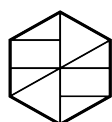


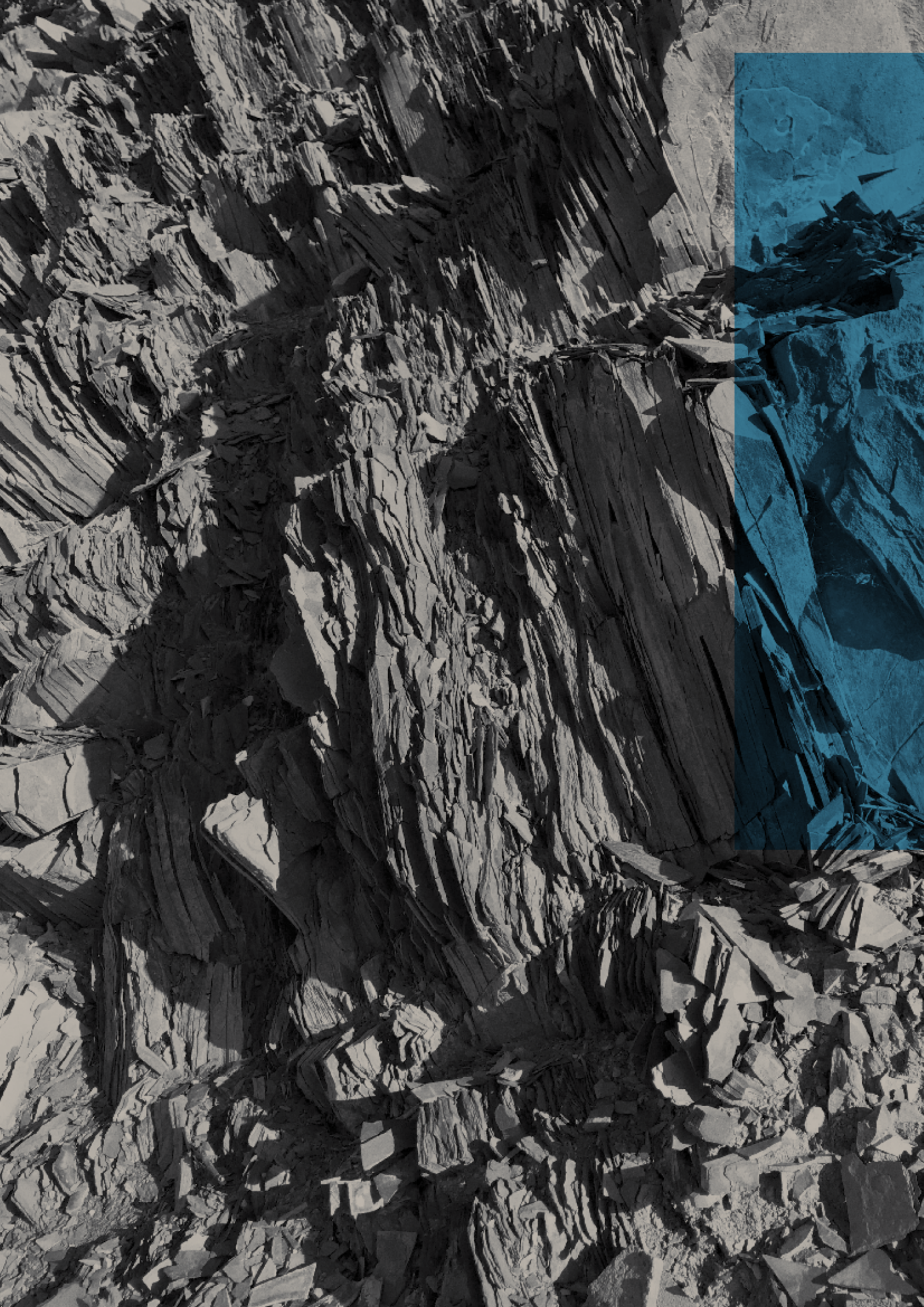
The background of the top half of the page is a photograph showing the silhouettes of two hikers on a rocky mountain peak. One hiker is standing on the peak, leaning forward and reaching out with their hands, while the other is climbing up towards them. The sky is a mix of blue and orange, indicating sunset or sunrise, with a few clouds and a visible sun on the horizon. The overall mood is one of teamwork and overcoming challenges.

