hindering factors in SMEs’ recovery.

The diagram below shows the revised recovery model, and each stage is then discussed individually.

It is difficult to provide specific profiles of SMEs in the new Stagnating and Booming stages. This is because the current research, which identifies these two new stages, is amongst stakeholders and IR staff. Proposed future research with SMEs will be able to provide a more detailed profile of the SMEs’ characteristics in these two stages.



### The Not trading stage

The 2012 research found that, following the 22 February 2011 earthquake, many SMEs were unable to trade for a period of time. This was due to property and material destruction, as well as injury and trauma. Many buildings were destroyed and business premises badly damaged. This was an *immediate* consequence of the earthquakes.

A variety of SMEs in different sectors (e.g. hospitality, retail and services) were affected by the earthquakes because of their location. For example, those SMEs located in the CBD were unable to access their stock or open for customers because the area was cordoned off. This meant they were unable to trade. In addition, customers were scared and not spending money on unessential items (e.g. dining out).

SMEs that were not trading faced great difficulty and required a lot of assistance to explore options, for example exiting the marketplace or reopening the business.

Today's research with stakeholders and IR staff supports these findings.

Two years on since the earthquakes, stakeholders and IR staff believe that SMEs are likely to have moved to the next stage (Surviving) or closed down their business permanently. Stakeholders and IR staff do not expect SMEs to remain not trading as a direct and immediate result of the earthquakes. However, they believe that if SMEs are not trading today, it is due to other issues rather than the earthquakes (e.g. lack of cashflow and insurance problems).

### The Surviving stage

This stage is characterised by SMEs' struggle for a period of time. For example, they are trying to relocate premises, salvage or reconstruct records, manage and look after employees, and address the financial situation of the business (e.g. wages, invoices, cashflow). SMEs face high uncertainty about their ability to resume business sustainably. SMEs from a range of industry types can be found in the Surviving stage.

Surviving SMEs have moved from Not trading to this new stage, because they use internal resources (e.g. business and personal resilience) and/or external resources (e.g. IR's assistance).

Support for SMEs is critical in the Surviving stage. They particularly need advice and information, financial assistance and professional guidance. These findings from the 2012 research are supported by stakeholders' and IR staff's views in the 2013 research.

*"There's a whole huge hunk of them [SMEs] that are actually still being affected... So,*

*progressively over the last six months, so that's a really short timeframe and not that far ago, there has been six small businesses closed just in that area [eastern suburb]. All of them are because of building damage. We had a pub, a hairdresser, an Indian and a dairy. The pub closed down first, then the owner of the buildings closed the rest of them down, so the dairy just closed. The Indian just closed. The hairdresser relocated up the road but into another hairdresser's. So, that hairdresser has gone. And then four months ago, the last lot of shops [in the eastern suburb] actually got closed down with four hours' notice. So, that was a cafe, liquor store, a pharmacy and a dairy. So, it's still going on. What I'm probably trying to say, there is still potential for SMEs to be caught up into this whole post-earthquake [disruption]."*  
(Interview 34, IR)

### The Stagnating stage

This is a new stage in the recovery model. A significant period of time has elapsed since the 2012 research<sup>5</sup>. This has enabled SMEs to adapt to their new environment and move through stages in the recovery model. Stagnating SMEs come from the Surviving stage and still face significant problems (e.g. lack of cashflow, slow and complex dealings with insurance companies). Because of these problems, Stagnating SMEs are unable to grow their business today. The three examples below illustrate some of these problems.

- Some business premises still need to be assessed for safety and a decision made to repair or demolish them. In the case of demolition, SMEs need to find new business premises, which will divert limited resources from business growth to business set-up (e.g. time, money, labour, business focus).
- Location is key to business activity. Some SMEs are located in areas where foot traffic and/or population are limited (e.g. near the Red Zone), therefore their earning potential is capped unless they find other ways of increasing business (e.g. reliance on online presence rather than foot traffic alone).
- Some SMEs have gained contracts for the rebuild and are ready to start work, for example, they have purchased equipment and recruited staff. However, the project is delayed and the business is not earning an income.

A few IR staff mention that some business people may not want to grow their business. These business people may find it easier to cope with a Stagnating business rather than a growing business, which requires more energy and commitment from their part.

<sup>5</sup> Fieldwork for the 2012 research was conducted in April 2012.

Compared with Surviving SMEs, Stagnating SMEs have regained some financial and business stability. However, Stagnating SMEs have a fragile financial position (e.g. irregular income and uncertain future), and a disruption can send them back to the Surviving stage (e.g. another earthquake or building demolition). The boundary between Surviving and Stagnating is difficult to pinpoint – it is a gradual change for SMEs rather than a sudden one.

For most stakeholders and IR staff, Stagnating SMEs have not been able to fully adapt their business to the new environment, and therefore their situation may stay the same or deteriorate over time. These stakeholders and IR staff believe that the difficulties Stagnating SMEs face are no longer directly related to the earthquakes and they should not keep blaming the earthquakes for their poor business situation.

### The Recovering stage

As with the 2012 research with SMEs and tax agents, this research with stakeholders and IR staff also discusses the characteristics of SMEs in the recovering stage. SMEs in this stage are still building up their business again and re-establishing effective daily operations, as well as a solid client base. Business owners want to have a solid business foundation to grow sustainably. Although SMEs in this stage still face challenges, they are in a better financial position than in previous stages to address them (e.g. they have a regular income).

Recovering SMEs still need to pay close attention to their business situation, as they are not immune to returning to the Surviving stage (for example, if unexpected roadworks prevent customers' access). However, Recovering SMEs can also move to the next stage (Recovered/Stabilised). External support (e.g. professional guidance/mentoring) and/or internal support (e.g. good business practice and processes) can help SMEs move to the Recovered/Stabilised stage more easily.

Recovering SMEs tend to be SMEs that had a solid business foundation with good management prior to the earthquakes. Stakeholders and IR staff do not specifically identify the types of SMEs they believe have reached this stage.

### The Booming stage

This is also a new stage in the recovery model. This stage mostly applies to SMEs in the building/construction sector, which have experienced an incredibly high level of growth after the earthquakes. For example, one SME grew from six to over 40 employees with a tenfold growth in turnover over the last 12 months.

Some SMEs in the hospitality industry (e.g. cafés, restaurants, bars) are also now in the Booming stage. Due to lack of competition, these SMEs have a thriving business. Over time, more competition is expected to enter the market and the high levels of current business growth are likely to decrease.

*“The biggest thing was that I had to start hiring labour. There was far too much [work] for [business partner] and I, so we went up to probably... at most we had 10 staff, so it's been a real big change and challenge for us. I've lost my role of actually going out there and being a builder. I'm more in charge and more on the computer, more meetings, scoping, pricing. My role's changed completely. I haven't touched a hammer for ages... I've actually hired my own builders, trade qualified builders so they just work under me. The role's absolutely dramatically changed since the earthquakes. It's just a completely different business, just 100% living in a different world than what we had before.”*

**(Interview 3)**

These SMEs are currently highly successful and making a comfortable profit. Many of them have never experienced such growth in the past and have to learn to adjust to their new situation. If not, they could incur a large tax debt. This tax debt may be incurred by, for example, falling behind in their tax payments or not putting enough money aside for their provisional and terminal tax payments. They need to ensure they have adequate systems and processes in place to manage their exponential growth. The 'rules of the game' have changed, for example, they have more choice when making decisions (e.g. invest in the business or save money).

*“Prior to the earthquake, I could probably name half a dozen medium-sized companies that were probably very close to going under, going to the wall. You know, since the earthquake has come along, those companies are absolutely thriving now and doing really well.”*

**(Interview 45)**

However, these SMEs may not fully appreciate the realities that their fast-growing nature is likely to be temporary and due to the large influx of investment into Canterbury. When the rebuild nears the end and the \$30 billion budget has been spent, stakeholders believe the ‘bubble will burst’ and these SMEs will not be able to continue growing so fast. They will need to plan for a slowed down, yet more sustainable version of growth. They may have to gradually downsize their business or look for contracts outside Canterbury. If Booming SMEs do not prepare for a slowed-down level of growth, they risk moving back to the Surviving stage. For example, some SMEs may reach a time when they are employing too many staff while not earning enough income to support them. This may lead to SMEs’ inability to pay wages, bills, and address tax issues.

### The Recovered/Stabilised stage

The 2012 research identified this last stage as Recovered. However, this current research found that the last stage can also mean ‘Stabilised’, which applies to SMEs that have been in the Booming stage. Stakeholders and IR staff believe that very few SMEs have yet to actually reach this stage.

In this final stage of the recovery model, SMEs are considered well established with effective business systems, processes and practices in place. SMEs are considered productive and profitable. They experience relative business stability and sustainable growth. Stakeholders and IR staff define this stage by:

- **Recovered SMEs:** they are expected to transition smoothly from the Recovering to the Recovered stage with relatively minor and safe adjustments to the business (e.g. improved customer service) rather than more fundamental and structural changes (e.g. building a new customer base). SMEs in the Recovered stage continue to grow their business gradually.
- **Stabilised SMEs:** after a period of strong growth, they are expected to experience a slowed-down yet more sustainable level of growth. They need to change some of their business management and/or practices to reflect the relative drop in growth and ensure the business can keep trading and sustain its new level of growth (e.g. need to downsize the business or relocate staff).