2020/21 SME Research Report

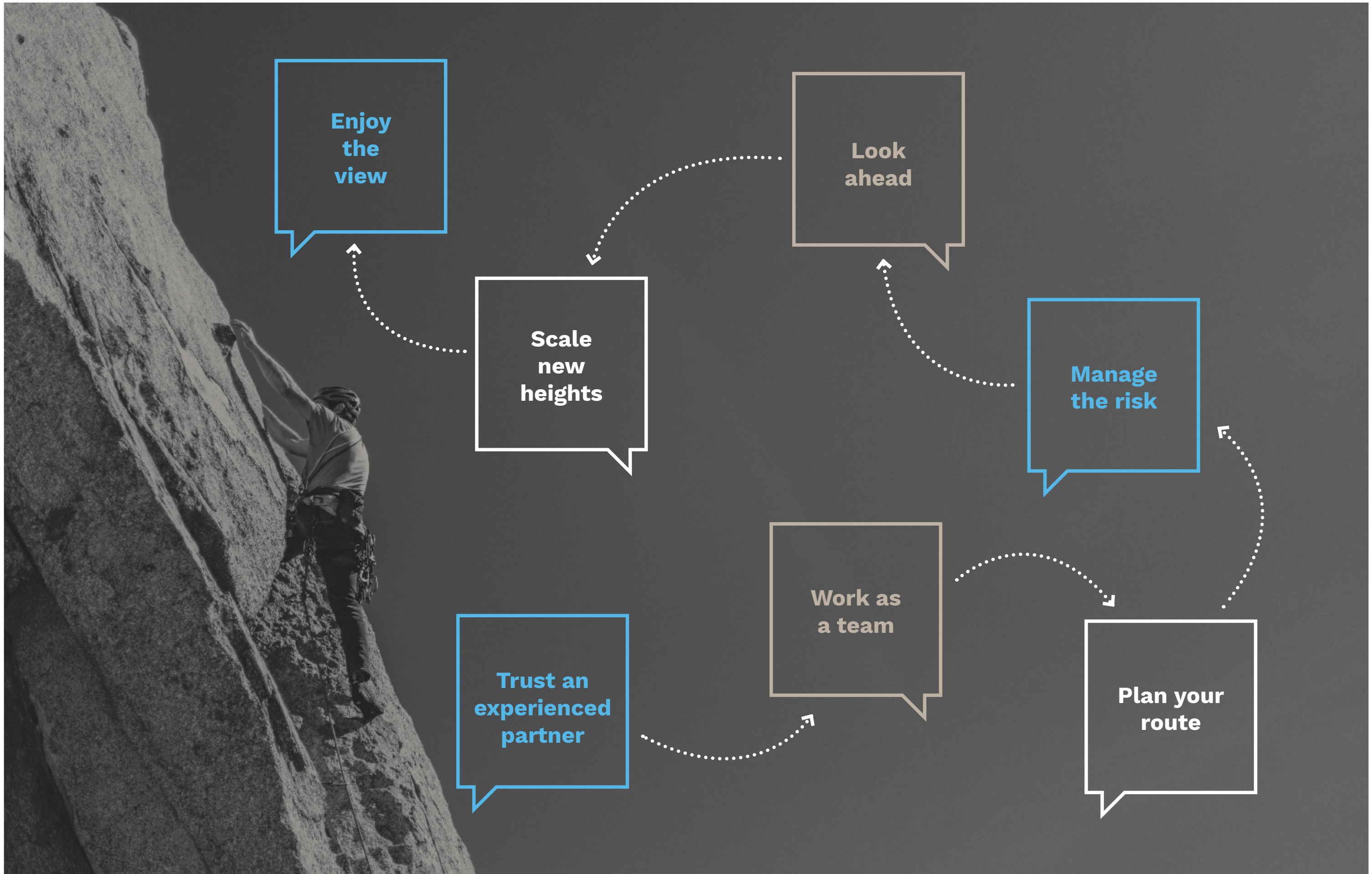
SMEs need a sounding board they can turn to and trust to reduce Non-financial Risks, improve business performance and owners' quality of life.



apiary FINANCIAL



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Foreword

A Word about Risks



While small to medium (SME) business owners may believe they have some level of control or influence over factors that affect their business and that they are adequately managing their risks, this is frequently not the case. External factors can develop quickly and in unpredictable ways to disrupt the status quo and significantly impact any business's operating conditions.

Who would have envisaged that in the space of a few weeks we would witness the locking down of entire countries, the banning of international travel and such volatile stockmarkets. These events highlight how interconnected we are and how fragile and vulnerable economies have become.

There is also significant pressure on businesses to maintain their reputation and image. We have all seen the direct and immediate impact of a public scandal on a business's bottom line.

To be successful in today's complicated world, business owners have to understand and manage these broader responsibilities. Owners have to expect that change will happen, and happen quickly.

While more businesses are preparing business continuity and disaster recovery plans, only the largest companies have the resources for regular crisis planning and scenario testing. Many owners have no significant experience in how to deal with unexpected disruptions to their market,

customer base or inputs (e.g. utilities, supplies and materials or transport).

While each crisis does eventually pass, SMEs that survive are those that have plans in place. Those SMEs that see, adapt and take advantage of opportunities that arise out of crises can emerge stronger.

Adversity also leads to opportunity. Business owners can aim to do more than react. They can act strategically, looking for opportunities and adapting to the new reality to grow and thrive.

We want to support our clients tackling today's challenges and help them build a profitable and sustainable business. SMEs are a highly valued client segment within our practice client base.

With the support of our research partner, Bstar, we are able to share insights into what's happening in the SME sector. Our 2020/21 SME Research Report discusses top business risks, analyses key non-financial risk and value drivers and introduces important industry profitability and valuation benchmarking data.

We have provided more information on the unique sounding board services we offer and how these services can de-risk your business, grow and improve profitability and cash flow, and ultimately grow its value.

We hope you enjoy reading the Report, and we welcome and value your feedback.

Executive Summary



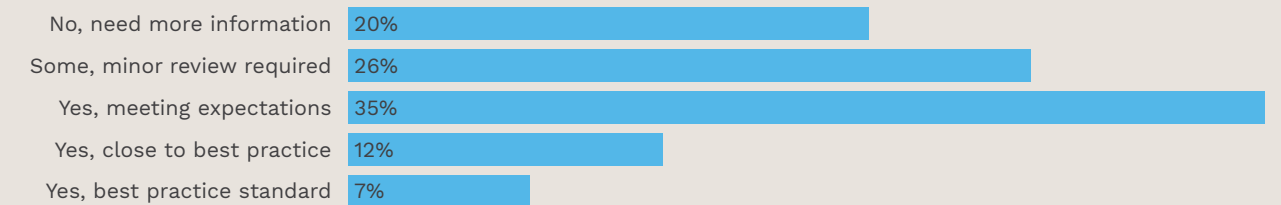
Key Insight

SMEs need a sounding board they can turn to and trust to reduce Non-financial Risks, improve business performance and owners' quality of life.

We are all increasingly interconnected, and impacted by both local and global events. Business owners are having to deal with and manage an increasing range of risks that affect their day-to-day business operations. As the range of risks extends and becomes more complicated, they require new and varied methods of management.

“Governance is an area where we’re really lacking.”