## So, is it business as usual for SMEs today in Christchurch?

Stakeholders and IR staff say that for some SMEs it is business as usual (BAU) today, because they show signs of recovery – they are in the Recovering, Booming and Recovered/Stabilised stages. However, they believe that for SMEs that are still struggling today (e.g. Surviving and Stagnating stages) it is not BAU yet. This section

explores these viewpoints in more depth. First, the concept of BAU is discussed and then the question of whether it is BAU in Christchurch today is explored.

### Defining business as usual for SMEs today in Christchurch

Today’s BAU is different from the BAU before the earthquakes, given that SMEs have had to adapt their business operations to the new environment. For example, Surviving and Stagnating SMEs indicate that their business activity level is not high enough to enable them to move to a more sustainable growth stage (e.g. Recovering). For them it is “business as unusual”.

SMEs that have reached BAU have resumed their normal, day-to-day operations and are able to grow their business. For example, they are able to meet their customers’ needs as they would have prior to the earthquakes. To do so successfully, they may have had to rethink their business model. For some SMEs, this has meant refocusing their business operations on their core activity or diversifying their activities after seeing new opportunities.

*“We were renovators and home improvers before the earthquakes. [Today] we chase business that [is] pretty similar to what we were doing, just on a larger scale now. So, it hasn’t changed too much, just the fact that it’s larger. I think [this] might be the biggest thing that’s changed. Personally, business as usual.”*  
(Interview 3)

Tax matters are an important aspect of business, however only a few IR staff consider tax issues as a characteristic of BAU. They say that some SMEs have resumed their everyday business operations, yet they are unable to meet their tax obligations. For these IR staff, such SMEs have not fully returned to BAU.

Despite having resumed their day-to-day operations, some SMEs have not reached *full capacity* yet. They are busy and work on high value projects, but some staff members are working less than prior to the earthquakes (e.g. ‘nine-day fortnight’, working part-time or on unrelated tasks). These SMEs feel they have reached BAU, but they expect to return to full capacity eventually.

### Is it realistic to talk about BAU today in Christchurch?

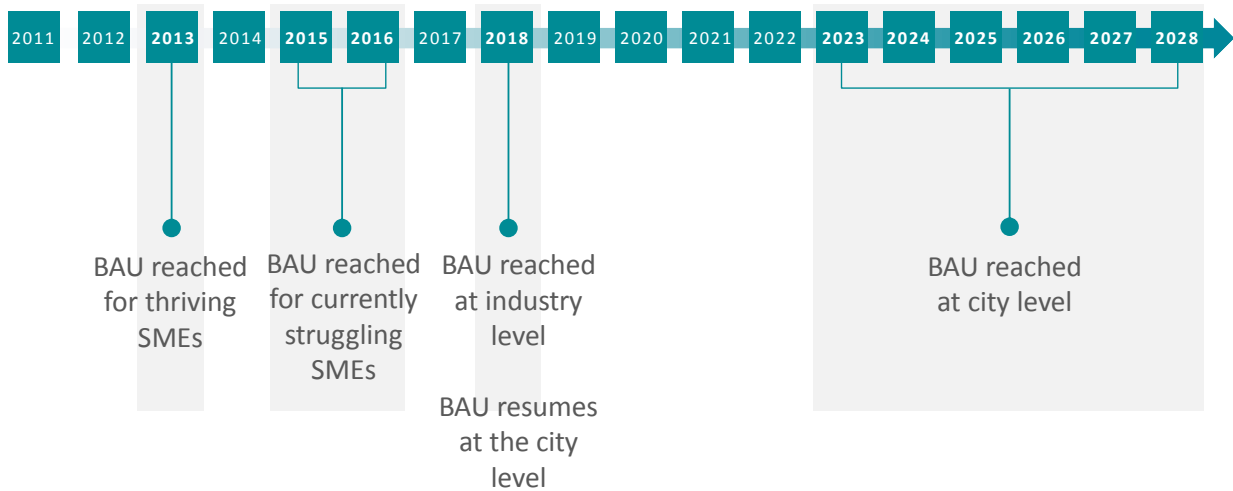
Stakeholders and IR staff consider that BAU is a journey rather than something that takes place at a point in time. SMEs move from one stage of the recovery model to another gradually, rather than suddenly. This process varies on a case-by-case basis.

Stakeholders and IR staff are divided in their views on the time taken to reach BAU, and what entities can reach BAU.

- At the city level, they believe it will take more than a decade to reach BAU. It is only when the CBD is re-established that it will be BAU.
- At the industry level, they think it will take about five years from now. This is because within industries, levels of recovery vary and some SMEs are still struggling.

- At the SME level, some respondents believe some SMEs have already reached BAU, while others will take a few more years to get there.

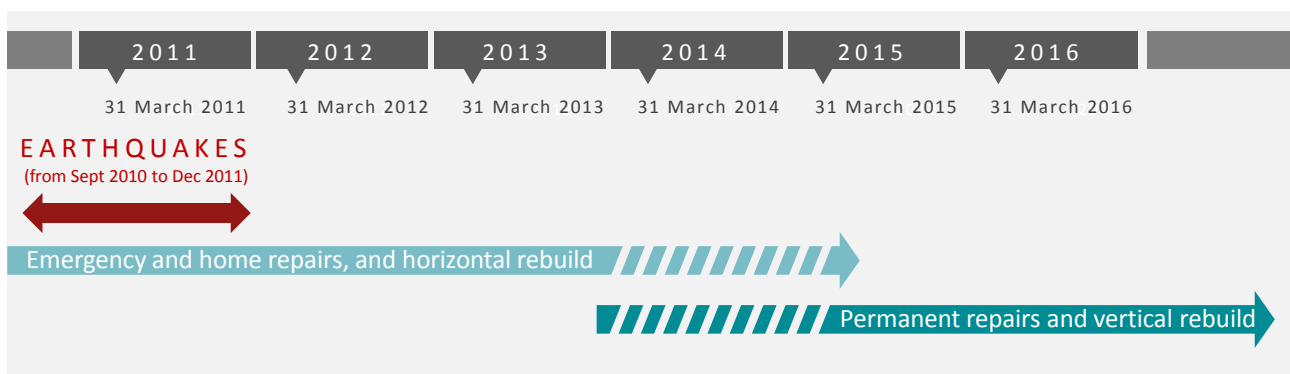
*“It depends. Some things are business as usual. People are back to paying people and buying things, but if you talk to most businesses, they’d really say ‘hey, look, it’s not going to be business as usual until all the services, and facilities we had in the city are back and running’.”*  
**(Interview 4)**



The diagram below shows stakeholders’ and IR staff’s expectations of reaching BAU.

Stakeholders and IR staff link the return to BAU to progress with the Christchurch rebuild. They explain that the horizontal rebuild has been underway for a while, but is unlikely to be completed soon. This is why some SMEs are still struggling to re-establish their business. The vertical rebuild is expected to start soon and it will change the shape and structure of Christchurch significantly. However, stakeholders and IR staff are unsure how SMEs will adapt to yet another new business environment (for example, when more business premises become available in the CBD, will SMEs return?). Stakeholders and IR staff consider that Christchurch is still in a transition phase.

The diagram below shows that Christchurch’s transition will last for a long period of time until the new environment is ‘settled’ (including the business environment).





## Question marks still remain about the future of Christchurch

Some stakeholders and IR staff worry about the **repopulation of the CBD**. With increased safety compliance costs and reinsurance fees, the original tenants of the CBD are unlikely to afford the increased rents of the new buildings. Only large companies and organisations (e.g. lawyers and government agencies) will be able to afford these rents. As a result, SMEs may decide to remain on the outskirts of the CBD or in the suburbs. Moreover, some SMEs have signed long-term leases on their current premises and may be unable to break their lease to move closer to the CBD. The dynamic of the new CBD may end up vastly different from what it was prior to the earthquakes.

**Confidence** needs to return to Christchurch and Cantabrians. Confidence will reinforce the new sense of normality where people get on with their life and SMEs do their business.

Confidence directly impacts on people's 'can do' attitudes and energy to set up and grow their business. Moreover, confident people and businesses are more likely to stay, which may entice outsiders to come and live/work in Canterbury. This may ensure that the higher socio-economic groups and SMEs remain in the region and contribute to its development.

The alternative scenario these stakeholders and IR staff describe would lead the higher socio-economic groups and SMEs to leave the region, because they can afford to, therefore leaving behind people whose social needs may be greater but who cannot afford the required services.

Some stakeholders and IR staff speculate that in the future, Canterbury could be an even more productive and efficient region, due to the **increased use of technology**. For example, many SMEs today have a disaster preparedness plan as normal business practice which involves data storage on a cloud system and smartphones/iPads; employees can be reached anywhere at any time and can deal with business situations more responsively.

## Section 2. Attitudes towards tax compliance

This section discusses stakeholders' and IR staff's perceptions about SMEs' attitudes to tax compliance. Some stakeholders and IR staff believe that SMEs' attitudes to tax compliance remain the same since the earthquakes. Others say they have noticed changes in SMEs' attitudes.

### Status quo

There is a strong sense by many stakeholders and IR staff that there has been little change in attitudes towards tax compliance. However, many stakeholders note that it is not a topic they tend to discuss with SMEs. As such, they feel unsure and simply do not have the knowledge or experience required to answer this question.

The perception of little change is underpinned by the belief that a well-functioning taxation system is critical in a societal context. This moral stance requires all citizens/businesses to contribute fairly. In line with this, there is a belief that paying taxes is not something one can easily avoid and is often referred to as "one of life's certainties".

Given attitudes towards tax compliance have a strong moral or values-based foundation, stakeholders and IR staff believe that any attitudinal shift will not occur easily. The opposite is also true. Those who do not believe in the importance of meeting their tax obligations will likely retain this as an enduring attitude.

*"If you're anti-regulation, anti-tax, then you don't like tax much. If you recognise that tax is fair dues, you pay to keep society running. You have different views."*

(Interview 49)

This reinforces the importance of reviewing businesses on a case-by-case basis, by gaining an understanding of their pre-adverse event behaviour.

### Change is about relative priority

Where there is likely to be a change, it is the *relative priority* businesses place on their tax obligations. Historically, businesses are likely to perceive IR as one of their most important creditors. Following an adverse

event, it is likely IR's position may be relegated. In the immediate aftermath, this is likely to be affected by the personal stress and uncertainty people experienced. As time passes, this may be influenced by a business shifting from a longer term (and strategic approach) to an immediate short-term (and quite functional approach).

*"But it's a business decision whether you pay the tax or you pay the power bill. Whereas prior, they may have thought we have to pay the tax or we might go to prison, now they might be thinking we'll pay the power bill because it will keep us trading."*

(Interview 40)

*"I always say PAYE and GST is somebody else's money. You're just collecting that from other people. You're only handling it so you need to keep records tidy. Some (SMEs) don't, either because they mentally reject the need or they are busy doing other things and it's not seen as important."*

(Interview 49)

### Positivity in the air

As businesses start to witness evidence of the rebuild, there is a sense that people and businesses have a more optimistic outlook. This optimism, along with expectations about creating a new, better Canterbury, assists in fostering a greater sense of community. Many believe this community spirit, along with the noticeable levels of greater collaboration in the business environment will reinforce the importance of contributing one's fair share to the rebuild (e.g. paying tax).

Similarly, those who are not perceived to be meeting their obligations (tax and otherwise) will be frowned upon.

### **Attitudes to tax may worsen in the future**

A few stakeholders and IR staff express some pessimism about how the slow rebuild could have an unintended impact on tax compliance, as people and SMEs may become more and more frustrated and disillusioned about the rebuild process and outcome. As time goes on, if people/SMEs do not see any real progress in the rebuild, their enthusiasm may drop. They may feel that tax compliance does not improve their personal, business and/or local situation, therefore they may feel that tax compliance is pointless.

However, a few IR staff also emphasise that some business people are still very much stressed and overwhelmed by their poor business situation. Their attitude to tax compliance may not have changed greatly since the earthquakes, because they continue to struggle. Their personal and/or business worries take priority over tax matters, which is reflected in poor tax compliance. These SMEs may see their tax situation worsen if they do not address their tax compliance issues.

## Section 3. Perceptions of the hidden economy in Canterbury

This section explores stakeholders' and IR staff's perceptions about whether there is now a greater prevalence for hidden economy activity, with particular reference to the re-establishment of a functioning business environment as the rebuild gets underway.

### Mixed perceptions about the Cantabrian hidden economy

There is a sense among stakeholders and IR staff that fundamental beliefs and value systems generally held about tax typically translate to the cash economy. That is, there are some business people who have always taken part in the hidden economy and will likely continue to do so, and those who will always avoid the hidden economy.

Stakeholders and IR staff also perceive that there are differences in the 'intent' of people participating in the hidden economy. Their participation can be either accidental or intentional.

- Those who are 'accidental' contributors inadvertently contribute to the hidden economy without conscious awareness. This may be a result of genuine mistakes, for example miscalculating tax or a lack of knowledge around tax legislation (e.g. definition of contractor vs. employee).
- 'Intentional' contributors, as the name implies, undertake an active and conscious strategy to avoid tax.

There is a general belief that the hidden economy operates, at some level, across a range of industries. The commonly cited sectors include tourism, hospitality, home-based businesses, and 'tradespeople'. However, stakeholders and IR staff generally believe that, for the most part, the level of activity has not changed dramatically pre- versus post-earthquakes.

*"Well in my experience in tourism, it's very prevalent.... They go around and pay cash for everything. No (it hasn't increased post-earthquake), it's been like that for a long time."*  
(Interview 20)

The exception to this is the role of 'tradespeople' and the construction industry involved in the rebuild. Whilst many perceive there to be little change in the 'intent' of

participation in the hidden economy, the sheer potential for opportunity will likely mean an increase in its prevalence.

*"I would say there are more opportunities out there for the cash economy. I am guessing, but if you looked at it you would say there are possibilities in construction, hospitality, you would look at those industries where things are booming and there are opportunities for new players to come in and operate, even at a lower level, but there is still the work available there. I think just the sheer volume... they may have been in another area and they have spotted an opportunity and they will come in, take the cash and disappear again."*  
(Interview 31, IR)

However, stakeholders and IR staff are quick to differentiate between home repairs and the vertical and horizontal rebuild. Most are confident that there will be little opportunity for hidden activity by principal contractors in the horizontal and vertical rebuild. This level of confidence stems from contractual obligations, governance structures and record keeping, which leads to a clear paper trail. There is a belief that hidden economy activity in the home repairs and renovations context is likely to be more intentional.

*"I don't think that will be happening as such, because as I say, EQC want records from Fletchers. For Fletchers to get paid, they have to have records from their contractors. For the contractors to get paid, they have to have invoices from their sub-contractors. So the sub-contractors will be writing out invoices and giving them to the contractor, it will have GST in it and everything else."*  
(Interview 41)

*"I don't see there is any more than what was there was before. Because by and large it's going through... Whether it's Fletchers, through the EQR programme, with EQC, or whether it's insurance companies paying direct..."*

**(Interview 47)**

For any transaction, there needs to be two (or more) parties. Those parties are referenced as 'facilitators' and 'perpetrators' and each have their own motivations for undertaking the activity.

'Perpetrators' are those who provide the goods and services. In this context, they tend to be the tradespeople. Stakeholders and IR staff identify a number of characteristics typically associated with 'perpetrators':

- Smaller SMEs or 'one-man bands' (as opposed to medium or larger businesses). Because their business structure is small and less formal, business owners have greater flexibility around the types of jobs they perform and the ensuing paperwork.
- SMEs that do 'the odd job'. Because the work performed is a one-off, the cost of the work may be small and the cost involved may not follow a set price list.

A few stakeholders and IR staff also identify 'sub-sub-contractors' as potential perpetrators. This makes it easier for them to work 'under the radar'.

*"You have got a principal, then you have got a contractor to the principal and then you have got all your subbies. So, I think when you get to about layer three down, there is quick money to be made and they're only accountable to the one above, they're not accountable to a more structured system. And so I personally believe that it's a lot of money being received that's not going to go through the books."*

**(Interview 36, IR)**

Stakeholders and IR staff identify the other party as those who assist in 'facilitating' the cash economy. Those on the receiving end of goods or services are, in this context, typically homeowners. Primary motivations (or benefits) for 'facilitators' include:

- 'Queue-jumping' or a reduction in lead-times due to increased competition for services. This means 'facilitators' are able to get repairs completed in a shortened timeframe.

- Cost savings, particularly through not paying the GST component. This may be driven by the 'facilitator' receiving lower than expected insurance claim settlement or wishing to maximise the differential between the insurance payout and the actual cost of repairs, in effect profiting from the exercise.

*"It's hard to say... 'Mum and dad' who get a cash insurance payout may be doing it..."*

**(Interview 12)**

However, stakeholders and IR staff perceive a number of potential pitfalls for those who 'facilitate' the cash economy. These include:

- Lack of recourse for faulty or sub-standard work, e.g. no warranties or builder's guarantee.
- Exposure to non-qualified tradespeople, potentially resulting in sub-standard work with limited possibility for recourse.

*"People are wiser, they know that if the work is done for cash, there is less written evidence to help homeowners in case of faulty repairs."*

**(Interview 9)**

*"The other thing that is going to be important in the rebuild, is that people are going to have to be accountable for the work they have done for some time. So you can't have a sneaky little cash job, rebuilding your house and then the roof falls off five years down the track and you want to go for the person that has done the cash job, because they won't be there. Now that's all done through legitimate channels, it has to be. So if you want that sort of guarantee you can't cheat the system."*

**(Interview 46)**

## Participation over time

There is a general sense that in the immediate aftermath of the earthquakes, there was little active intent to profit from the hidden economy. Any perceived 'cash jobs' or bartering/exchange of services were undertaken in the spirit of helping the community.

As the rebuild continues, most acknowledge a greater opportunity exists to undertake hidden economy activities.