Governance Policies, Procedures and Training Programs in place (e.g. for directors, executives and key staff)

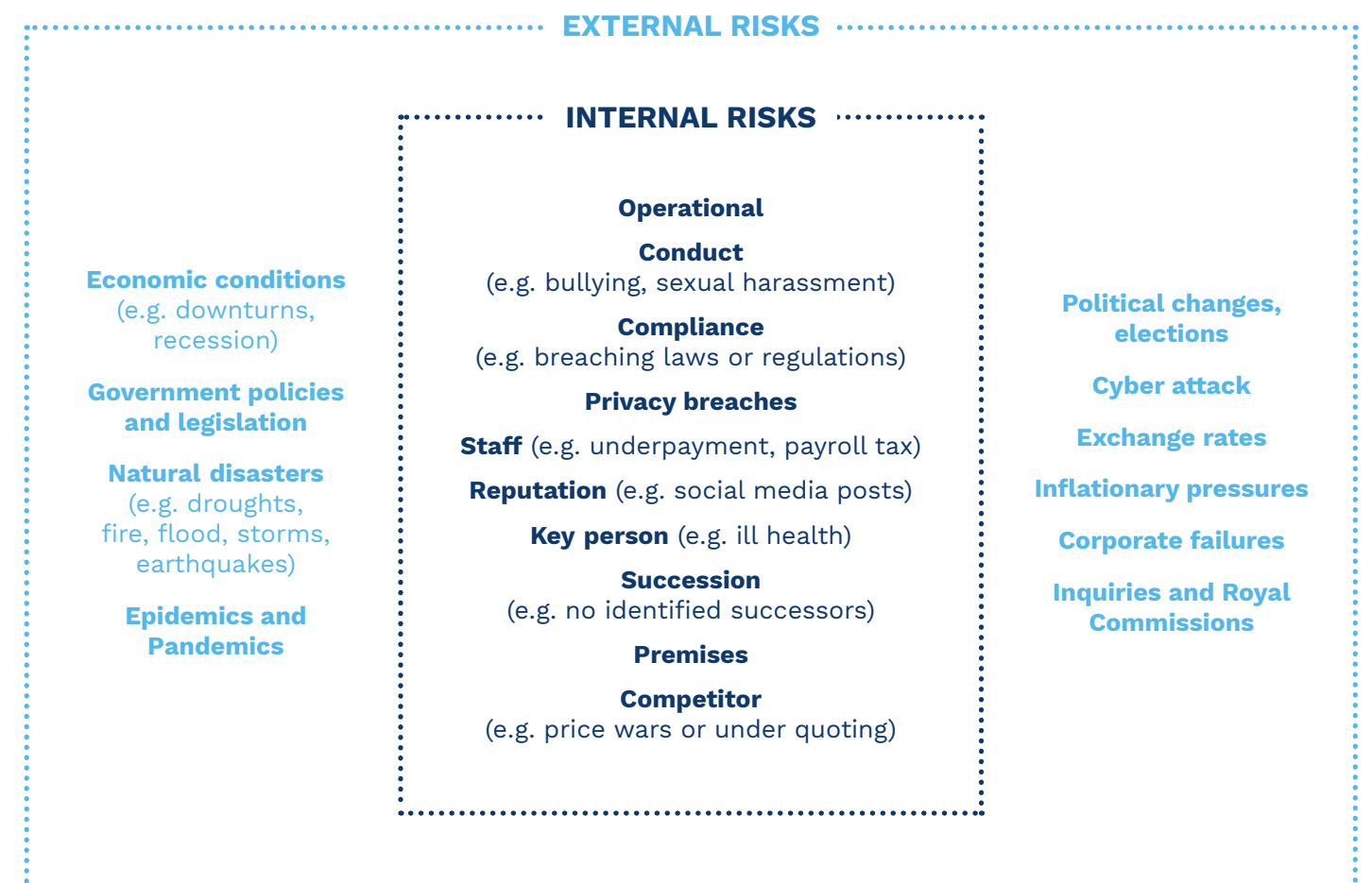


Source: RAVDA Data

These risks come in myriad forms, can be internal or external, specific to an industry or business, and local or global in impact - refer to the box for some current examples. We call these **Non-financial Risks** as they are not purely financial, and generally do not emerge from the financial accounts of an SME.

Wide range of Non-financial Risks

Risks that impact business operations take many different forms.



However, when Non-financial Risks are not well managed, they can quickly affect the profitability and impact the survival of an SME.

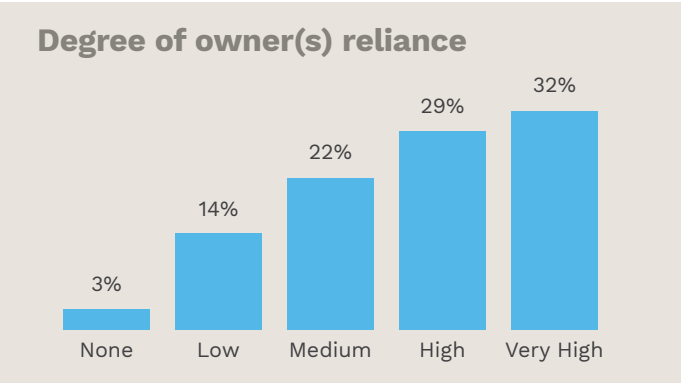
The impact of Non-financial Risks has been recognised by the Australian Securities and Investments Commission (ASIC). In a recent report¹ ASIC reminded directors of companies of their responsibilities to focus on managing these wider risks. The report showed why ASIC considers good management of Non-financial Risks to be essential to the long term success of a business enterprise.

“The costs and consequences of poorly handled non-financial risks can be immense and, at an extreme, catastrophic.”
(James Shipton, ASIC Chair)

How are SMEs currently handling these risks?

To find out how SMEs are currently dealing with risks, we asked business owners a number of questions about all types of risk. We used both a short Business Risks Survey (10 questions) and a more detailed Risk and Value Driver Assessment (80 questions).

While each business is unique, our research shows that business owners have common experiences and share common concerns. While there is no ‘one-size-fits-all’ solution, the starting point is for business owners to identify and prioritise the risks that affect their business.



“All our eggs are in this basket at the moment and the business has got to start earning us some money soon! I’m pretty uncomfortable with the level of risk.”

Many SMEs are being overwhelmed with the challenges and increasing pressures facing their business and **61%** of SMEs report a high (**29%**) or very high (**32%**) degree of owner reliance.

Succession risk was the highest risk identified by our Business Risks Survey. Further detailed analysis² showed only **18%** of business owners have documented management and ownership succession plans in place, with more than half of those plans (**11%**) needing to be reviewed and updated.

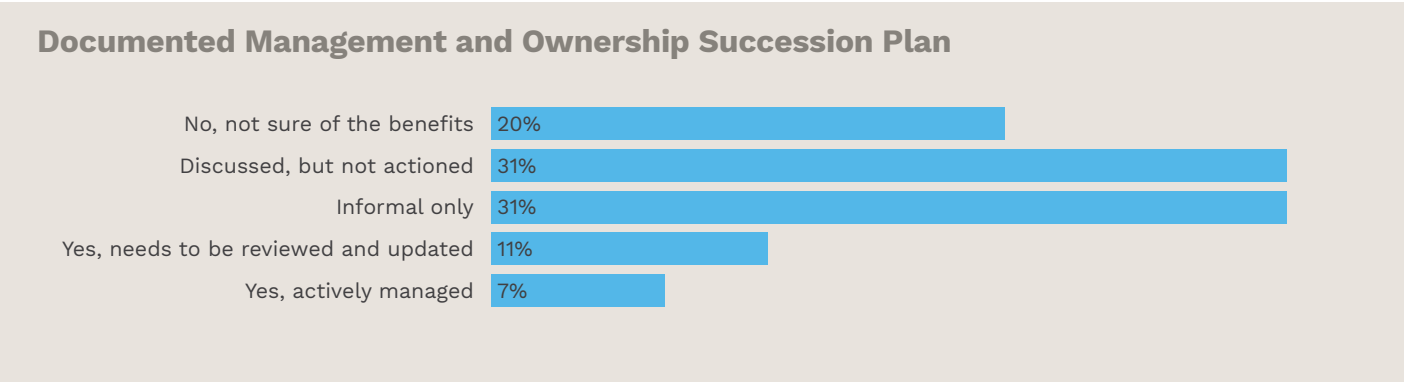
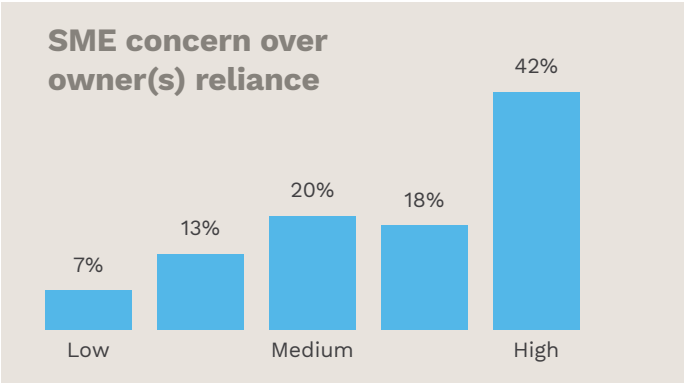
Succession: Australia and New Zealand Comparison

Only one in three (**36%**) of NZ SMEs and one in four (**25%**) Australian SMEs had succession arrangements in place. Additional data makes it clear that less have documented management and ownership succession plans in place.

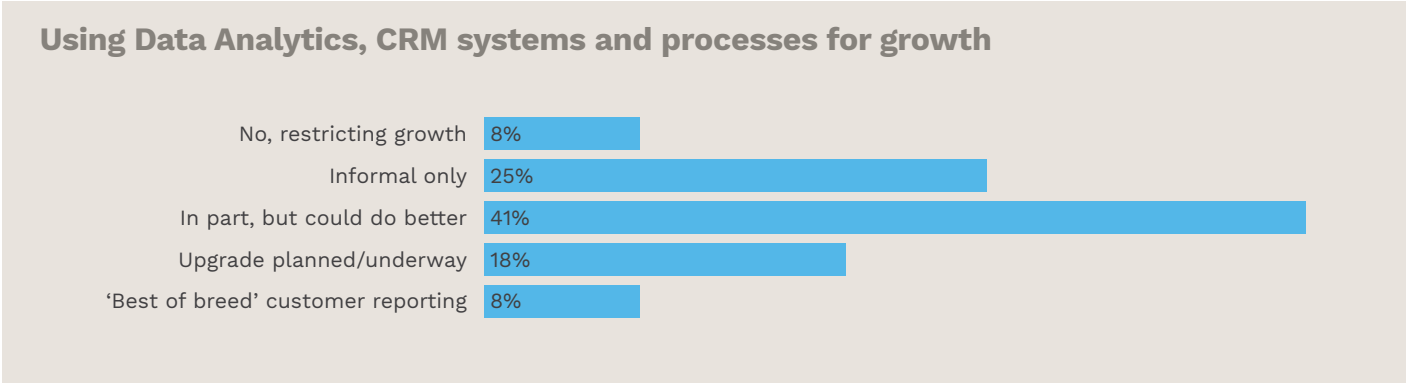
Financial Risks

Financial risks are also challenging, as **57%** of SMEs had gross profit margin growth of less than **5%**, including **25%** with shrinking margins.

1. The Director and Officer Oversight of Non-financial Risk Report released by ASIC’s Corporate Governance Taskforce on 2 October 2019 (see www.asic.gov.au)
2. Refer to the Finance Valuation Succession and Estate Planning section for more information.



Source: RAVDA data



Source: RAVDA data

“There is a lot of financial information that is available from our systems, but it is not being used or analysed.”

Growth is difficult, but only **8%** are currently using best of breed data analytics, CRM systems and processes to manage customer relationships, grow sales and attract new customers. **65%** listed it as a medium to high or high concern.