*"It's always been big, but now there is so much more ability to get away with it. People illegally working, immigrants, people hidden away and working at night, individuals working under the table because they've lost their job."*

**(Interview 33, IR)**

*“There are a lot more people that are doing cash jobs. To give an example, without naming the company, the guys that fixed my house through EQC and Fletchers, I wanted some remedial work done on the house and the first thing they’re all asking outside of the contract ‘Will you pay cash?’ You talk to my staff and the conversations we’re having are exactly the same conversation – ‘someone came to fix my house and they wanted to know if I’d pay cash.’ ... But it seems to be since the earthquake everyone’s saying to you... it’s the first conversation you have. It’s amazing because I’m the District Commander. They know who I am and they still ask.”*

**(Interview 29)**

However, stakeholders and IR staff believe that despite the creation of a new business environment, safeguards exist to inhibit the hidden economy increasing. Some of the safeguards include:

- Stringent administrative systems:
  - Increased bureaucracy, red tape and paperwork when working on a relatively large project (e.g. more than \$10,000 to 15,000). The administrative processes developed by EQC, CERA, the City Council and insurance companies require approval at different stages in the process.
- Prevalence of electronic transactions:
  - Building projects involving relatively large amounts of money are paid using bank transfers/electronic transactions rather than cash. This severely limits the amount of money that can remain unaccounted for.
  - More and more business and personal payments tend to be made using credit or EFTPOS cards rather than cash, even for small amounts. These transactions create a record of the transaction.
  - Stronger preference for electronic payments by some, due to the ‘inconvenience’ of having to carry and spend cash.
- Potential consequences:
  - Given the extent of new employment and business opportunities, there is a sense that the risk outweighs the benefit – “Why risk it?”
- Impact on the value of the business:
  - Involvement in the cash economy, meaning revenue is under-recorded, has potential to negatively affect the value of a business. This has an even greater importance if the owner has intentions to sell the business.

- Professionalism:
  - Some SMEs are becoming more structured/less casual. They need to access and maintain a good level of professionalism. This is reflected in more formal and stringent systems and processes being in place.
- IR’s knowledge base:
  - Some stakeholders believe that IR has the knowledge and information about the hidden economy, as well as the tools and techniques to decrease it (e.g. ratios that identify anomalies). There is a belief that IR is the best placed organisation to deal with the hidden economy, because it can draw on its experience and actively mine the data available.

## Suggestions to mitigate hidden economy activities

Stakeholders and IR staff suggest a number of strategies and interventions that IR could implement to decrease participation in the hidden economy. These strategies are discussed below.

### Education

IR needs to identify and focus on the industries and types of SMEs at risk of participating in the hidden economy. IR also needs to communicate explicitly and educate business people about the rules and regulations relating to cash transactions. Aspects to cover include what types of activities are considered part of the hidden economy and what needs to be done to operate legally. This information could be made available through a range of channels, including IR’s publications or website. Enhanced education may serve to influence both the accidental, as well as the intentional, participants.

*“IR needs to identify risk areas (e.g. trades), go to industry groups to talk with them about the risks, create profiles of those likely to deal in cash, and communicate/educate business people about the cash economy.”*

**(Interview 18)**

## Emotive appeal

A possible strategy is to appeal to people's 'moral compass'. Communicate the choices available, along with the consequences for each course of action. This would empower people to think about alternatives and make an ethical decision with a good understanding of the implications. In line with this, could be a strategy around overall 'fairness'. Social marketing may help showcase what an 'ethical' decision looks like, for example, by telling Cantabrians about what their tax money is used for (e.g. rebuilding roads and providing services to the community).

*"I think the critical issue is that Christchurch people need to understand, that if people are going to cheat the system, and if you're going to support people cheating the system, in the end you pay. Inland Revenue told me, that if everyone in New Zealand paid their taxes legitimately we would have a 15% top tax rate and we would still collect the same amount of tax we are collecting now. That's the sort of carrot we have to put out in front of the population of New Zealand to say 'behave yourselves, don't pay \$500 cash to get your chimney knocked down, make sure you get a tax invoice and do it properly'. And it has to be on the basis of, 'this is unfair to the rest of New Zealand', not 'this is money that Inland Revenue is missing'. It has to be on the basis that we are doing this on behalf of the country. There is a perception that it's just greedy Inland Revenue picking off on the small little guys that have just cheated a little bit. It's not fair on the rest of us."*

(Interview 46)

*"There seems to be an attitude that tax is just to pay the Government... The whole of our culture needs to be aware that it is what pays for our health, pays for our roads, etc. And, helps fund our rebuild. So, there needs to be some sort of awareness. I don't know how you build awareness in that area. Another thing that could help is if you quantify. So, get examples out there of this person didn't pay tax on this. If so many people did that it would mean we couldn't have so many eye operations. Bring it down to something people can understand."*

(Interview 48)

## Consequences

Many stakeholders and IR staff believe that IR needs to explicitly communicate the potential personal and legal consequences of involvement in the hidden economy, to businesses and homeowners.

*"Inland Revenue is not doing enough, that is, not using publicity enough. Inland Revenue needs to conduct 'two-pronged' education campaigns on the implications of cash dealings: those paying cash and those accepting it."*

(Interview 14)

Similarly, 'making an example' of those who have taken part in the hidden economy. That is, IR needs to investigate and prosecute those who undertake cash economy activity with the intent of avoiding tax/minimising income reporting.

*"IR needs to target its investigations and conduct targeted audits. IR has the means to identify what doesn't look right and needs to take action. A hotline for tax evasion is not going to work, as people do not see it as harmful or a real problem."*

(Interview 4)

*"IR needs to be more visible and also increase its levels of policing, auditing, making an example of people breaking the rules. IR needs to advertise its actions more to make people aware."*

(Interview 11)

## Process and systems upgrade

Some stakeholders express a need for IR internal systems and processes to be updated to enhance its proactivity and responsiveness to SMEs at risk of dealing in cash.

In addition, the process needs to be streamlined with a reduced time lag between flagging the problem and contacting the SME. It is also suggested that to make IR more effective at identifying cash dealings, more IR teams need to be on the ground, more regularly, to visit SMEs in order to educate and audit them.

*"IR needs to know more about their industry [SMEs targeted for review and/or audit] to see if there's truth in the books or lies, anomalies. IR needs to do more audits. The investigation team needs to collaborate with the debt team."*

(Interview 38, IR)

*"Inland Revenue needs to act faster... Currently Inland Revenue acts too late. It's the same with tax debt. Inland Revenue lets it balloon out of proportion, before talking with SMEs about it. Inland Revenue needs to change its systems to make them more responsive."*

(Interview 18)

## Licence to trade

There is also suggestion that greater and tighter business regulations across trades will help address the issue of cash dealings. Licencing all tradespeople (across all trades) would help identify the genuine tradespeople from the 'cowboys', and greater record keeping would help minimise cash dealings.

*"It's something that I have always thought was desperately missing in New Zealand business, especially in the SMEs area, is a licensed trade. Through Europe there is no question, if you want to trade you have to have a licence and if a policeman turns up on your worksite and you haven't got a licence, that's it. You won't stop the complete cowboys that are operating completely under the radar, but there is a different target in that. It would mean that you could target education at those people, so to get their licence they would need to do some basic education on what their obligations are to their own industry and to the tax department. That would place an obligation on them to do it. They would be known, because a lot of people are trading out there that Inland Revenue know nothing about. They just don't exist. And you could target resources to that education."*

**(Interview 40)**



## Section 4. Impact of the earthquakes on SME tax compliance

This section discusses stakeholders' and IR staff's perceptions about SMEs' tax compliance behaviour since the earthquakes and how the rebuild is affecting tax matters.

### SMEs' varied ability to meet tax obligations

There is general agreement amongst stakeholders and IR staff that the ability of SMEs to file returns and pay tax over the past two years has varied. Some SMEs sustained little impact as a result of the earthquakes and were able to meet their tax obligations fully. However, other SMEs could only partially meet their obligations, and some not at all.

SMEs' ability to meet their tax obligations following an adverse event is influenced by the stage of recovery they are at. Those SMEs that are Not trading, Surviving or Stagnating will find tax compliance difficult. Whereas tax compliance should be more achievable for those SMEs that are Recovering, Booming or Recovered/Stabilised. SMEs' ability to meet their tax obligations at each stage is discussed in more detail below.

#### Not trading

Stakeholders and IR staff believe that SMEs that are not trading immediately after an adverse event experience difficulty in meeting their tax obligations because of the following factors:

- While they are not trading, SMEs do not have an income, yet they still need to pay their bills and overheads. Tax payments are often not a priority relative to these other financial obligations.
- Even before the earthquakes some SMEs had tax debt. Now that they are not trading, it is even more difficult for them to return to tax compliance.

The longer SMEs stay in the Not trading stage, the more financial strain they are put under and risk permanent closure if they cannot resume trading. SMEs in this stage find it difficult to pay GST and PAYE and may have to use sources of support unrelated to the business (e.g. personal savings or the wage subsidy). Provisional and terminal tax payments are also likely to be affected and

business owners are unlikely to pay those in full and on time without support (e.g. payment plan with IR).

SMEs that have accumulated tax debt prior to the earthquakes and are not trading today are unable to repay their tax debt. IR may not be able to recover this debt, if these SMEs do not resume trading soon.

#### Surviving

Many SMEs in the Surviving stage also face difficulty in meeting their tax obligations in full and on time, despite having partially resumed business. They are likely to struggle to be tax compliant because of the following factors:

- The lack of regular income means that these SMEs prioritise their outgoings, and staff wages tend to take priority over invoices and tax.
- If they have not made provisions for GST and PAYE payments, they are likely to find it difficult to meet their obligations.
- Provisional and terminal tax payments are also difficult to meet the longer SMEs stay in the Surviving stage.