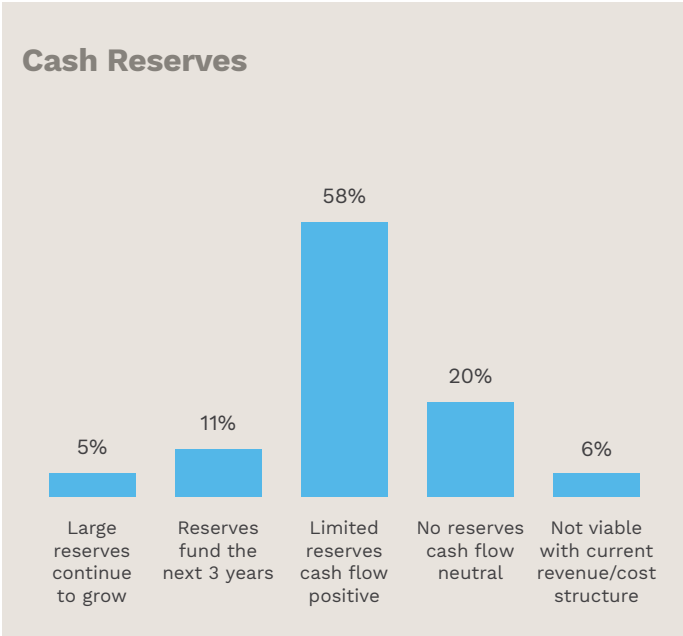
Cash Reserves

Surprisingly, a majority (**78%**) of SMEs are vulnerable to even a short term shock or disruption, indicating they held either no cash reserves (**20%**) or ‘limited’ cash reserves (**58%**).

“Our main exposure remains our relatively low cash reserves and the seasonal downturn over Christmas.”

Lack of Planning

Only a quarter (**26%**) of SMEs engaged in regular planning, with only **6%** having comprehensive current plans that were actively managed.



Source: RAVDA data

“We make a lot of informal plans and sometimes roll things out, in hope more than anything. Some things work, and some things don’t.”

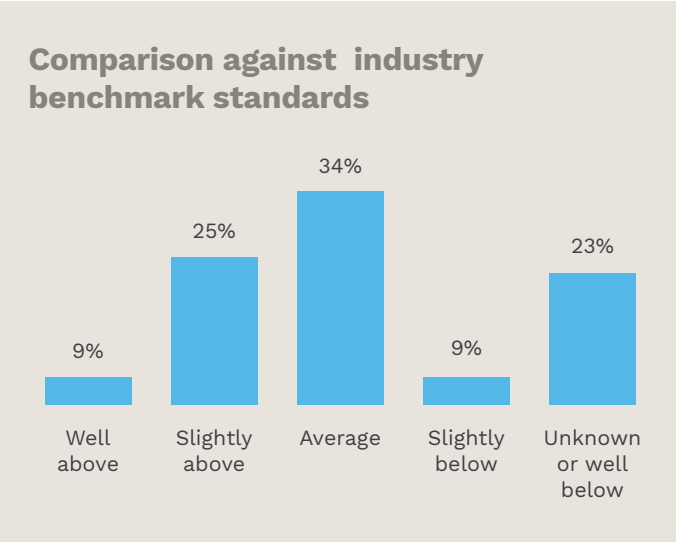
The standout personal risks all relate to planning for the future. Across three measures, **two in three individuals** have not taken action to make themselves financially independent.

“I didn’t enter into small business to build an asset, I created a job I’d love with a pathway to high income. It’s really happened organically and without planning. I need help to shape it into something saleable, with future value, but I still have time to do so.”

Risk and Value Drivers

The Report features in-depth analysis, statistics and comments in relation to a business’s key risk and value drivers across ten categories. We captured this information, including business owners’ comments and level of concern through our detailed **Risk and Value Driver Assessment or ‘RAVDA’**.





Source: RAVDA data

“In our sector, technology is disrupting the role that humans play. Much of what was done by a human five years ago is now entirely being done by tech, changing the roles we play. We are trying to position ourselves as helping clients to use the right tech, with the right strategy.”

RAVDA Benchmarks

The Report includes a list of RAVDA benchmarks listed by ANZSIC divisions³.

“Who wants to be average? We want to be the benchmark and need a plan to get there.”

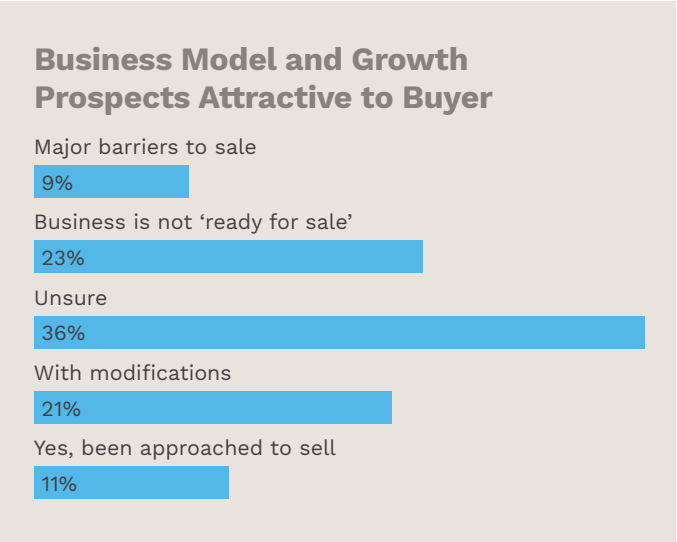
Most Profitable and Valuable SME Businesses

The Report highlights the most profitable and valuable industry segments, SME profitability and valuation statistics and lists the most accurate industry average risk, profitability and valuation benchmarks.

Shared Experiences and Improvement Ideas

We have included real life comments and observations from SMEs who have shared their experiences, frustrations and aspirations on their business and what they are doing to achieve success. **The Report features ideas to reduce all types of risks.**

3. Australian and New Zealand Standard Industrial Classification (ANZSIC) refer to www.abs.gov.au for more information



Key idea: Customers & Market Demand

Analyse your sales per customer group to determine your customer ‘sensitivity’ risk.

Key idea: Staff

Survey your staff to improve communication and engagement.

Key idea: Owner(s)

Develop a business operations manual to reduce owner(s) reliance.

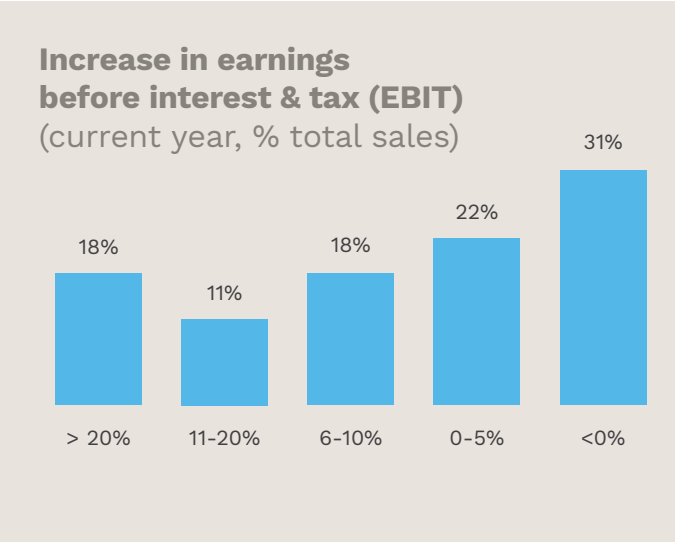
Key Observation - Sounding Board Support

Business owners are increasingly aware that the pressures of running an SME are as individual as their business. In addition to financial matters, there is a wide range of risks that need to be managed on a daily basis. They are looking for ways to manage those risks, and proactively adapt to changes.

But reliance on business owners is already very high, and the level of planning is low. Many are already stretched, and it is easy to see risk management as an additional responsibility, increasing the burden on owners.

“Business planning has only started this year and is a work in process. We have new plans and strategies currently in play but it’s too soon to judge the effects.”

SMEs are looking for solutions, ways to lighten their load, but they can’t do it alone. This research highlights **business owners need the support of a sounding board**. The primary support needed is with planning, but the advice and support provided by a trusted adviser goes well beyond looking at the numbers.



Source: RAVDA data

“I created our last Business Plan which to be honest was largely ignored by my co-owners. Rather than start another cycle, I challenged them about growth and the need to bring different thinking into the business. We are now getting external help.”

How will a Sounding Board help an SME business?

A professional **sounding board** will provide advice and support where owners need it most, allowing them to:

- Build confidence with independent and objective professional advice;
- Identify, manage and reduce key qualitative and financial business risks;
- Step away from their business to focus on planning;
- Be held accountable for implementing the

FINANCIAL BENEFITS

- Improved financial reporting, profitability, cash flow and risks score
- Benchmark performance
- Reduced operating costs
- Higher business value, lower value gap risk - business revaluation

What is a sounding board?

A **sounding board** is a person you run things by, or **someone** you turn to for advice*.

The ability to discuss issues with someone you trust helps to develop ideas and solutions, while sharing the load, and reducing stress. Your sounding board can agree or provide a different point of view, and bring new skills to solve issues.

* www.yourdictionary.com

changes necessary to improve performance;

- Achieve a more balanced personal, business and family lifestyle.

“Our approach is, don’t be afraid to try new things but know when to cut your losses.”

Outcomes Matter

Business owners are focused on outcomes. However, sometimes the personal, family or lifestyle benefits outweigh the financial metrics.

“We engaged [our accountant] to chair our board of advice. Our primary goal was to replace me so I could spend more time with our children. They are young and I didn’t want to miss this important part of our lives together as a family”.

NON-FINANCIAL BENEFITS

- Aligned owners, less owner reliance
- Engaged, productive staff
- Better business resilience for change
- Better lifestyle with less stress
- Stronger family group
- Business legacy

Sounding Board Relationships and Services

There are a range of sounding board services available to SMEs. Each service is tailored to the key need of the business owner(s) and will change as the business grows (refer to the Appendix).

BUSINESS PROFILE	KEY ISSUE	SOLUTION BOARD SERVICE & OBJECTIVE
Small	44% of SMEs don't have a business plan.	Business Planning Mentoring Prepare and document a business plan.
Medium	31% of SMEs had less than 0% growth in Profitability.	CFO Service Establish accurate financial reporting, improve profitability and cash flow.
Large	Only 12% of SME owner(s) were not intending to rely on the sale of their interest in the business to fund their retirement or next business venture.	Board of Advice Program Determine the 'true' business value, grow and transition the value to reduce the owner(s) value gap risk.

Source: RAVDA Data

The Report includes a Matrix (refer to the Appendix) outlining the different advisory solutions available to our SME clients to minimise key risks and grow their business. Support can be delivered face-to-face or remotely, through online tools, virtual meetings and webinars.

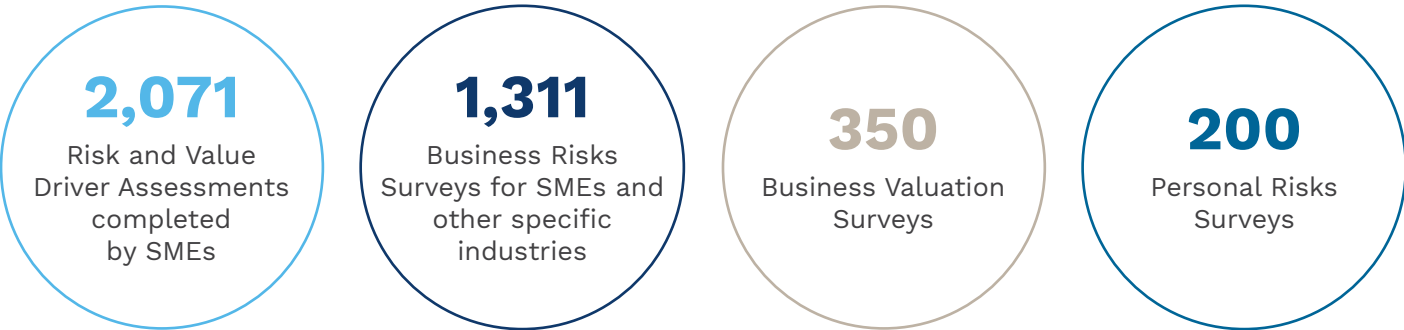
3 Steps to Success

We encourage our clients and readers of this Report to take action to get support and recommend one or all of the following steps:

- 1 Understand the risk and value drivers in your business.
- 2 Collaborate to improve business performance.
- 3 Select a partner to support success.