However, a few SMEs in the Surviving stage are better able to meet their tax obligations. This occurs when the SMEs':

- Business finances prior to the earthquakes were sound (e.g. no or limited tax debt, regular income, outgoings in control).
- Personal finances can be used to supplement business shortfalls (e.g. personal savings used to pay wages, bills and tax).
- Access to financial support and assistance is available (e.g. wage subsidy and bank overdrafts).

These SMEs are likely to be able to meet their tax obligations, if they make payment arrangements with IR.

## Stagnating

Stakeholders and IR staff believe that SMEs in the Stagnating stage face similar difficulties in being tax compliant to those in the Surviving stage. Their irregular income impacts on their business cashflow and their ability to pay tax in full and on time. However, Stagnating SMEs should be able to file their returns on time.

Stagnating SMEs are unlikely to be able to regularly meet their tax obligations unless they organise a payment plan with IR or if their financial situation changes (i.e. they move to the Recovering or Booming stage). Compliant behaviour will be even less likely if these SMEs have accumulated tax debt or their business interruption insurance pay out (which they have been using as business income) has come to an end.

## Recovering

SMEs in the Recovering stage are gradually re-establishing their business (e.g. appropriate systems and processes in place, increased client base). Their income stream is steadier than in the previous stages.

Generally, these SMEs are in a more stable financial situation, which enables them to more regularly meet their filing and paying tax obligations. For recovering SMEs:

- GST and PAYE payments can be made regularly. To meet their obligations, some SMEs may need to organise a payment plan.
- Provisional and terminal tax payments may also need to be met via an agreed payment plan with IR.
- They are generally in a better position to manage their cashflow (e.g. retain funds for tax purposes).
- Those with tax debt are more likely to be able to repay their debt, albeit through a payment plan with IR.

Recovering SMEs show limited risk to IR's revenue collection, as these SMEs have good systems and processes in place to manage and grow the business. They can meet their tax payments, including potential tax debt repayments.

## Booming

Stakeholders and IR staff believe that SMEs in the Booming stage are able to meet their tax obligations (i.e. filing returns and paying tax on time). These SMEs should also be able to pay off any tax debt. This is because of their rapid business growth and level of income.

However, some Booming SMEs face a new set of issues that may impact on their ability to meet their tax obligations and repay their tax debt. These include:

- Some business owners may feel overwhelmed with the new administrative requirements of their business and neglect their tax obligations.
- With an increased workload comes the need to upgrade or invest in capital expenditure, such as equipment that will be fit for work – investing in the business may mean that there are insufficient funds for tax purposes.
- Some projects in the building industry may be underway or completed, yet payment to the SME is slow and business owners are unable to pay tax on time.
- A higher business turnover means the SME will owe more provisional tax. Business owners need to be aware of this and make provisions to pay this increased amount.

IR faces the risk that these business people may not meet their tax obligations in full and on time, although financially they can. Lack of compliance is due to tax matters losing priority against growing the business. These SMEs are in a financial position to address their tax debt, yet they may choose not to do so in order to focus on business growth.

*“You’re getting a lot of growth, so the other thing that we have seen is that a lot of the small enterprises that are in the right sector have actually gone from businesses that might have been 10 people to now being 30 people. That always brings risk of just cashflow. I’m not hearing specifically that they’re having any issues, but it is something that you do become aware of. We’re concerned about generally, whether they’re able to pay their bills, if they grow too fast. Typically they’re not so bad at paying the day-to-day bills, but they tend to forget they’ve got a big income tax bill at the end of the year, because they’ve grown so fast.”*  
(Interview 4)

*The biggest thing with growth is, if it stops instantly [it] could destroy a business. It’s like gearing up: do I spend another hundred thousand [dollars] on plant equipment with anticipated growth, or do I [not]? My outgoings are quite large per week, wages and materials. [I’m] not used to that and that was only caused by growth. The income at the moment is supporting that.”*  
(Interview 3)

Business owners in this stage need to become more familiar with and knowledgeable about their new tax requirements in order to be able to meet their obligations. Despite an apparently positive financial situation, the key to their sustained recovery is to look further than their current growth situation and plan for the future (i.e. put business and tax strategies in place to address the end of the Booming stage). If business owners do not recognise that the 'bubble will burst' and growth will become much slower in future, they run the risk of slipping back to the Surviving stage. This could result in having to let staff go, an inability to pay GST/PAYE, and increasing tax debt due to an inability to pay provisional/terminal tax.

A few stakeholders mention that Booming SMEs are less likely to take part in hidden economy activities. Given the large sums of money they handle, their finances need to be 'above board'. Business people understand cash dealings could cost their business (e.g. fines and reputation).

### **Recovered/Stabilised**

Stakeholders and IR staff expect SMEs in this stage to be able to effectively meet their tax obligations. Recovered/Stabilised SMEs have regular income streams and relatively predictable outgoings. Their business situation is now stable (e.g. regular customers, familiar internal processes and practices), therefore business owners are in a better financial position to address their tax obligations (e.g. tax debt and upcoming payments).

Some business owners may be currently following a payment plan agreed with IR. This could be as a result of the business being in a previous stage and needing IR's assistance to meet its tax obligations.

Recovered/Stabilised SMEs are similar to Recovering SMEs in that they are able to meet their tax obligations and address potential tax debt.

## **Impacts of the rebuild on tax matters**

Two key issues linked to the rebuild affect SMEs' ability to meet their tax obligations.

### **Insurance issues**

Many SMEs are still dealing with their insurance company to sort out claims and payouts on property and/or content. These business people spend time, effort and money on issues unrelated to growing their business. These distractions have a negative impact on these business people's ability to re-establish their business and earn a regular income. In turn, this

decreases their ability to meet their tax obligations in full and on time.

Some SMEs were not well insured when the earthquakes occurred, which has made their financial position and ability to resume trading worse. These SMEs are likely to incur tax debt and fall behind their tax payments, unless they have managed to re-establish their business successfully.

Some SMEs that were adequately insured are now running out of their two-year business interruption insurance, which may make it difficult to pay their tax. If they have not been able to re-establish a strong business, their situation may regress to a survival scenario where they struggle to earn an income.

### **Protracted and multi-partied decision-making process**

Stakeholders and IR staff believe land use and property decision-making processes are too slow. This impedes SMEs' ability to relocate and make long-term forecasts. SMEs have to make the best of their potentially inadequate situation (e.g. trading from home) until decisions are confirmed. For example, if SMEs know that their business premises will be repaired and not demolished, they can stop looking at relocating and focus on strengthening their local client base.

In addition, SMEs have to deal with a variety of organisations that have stakes in the rebuild (e.g. CERA, insurance companies, City Council). This makes the decision-making process more complex for business people who have to learn who to deal with and in what circumstances. This adds to the administrative pressures business people are under, which distracts them from focusing on their business.

As a result, business people are likely to see tax matters as another complex administrative task, which they may deprioritise.

## Section 5. Inland Revenue's presence

This section discusses IR's support for SMEs and the conditions under which this support was delivered to SMEs. It then discusses stakeholders' and IR staff's suggested support measures to help SMEs recover

### Significant support for SMEs immediately after the earthquakes

IR staff recall IR's support for SMEs since the earthquakes occurred. However, it is more difficult for stakeholders to remember what measures IR took. In some cases, they do not distinguish between IR's interventions and the Government's. For example, for some stakeholders, the wage subsidy was IR's measure, whereas for others the Government implemented it.

IR staff and stakeholders mention the following measures from IR. They believe these have helped SMEs (and also their own business) cope with their disrupted finances:

- IR also authorised time extensions for filing returns and paying tax.
- Penalties for late tax payments were waived in some cases.
- Some regulatory changes to depreciation helped property owners address the cost issue of rebuilding and then selling a new building.

They recall that IR publicised its assistance through different channels to reach as many Cantabrians and businesses as possible (e.g. newspapers, radio, local TV, flyers, billboards).

These stakeholders have positive impressions of IR's actions during this period. And, as a consequence, they see IR as an approachable, friendly, available and flexible organisation, ready to discuss options with businesses. They believe that IR provided helpful, tailored assistance to SMEs. This has lifted IR's reputation and profile in the community.

*"I think IRD were very responsive originally when the earthquake hit, accepting people filing late, payments being late etc. So, their response*

*originally was very good. I think most businesses appreciated that. They were stressed about other things... And I mean, obviously, it had an impact on cashflow for the government, but it was done well [IR's help to SMEs]."*

**(Interview 4)**

Some stakeholders are aware the Government, including IR, assisted SMEs after the earthquakes, but they are unaware of IR's specific assistance packages for SMEs.

Stakeholders believe that IR reacted promptly and well to the earthquakes, regardless of stakeholders' awareness of IR's interventions. They believe that, as a consequence, IR's reputation has become more positive and the organisation is seen as more approachable.

### IR's delivery of services post-earthquakes

This section explains that IR has been affected by the earthquakes and has had to adapt its service delivery practices. Today, stakeholders and IR staff believe that IR needs to tighten its practices.

#### A new service delivery model for IR

Some stakeholders and IR staff believe that IR did particularly well when assisting SMEs, given that its premises were closed down after the earthquakes. This made coordination and logistics of SME support all the more challenging. The speed of IR's reaction and its willingness to help have been beneficial to SMEs' recovery.

Sharing office space and working collaboratively with other organisations has been useful for IR in delivering its assistance to SMEs. The learnings and sharing of information internally and across organisations (with respect to privacy and confidentiality) have meant that IR can work more effectively. Stakeholders and IR staff want IR to keep working in collaboration with other

government agencies and not-for-profit organisations as partners. They believe that a partnership approach is more effective to ensure all parties are aware of and know their obligations and responsibilities.

IR's approach to helping SMEs has changed as an unintended consequence of the earthquakes. It has combined the knowledge of basic financial information about the business (e.g. amount of tax debt, profit, expenses) with a wider understanding of the SME's situation (e.g. level of impact of the earthquakes on the business). IR has also allowed time for the SME to 'get back on track'. This has enabled IR to develop more realistic payment arrangements with SMEs and have a greater understanding of their business.

### Going back to business as usual today

Stakeholders and IR staff believe that "the timing is right" for IR to return to BAU, because today most SMEs should be able to address their tax obligations – at the very least, they should be able to file their returns on time. IR needs to be both strict and consistent when educating, investigating, following up, auditing and prosecuting SMEs. Some stakeholders want IR to make an example of non-compliant SMEs to ensure that all businesses now understand they need to reprioritise tax matters and become more compliant.

Stakeholders and IR staff explain that the longer IR takes to return to BAU, the more SMEs may be tempted to keep deprioritising tax. As a result, IR may be perceived as not enforcing tax compliance.

Whilst all stakeholders and IR staff expressed a view that tax obligations must be met and the legislation upheld, there is also a need for flexibility. A consistent outtake is the belief that IR needs to evaluate SMEs on an individual, case-by-case basis, and be consistent. For example, some SMEs have benefited from a tax debt write-off, but this has not been consistently applied to all businesses in similar situations. IR can use its discretion and implement a recommended course of action.

*"If they are non-compliant taxpayers, we need to establish whether it's something in their nature that's peculiar to them. I mean, I am talking about taxpayers that were compliant before and they aren't compliant now. I think taxpayers who weren't compliant before, well we are not going to treat them any differently. They are never going to change. So the ones that were compliant before and are not compliant now, why? We need to find out why. And it may be that it just got too much for them, they have got a huge debt, they just can't cope, maybe they shouldn't be trading anymore. But we don't*

*know. And it's too late to talk to them when they have gone into liquidation or bankrupt."*  
(Interview 40)

When SMEs leave the Surviving stage (i.e. move to Recovering, Stagnating or Booming), stakeholders and IR staff believe that tax obligations need to become SMEs' priority again, even though some SMEs may still face difficulties paying tax in full and on time. Stakeholders and IR staff explain that the longer SMEs stay out of tune with their tax obligations, the easier it is for them to keep deprioritising tax and potentially making their tax situation go from bad to worse. SMEs need to apply good business practice as soon as possible, even if it means entering into a payment plan. IR needs to use its discretion and flexibility (e.g. individual assessment of SMEs) to agree on payment arrangements, especially when SMEs move to the next recovery stage and have an increased cashflow.

*"The most serious consequence was that some people got out of the habit of paying tax because Inland Revenue were being very flexible... And I know that Inland Revenue are struggling to get some people, including some tax advisors, back on the same page in terms of 'OK we are now back to business as normal'."*  
(Interview 46)

A few stakeholders believe that the rest of the country has moved on from the earthquakes and does not understand that Canterbury is still in recovery mode. They explain that IR call centres and employees outside of Canterbury do not relate to or understand what Cantabrian SMEs are still going through and are not always aware of the special measures/packages that are in place for Cantabrian SMEs.

*"There is the sense from outside of Canterbury, or outside of Christchurch, that actually things are back to normal. And really we are right at the beginning part of the rebuild and [in] the last two years [there] has been a lot of dealing and grappling with issues and a lot of planning. Now some businesses, they've got back on their feet very quickly, but the rubber is still to hit the road for many... I think depending which sector you are dealing with, I think there is the strong sense that those in Wellington have limited or very little understanding."*  
(Interview 43)

Stakeholders and IR staff believe that SMEs would like to interact with IR employees based in Canterbury. Very few stakeholders are aware that today IR has Christchurch-based employees dedicated to helping local SMEs.

IR staff, who are aware of its localised support, believe it has been an effective way to support those SMEs that are struggling.

*“We have debt teams all over New Zealand. If, say, someone in our Takapuna team was talking to a Christchurch customer and through their communications found this person has been affected, then, and [if] we thought that [having] localised management was a good idea to meet the customer’s needs, we would transfer that case down to Christchurch, and we still do that even today. We actually have three full-time Collection Officers in Christchurch... who actually are dedicated to [assisting local SMEs]. We call it EQC type work, it’s not EQC. It’s just earthquake related, but anyway, it’s earthquake related work. So, where we have customers, small enterprises or individuals who have been materially affected and we believe that [they] need that one, that more localised attention, in a good way, we transfer it here... I can’t see that work stopping for quite some time. They [Collection Officers] have got full caseloads, the three of them.”*

**(Interview 35, IR)**

## Reflections for policy after destructive earthquakes

Policy measures **immediately after the earthquakes** need to focus on tax and financial relief for SMEs. This will ensure that SMEs retain their employees, relocate and re-establish their business (e.g. buying new computers).

During the **first year** after a large-scale adverse event, the focus needs to be on helping SMEs reprioritise tax matters. This will ensure that SMEs re-establish good business practice and are in a better position to remain in business.

Policy measures during the **second year** after a large-scale adverse event need to reflect BAU. However, measures need to show flexibility for those SMEs still struggling.

## Measures and suggestions for each recovery stage

The 2012 research with SMEs and tax agents provided recommendations for more effective support for SMEs to assist with their recovery from an adverse event. Stakeholders and IR staff discussed these recommendations and complemented them with new feedback in this phase of the research.

Colmar Brunton and IR’s project research team identified key themes to help IR’s approach to finding solutions and provided these to IR’s Advisory Group for further development. These will be reported in year three of the research project.

## Appendix. Contractors' views of their industry post the earthquakes

This section presents themes that emerged from discussions with building and construction contractors in Christchurch in relation to their business experiences following the Canterbury earthquakes. The views of the participating contractors will augment and add depth to the information that is being collected for the longitudinal study.

### Background

In early 2013, the Southern Regional Manager for the New Zealand Contractors' Federation was made aware, by Inland Revenue researchers, of the longitudinal research which they were undertaking on the impact of adverse events on tax compliance behaviour. This led to an offer by the Regional Manager to shoulder-tap members of the Federation to provide Inland Revenue with their experiences of working in Christchurch following the earthquakes.

### Method

Face-to-face discussions were held with seven contractors between 4 and 10 April 2013. The discussions were an in-depth exploration, from their industry's perspective, of the realities of working in Christchurch post the earthquakes.

### Participant characteristics

The companies range in size from less than 25 employees to over 200 employees, most have between 30 and 100 employees. All have been in business for over 20 years and some are split into a number of companies. Some are family firms. Most of the companies are sub-contracting to one or more of the SCIRT<sup>6</sup> team.

None of the participating companies had sought help from Inland Revenue or any other agency for problems arising from the quakes.

### Immediately post-quake

Four of the companies closest to Christchurch were involved in the clean-up straight after the February earthquake. They conveyed a sense of the enormous energy and excitement of 'getting out there and doing something'. The first thought was to look after their staff and do what they could for those whose houses

were damaged or uninhabitable. Two participants related with enormous pride how the majority of their staff, even those whose own houses were wrecked, turned up the next morning to work on the clean-up. Some were in town on the evening of February 22<sup>nd</sup> with diggers and water-carts and connecting up people's water at 10 o'clock at night. One said that although there was "*some order to it, a lot was done on the fly, no contracts.*"<sup>7</sup>

### Key themes

#### Themes

The key themes emerging from the interviews (in order of number of mentions) were:

- Cashflow
- Staff
- Compliance costs
- Contracting agencies
- Growth of business
- Retentions.

#### Cashflow

Cashflow is the number one issue for the smaller companies, some of whom struggled to survive the two years of recession and have only recently stabilised. For these companies, the "*earthquake revitalised our business*"<sup>8</sup> and enabled them to recover from the recession. The week before the 2011 earthquake, one company had discussed closing down.

For the two largest companies cashflow doesn't appear to be an issue, but it is apparent that they keep a careful eye on their finances. The main factors contributing to cashflow problems are seen to be:

1. The seasonality of their industry and the delays in SCIRT work being released, "*the flow of cash, business, is pretty hard to predict sometimes.*"<sup>9</sup>
2. Provisional tax, particularly given the growth in income since the earthquakes, "*our industry is so volatile*"<sup>10</sup> that it is always hard to calculate Provisional tax.

<sup>7</sup> 'Omega' Contracting.

<sup>8</sup> 'Omicron' Contracting.

<sup>9</sup> 'Kappa' Construction.

<sup>10</sup> 'Gamma' Groundworks.

<sup>6</sup> Stronger Christchurch infrastructure Rebuild Team

Timing of payments, for example, for invoices over \$100,000, Fulton Hogan pay on the last day of the month and sometimes there is a delay in turning this around. Suppliers are paid on the 20<sup>th</sup> of the month, so *“you carry the costs of your materials for that time ...”* This gap is worse when *“you’re involved with players that trade on 60 day terms, even though they’ve signed up to 30 days”*. In addition, there are wages and PAYE. Christmas is hard as most contractors shut down for several weeks so there is a big holiday pay. Additionally, GST is due 28 November, Provisional tax and GST 15 January and 28 February.