Sources of Information

The primary source of data for this Report were responses from SME clients of accounting practices relating to the two-year period from January 2017 to December 2019. This included more than 4,500 observations and comments from SME owners. We have drawn on an extensive database of more than 6,000 valuation and performance benchmarks and more than 5,000 benchmarked Risk and Value Driver Assessments. A range of different SME client engagement/business advisory tools were available for the statistical information:



In preparing this section of the Report, we relied on information from business owners that completed a Business Risks Survey. Survey responses were analysed for those operating in the SME sector and in a range of specific industry segments. The table below highlights the Top Risks identified.

INDUSTRY	TOP RISK	% MANAGING RISK
SMEs	Management and Ownership Succession Plan in place	25%
Financial Planning	Conducting regular, formal client surveys	34%
Building and Construction	Top 5 business risks identified and managed	34%
Tradies	Written business plan for growth	11%

Source: Business Risks Survey data.

#1 SME Risk - Succession

For a majority of business owners, the business is both their source of income and a key asset, but they have not taken steps to protect it.

“I would like to increase revenue so that we do have income to fund our retirement. I would also like to set up the business so that it is attractive to a buyer and I would like advice on this. Our estate planning needs updating and there's no asset protection in place.”

Respondents rated succession risk as very high. Only one in three (36%) of NZ SMEs and one in four (25%) Australian SMEs said they had succession plans in place.

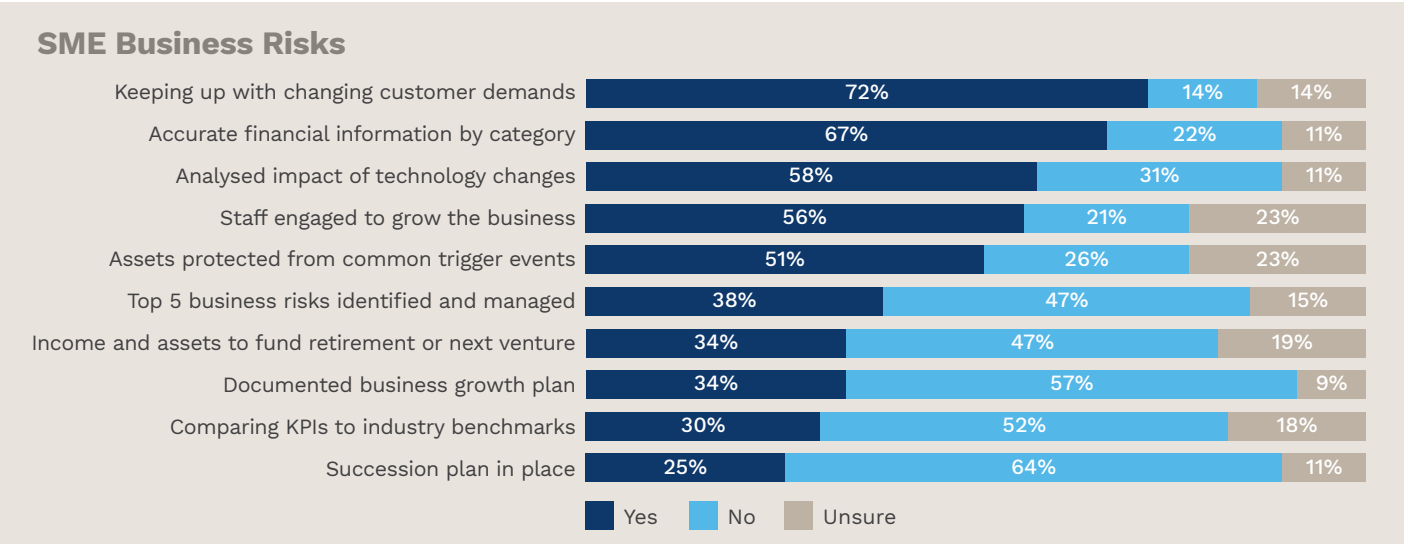
“All the owners are over 60 years, and no-one in the families wants to step into the business. We are starting to discuss an exit plan, but there's nothing in place now.”

The size of this risk is confirmed by the more detailed Risk and Value Driver Assessment, where only 7% (of a larger group of SMEs) said they had detailed up-to-date management and ownership succession plans in place (Refer to the section on Finance, Valuation, and Succession and Estate Planning).

“We have spent a lot of time working on whether to keep, sell or put in a general manager. Once we decide it will really need tailoring. They all require different strategies.”

Given the low levels of succession planning, it is not surprising that SMEs reported very high levels of owner reliance and key person risk. Management succession plans are key to reducing the day-to-day reliance on the owners.

“I AM the business. I have no time to work on it or take holidays with my family. I find it hard to trust others to do the work as I would do it. I can't see how I can change this.”



Source: Business Risks Survey data

Identifying and managing all risks is critical for SMEs to succeed.

Today business owners frequently have access to more information than ever before. Despite this, business owners are frequently overwhelmed. They struggle to interpret their data, to understand what is important and to identify and prioritise risks.

Our survey data supports this, as only 38% of SMEs had identified and prioritised their top 5 business risks. Frequently, there is a time lag - emerging risks are not identified, only reacted to when they have an impact.