One company, however, considers that if people have *“cashflow problems, they’ve probably mismanaged themselves.”*<sup>11</sup> There is a perception that the small companies and ‘one-man-bands’ will be those struggling most. It is thought that many, particularly ‘start-ups’, will have spent money on equipment and Utes, not realising that they should set aside money for Provisional tax.

### Shortage of skilled staff

Recruiting suitable staff is a problem. The issues are not, however, limited to Christchurch.

The over-riding issue is the lack of quality skilled staff, particularly those who can supervise and train, *“they’re the kingmakers at the moment”*.<sup>12</sup> At the lower levels, people with transferable skills are needed. There are workers who claim to have more experience and skills than they actually have; one example is a drain-layer who laid a whole pipeline backwards. Some participants cited the lack of training, doing away with the apprenticeship scheme and poor quality of the Industry Training Organisations’ (ITO) courses as key causes. One company had worked with the Ministry of Business Innovation and Employment in giving their benefit people employment, but *“That hasn’t been a great experience”*.<sup>13</sup> The drift to the mining industry in Australia was identified by others as a cause of the shortage of skilled labour.

Coupled with the lack of skills is employees’ lack of work ethic, *“it’s really, really, woeful.”*<sup>14</sup> Several participants mentioned that people often start one week but do not turn up on the following Monday, in one case retaining \$800 of the company’s branded gear.

Other contractors coming to Christchurch after the earthquakes had significantly increased the demand for experienced staff. This in turn pushed the rates up, particularly for digger drivers. In addition to the increase in rates, the demand for ‘perks’ rose, for

example, vehicles, mobile phones. Some contractors were flying their workers back to the North Island every second weekend.

The companies in this study have largely resisted paying the top rates and fringe benefits, though their top people are likely to be on around \$100,000 plus a vehicle and phone. All, however, appear to put time and effort into training, looking after their people and building up the work culture. One participant said *“...you can pay the top dollar, but if your culture isn’t around that, it won’t work.”*<sup>15</sup>

The employment scene is now said to be fairly stable, as are the payment rates. One company attributed this to the availability of immigrant workers, Irish, English, Czech Republic, Philippines.

### Compliance costs

Most companies said that compliance costs (health and safety, drug testing) have increased considerably since the earthquakes. They were increasing before, but have escalated since the earthquakes. The paperwork associated with compliance is felt to be burdensome. While recognising the importance of health and safety, the majority of the participants consider it is overly bureaucratic, *“The compliance requirements in the SCIRT model are out of control and really affecting productivity, it’s just got ridiculous.”*<sup>16</sup> The requirement to wear long-sleeved shirts attracted the most negative comments.

Most of the companies see bureaucracy making it more difficult to do even simple things, like getting a temporary power supply to a work site. The SCIRT companies require sub-contractors to put their staff through site safety courses every two years. Each course costs \$300. One participant said that their on-the-job training *“doesn’t mean anything.”*<sup>17</sup> Another participant said that training costs for their company were about \$8,000 a year, covering a multiplicity of courses from gas detection, STMS (traffic cone placement) to training for grade 4 and 5 licences to operate heavy machinery and trucks.

Concern was expressed by one participant that the requirements operate against the one-man-bands who are good operators and operate safely, but would have to employ someone to do the paperwork *“it’s very expensive, dilutes (the profits) by 20-25% straight away. It’s neither sensible nor easy. The ones who do well out of it are the five delivery teams.”*<sup>18</sup>

<sup>11</sup> ‘Omega’ Contracting.

<sup>12</sup> ‘Omicron’ Contracting.

<sup>13</sup> ‘Kappa’ Construction.

<sup>14</sup> ‘Sigma’ Contractors.

<sup>15</sup> ‘Sigma’ Contractors.

<sup>16</sup> ‘Omicron’ Contracting.

<sup>17</sup> ‘Gamma’ Groundworks.

<sup>18</sup> ‘Omicron’ Contracting.



Although recognising the toughness of the regulations and associated paperwork, one of the larger participants considers that the regulations are positive, *“good to have ... there’s consistency ... the quality of the regulations is better ... it’s lifted everybody’s game.”*<sup>19</sup>

### Key agencies in the Christchurch rebuild

CERA<sup>20</sup> is the body designing and planning the Christchurch rebuild and SCIRT is the main contracting body for the rebuild. SCIRT comprises five delivery teams, Fulton Hogan, McConnell Dowell, Downers, City Care and Fletcher. An issue for some participants is that *“... the work is owned by so few. Definitely an oligarchy. One stated it is unfair that the “little guy at the bottom is reliant on so few”<sup>21</sup>, and “... most (work) seems to be done by the five big companies.”<sup>22</sup>* A number of the companies in this study held negative views of the SCIRT delivery teams. The two main issues were the uneven (and unpredictable) flow of work and rates of pay.

**Uneven flow of work:** Sub-contractors can be held up until the work has been divided between the five SCIRT members. Others struggle with cashflow *“when SCIRT work fails to materialise as promised.”<sup>23</sup>* This was particularly so in the early days after the emergency.

**Rates of pay:** When SCIRT was first set up, their rates were considered too low to make a profit. Some companies turned to the private sector, mainly sub-division work. In some cases these comments may relate to the period prior to the establishment of SCIRT. Conversely, a number were positive about SCIRT. One participant saying that *“I think that the SCIRT model is the only way Christchurch is going to be built affordably and timely.”<sup>24</sup>* Several companies are also happy with the way SCIRT is working. One participant considers that the circulation of money is better; *“There’s more profit in construction, SCIRT introducing money into Christchurch makes it flow round quicker”<sup>25</sup>.* This participant also felt that working for SCIRT and the Council meant there was more surety about being paid. Another participant said (SCIRT has) *“really good systems in place, systems are working. ... The pricing is more realistic now.”<sup>26</sup>*

**Delays in payments:** A few participants had experienced delays in receiving payments from SCIRT and one reported that he knew a contractor who was unable to pay his supplier’s bills because SCIRT hadn’t paid a retention they owed him.

CERA also attracted criticism from one participant, who gave as an example, *“CERA get \$28,000, the sub-contractor who demolishes the house gets \$8,000 and pays for the plant, labour and dumping fees.”<sup>27</sup>* (The last are very expensive). Another criticism of CERA is that they have a compulsory drug test for all workers going on-site. If one worker tests positive, the whole company is put off-site. This participant’s company is ISO certified and about to get tertiary accreditation with ACC, *“... it makes all our hard work for nothing.”<sup>28</sup>*

EQC is considered *“an anachronism”* by one participant, who said that *“it’s caused more stumbling blocks than anything.”<sup>29</sup>* This company had also experienced considerable delays in being paid by EQC. Another participant considered that *“EQC got it pretty right.”<sup>30</sup>*

ECan<sup>31</sup> was thought to have got better, *“more practical”<sup>32</sup>* since the government replaced the Board with Commissioners.

### Business growth

All the companies had experienced growth, for some it was huge, *“the company just bounced”*; *“growing right from day one”<sup>33</sup>*, for others it was more modest *“the earthquake revitalised our business”<sup>34</sup>*, probably because they had been seriously struggling in the recession immediately prior to the quakes. For these companies, it has taken them longer to reach the point where they consider themselves stable. In some cases the growth is more in productivity than in staff numbers, but for most, staff numbers have increased considerably, doubling for some. Some companies have upgraded or purchased machinery to meet work demands. All companies are aware of the risks and costs of such growth, in particular for their cash flow.

Two companies commented on their increased efficiency *“The efficiency of the personnel and machines has gone up considerably”<sup>35</sup>*, but neither could explain how this had occurred.

### Retentions

Just three of the companies had major issues with retentions, for the others it was just the way their industry operates. Two had lost money in the Mainzeal collapse, one *“only \$26,000”<sup>36</sup>* the other *“only*

<sup>19</sup> ‘Omega’ Contracting.

<sup>20</sup> Canterbury Earthquake Recovery Authority

<sup>21</sup> ‘Alpha’ Contracting Company.

<sup>22</sup> ‘Gamma’ Groundworks.

<sup>23</sup> ‘Gamma’ Groundworks.

<sup>24</sup> ‘Kappa’ Construction.

<sup>25</sup> ‘Beta’ Contractors.

<sup>26</sup> ‘Sigma’ Contractors.

<sup>27</sup> ‘Alpha’ Contracting Company.

<sup>28</sup> ‘Beta’ Contractors.

<sup>29</sup> ‘Beta’ Contractors.

<sup>30</sup> ‘Kappa’ Construction.

<sup>31</sup> Environment Canterbury

<sup>32</sup> ‘Gamma’ Groundworks.

<sup>33</sup> ‘Alpha’ Contracting Company.

<sup>34</sup> ‘Omicron’ Contracting.

<sup>35</sup> ‘Beta’ Contractors.

<sup>36</sup> ‘Beta’ Contractors.

\$20,000"<sup>37</sup>. It is thought that there are lots of smaller people affected. One considered that *"It's (retentions) an archaic system based on English law with case history built up over the centuries."*<sup>38</sup> And, *"We have to operate on two thirds of the money due"*<sup>39</sup>. Retentions mean that sub-contractors will always be vulnerable to the owner, but it's nothing new.

### Attitudes to tax compliance

For the companies participating in this study, paying tax is a fact of life. One of the participants (a tax agent) said *"None of my clients have an issue with paying tax ..."*<sup>40</sup> Some said that paying tax, especially Provisional, was sometimes a struggle. One company was behind and paying interest because one of their suppliers was slow in paying. He thinks a lot of people just don't have the money to pay, not that they are unwilling to pay.

The other tax agent participant thought that most businesses would pay their tax if they had the money. He believes that *"it's getting the (young guys) into that mind-set"*, filing more regularly, *"not just sitting on their tools."*<sup>41</sup>

Some thought that compliance was a problem for the smaller contractors, particularly the 'start-ups', who have seen big growth and haven't thought how they'll manage their tax bill *"they buy a digger but forget to do the bookkeeping."*<sup>42</sup>

### Cash economy<sup>43</sup>

Few had any knowledge of the cash economy, their contracts are large and subject to strict accountability *"There could be some smaller ones ... There must be some ..."*<sup>44</sup> Others thought that it was *"less apparent now"* and, *"it shouldn't exist"*<sup>45</sup>. The low rates and the amount of paperwork were suggested causes.

All those commenting think that any cash economy will be in the small, one-man-bands, back-of-a-ute operators. Three reported hearing of instances of cash jobs, supporting the view that the cash economy may be confined to smaller operators.

1. A *"young guy"* asked me if I would be interested in *"coming in with an excavator to do driveways - ... "it's for a lot of cash"*

2. Painters *"...who quote for three days and if the boys go under that they're painting somewhere else on the third day for cash"*<sup>46</sup>
3. *"I got a concrete placer from the North Island who was going out of business because another firm in the same area had let 60 staff go. They were all running around pricing jobs for cash and my guy couldn't compete."*<sup>47</sup>

One of the tax agent participants considered that *"The cash society is a major issue in Christchurch, it's across the board ..."* He is not aware of the extent or impact, but it *"pisses me off"*.<sup>48</sup>

### The future

All are quite clear that they do not expect their business to continue as it is now and predict that the demand for their work will diminish. Some have plans in place, while others are considering what they will be doing.

1. *"(We) don't have purchase agreements for longer than three years. I believe the work will still be there in ten years or more. ... We're looking at succession planning"*<sup>49</sup>
2. *"We're comfortable ... (where) we are and plan to pay off our bank loan ... within the next five years. If it gets tough, we've negotiated a bail-out option with the bank ..."*<sup>50</sup>
3. *"We've a few big projects ... we've only got another year's work and can't see anything coming up. ... If SCIRT hasn't changed, ... after the sub-divisions are done, we'll be looking to sell up ..."*<sup>51</sup>
4. *"We're starting to talk about succession planning. Everyone talks about the rebuild taking five, twenty years. ... The sub-divisions have twelve months, I'd say"*<sup>52</sup>.
5. *"It's stable in the medium term (5 -6 years), but ... long term (6 -7 years) for our sector is pretty bad. We're optimistic we'll get a chunk of (the Ports of Lyttleton) work ...", but "... (Our) city (will be) almost new, so the renewal programme will be zilch and maintenance pretty low."*<sup>53</sup>

<sup>37</sup> 'Kappa' Construction.

<sup>38</sup> 'Beta' Contractors.

<sup>39</sup> 'Beta' Contractors.

<sup>40</sup> 'Omega' Contracting.

<sup>41</sup> 'Alpha' contracting Company.

<sup>42</sup> 'Beta' Contractors.

<sup>43</sup> Participants were not familiar with 'hidden'.

<sup>44</sup> 'Beta' Contractors.

<sup>45</sup> 'Gamma' Groundworks.

<sup>46</sup> 'Omicron' Contracting.

<sup>47</sup> 'Gamma' Groundworks.

<sup>48</sup> 'Alpha' Contracting Company.

<sup>49</sup> 'Alpha' Contracting Company.

<sup>50</sup> 'Beta' Contractors.

<sup>51</sup> 'Gamma' Groundworks.

<sup>52</sup> 'Omicron' Contracting.

<sup>53</sup> 'Kappa' Contracting.

6. *"We're committed to being here long term, certainly not going to be the fly-by-nighters ... We'll just adapt to what has to happen next and target some other work."*<sup>54</sup>
7. *"We'll still be here in five years. What we'll be doing is anyone's guess, but we're quite a diversified company. At present, contracting in Christchurch is bloody great and if you're not making a living out of it, you're doing something wrong"*<sup>55</sup>.
- registered ... some sort of information pack ... booklet?"*<sup>61</sup>

### Suggestions for what would help businesses

1. *"Help them by spreading their cashflow out. A late payment penalty of 1% for the first week, 4% for weeks two to four would help. Make the discount for filing monthly more worthwhile, 6%, use of interest. If people don't file, ping them 10%. If they can't pay come to an arrangement rather than ping them 10%. Get rid six monthly filing for GST."*<sup>56</sup>
2. *"IRD could change the world if they chose to. ...Change the retention regime ...set up a Trust. Sort out the insurance companies. For start-uppers ... compulsory business plans, understanding finances, basic employment laws, maybe an exam before you start up. ... Employment ... grievance cases, health and safety. That sort of thing needs looking at"*<sup>57</sup>.
3. *"Every time a big company goes under, it takes subbies with it. (Retentions) should all be in a government trust fund and the government can make some interest for the management costs"*<sup>58</sup>
4. *"(SCIRT) centralising compliance, taking a practical look ... what do we actually need, how's this going to deliver value rather than just ticking boxes. Look at ANZ Standard 3910, it's so diluted. Retentions are a very real thing, but only part of the problem. Inland Revenue could help by flexibility to consider case by case."*<sup>59</sup>
5. *"The tax holidays, periods of relief (that) IRD did made a lot of sense"*<sup>60</sup>
6. *"Your website's good but you have to go into so many things. Maybe when a business is*

<sup>54</sup> 'Sigma' Contractors.

<sup>55</sup> 'Omega' Contracting.

<sup>56</sup> 'Alpha' Contracting Company.

<sup>57</sup> 'Beta' Contractors.

<sup>58</sup> 'Gamma' Groundworks.

<sup>59</sup> 'Omicron' Contracting.

<sup>60</sup> 'Kappa' Construction.

<sup>61</sup> 'Sigma' Contractors.

## Other topics

### Start-ups

A number of the participating companies mentioned start-ups and their lack of business understanding. *"... They're suddenly dealing with cashflows. The problem is that the start-up industry's encouraged, but sustainable industry is not. Start-up failures are massive. It's nothing to do with the earthquake, just that a lot of guys can drive a machine but not a calculator."*<sup>62</sup>

### 'Norms'

There is no clear view on the part of participants on what 'normal' looks like. On the one hand, many claim that some things, such as difficulty in recruiting skilled staff, cashflows, retentions and unexpected problems when drilling or tunnelling are normal, at the same time the same people were saying what things have changed since the earthquakes, *"The earthquakes have changed everything, the way people think. Previously the emphasis was on work, now it's the family"*<sup>63</sup>. Six months after the emergency work, one participant said they were *'... back to our normal work and regular clients'*. The same participant believes that *"The fluctuations in normal will continue exactly the same; there'll be highs and lows"*.<sup>64</sup>

The lag between paying suppliers and receiving payment from the delivery teams is seen to be the norm now. This is also in the North Island not just in Christchurch, so while it may have become more apparent after the earthquakes, it is unlikely that the earthquakes were the cause.

## Conclusions

It is clear that the demand for the industry's skills since the earthquakes has significantly impacted on the business outlook for all the companies. Growth has been fuelled by the earthquakes. None of the participants expected present business conditions to continue further than five to ten years out. All expect they will have to adapt or diversify or, in the case of two companies, look at selling up.

Uncertainty and volatility of work flow has always been the reality for the contracting industry, but was accentuated by the earthquakes. In the early stages of the infrastructure work, it appears that SCIRT over promised and under delivered on releasing work. It is probable that some companies gearing up in anticipation of this work may have been financially embarrassed.

Retentions pose, and have for a long time, a risk for the industry. If the principals 'fall over', it is the sub-contractors who lose out.

The SCIRT model has resulted in the early excitement of just getting out there and 'doing something' being replaced by a more consistent, measured and accountable approach. This appears frustrating for some, particularly in relation to the slowing of the processes and compliance costs (*"jumping through hoops"*).

Growth posed the greatest risks for the smaller companies and those worst hit by the recession. Some of these companies are still struggling with managing cashflows and meeting their tax requirements. Even some of the larger ones find that this can be a challenge.

All companies are very clear that the current level of growth in their industry is unsustainable in the medium to long term. Unsurprisingly, the larger, more financially stable companies are the most optimistic about the future. The smaller ones and those recently 'stabilised' are likely to remain vulnerable.

The contracting industry plays a major role in emergency, recovery and rebuild after a major disaster. While all the participants mentioned that inconsistency of work flows (and, therefore, cashflow) was part of their industry, it is likely to be even more volatile in a major disaster. This indicates the importance of having measures in place that will enable them to remain financially viable if there are substantial delays in the release of work.

In conclusion, despite a level of uncertainty, there is a sense that the rebuild is starting to happen. A number of companies express excitement at being part of it.

<sup>62</sup> 'Beta' Contractors.

<sup>63</sup> 'Omega' Contracting.

<sup>64</sup> 'Beta' Contractors.