“The costs and consequences of poorly handled non-financial risks can be immense and, at an extreme, catastrophic.”
(James Shipton, ASIC Chair)

The report from ASIC’s Governance Taskforce⁴ provides ample evidence that unlike financial risks, Non-financial Risks have generally not received enough attention, or active management. While the report concentrates on larger, publicly listed companies, ASIC makes it clear that all directors and business operators are accountable for mitigating both financial and non-financial risks and this applies to enterprises large and small, whether for profit or not.

ASIC acknowledges the challenges involved in seeing and managing these risks, and recognises that directors and business owners need help. The payoff for pro-actively planning for risks occurs in how effectively SMEs deal with problems as they arise, and in the time and money saved when risks are prevented entirely.

4. The Director and Officer Oversight of Non-financial risk Report released by ASIC’s Corporate Governance Taskforce on 2 October 2019 (see www.asic.gov.au)

Top Personal Risks - Snapshot

Our Personal Risks Survey also identified concerns with individual client risks. The best result was that three in four (75%) respondents indicated they were taking care of their health and diet. 65% had insurance in place to protect their family or key assets from common ‘trigger’ events such as accidents, ill health or death.

Glass half full

However, while a small majority (63%) of individuals would be able to manage financially if their income dropped by 15% for six months, only just over half said they were free from financial stress (52%), (using a measure of rent and debt being less than 25% of gross income) or confident (55%) that

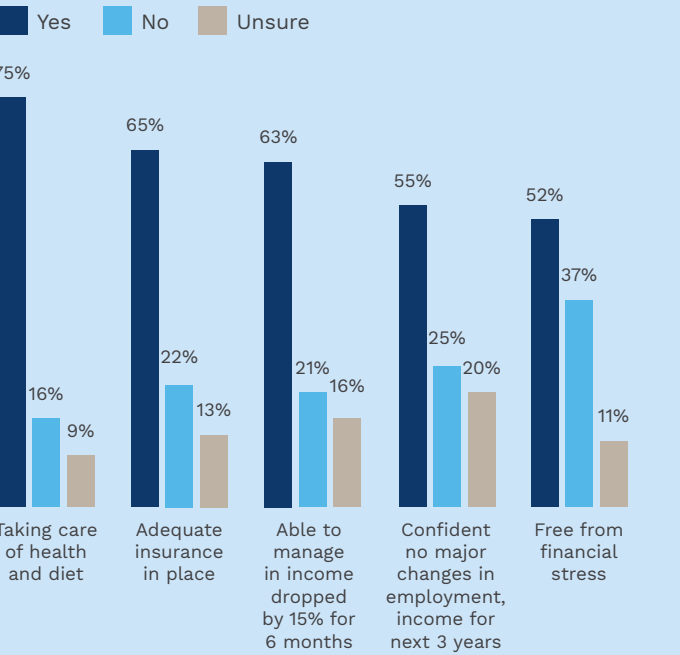
their income and employment were secure from significant changes for the next 3 years.

The standout personal risks all relate to planning for the future.

Across three measures, two in three individuals have not taken action to make themselves financially independent:

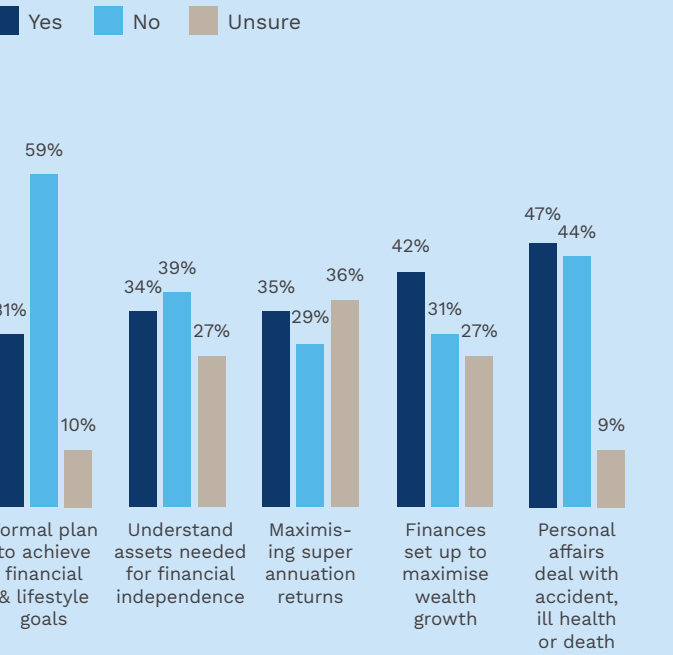
- 69% did not have a formal plan to achieve their financial and lifestyle goals;
- 66% did not understand what they needed, in assets or net worth, to be financially independent;
- 65% were not maximising their superannuation returns.

Personal Risks – better managed



Source: Personal Risks Survey data

Personal Risks – poorly managed



Risk and Value Drivers



In preparing the Report, we have compiled statistics and comments from business owners from a wide range of industries, and share their insights. We relied on information from owners that completed a SME **Risk and Value Driver Assessment**.

What is a Risk and Value Driver Assessment?

The Risk and Value Driver Assessment is a detailed questionnaire for business owners on 10 key areas of risk and performance.



The Risk and Value Driver Assessment (RAVDA) is a key tool we use to identify opportunities to improve our client's business performance, which will grow the value of their business.

The analysis is two stepped - firstly, a detailed online questionnaire that investigates a wide range of risks facing business owners, and rates their level of concern on each issue. This is supported by a database of financial and qualitative RAVDA benchmarks across most SME industries.

The second step of the process produces a Scorecard which includes our clients' risk score, rating and highlights their value improvement opportunity.

This section of the Report features in-depth analysis on responses from SMEs for each risk category listed in the Risk and Value Driver Assessment and key ideas for improvement.

1. Industry

“Our approach is, don't be afraid to try new things but know when to cut your losses.”

The majority of business owners surveyed (72%) believed their industries were well established and stable. Of those anticipating change (28%) only 7% expected significant rates of disruption.

“Our market is shrinking by the day with some significant players going out of business. This trend will accelerate over time. However, we have micro-niche markets that can still be exploited, especially as a market disruptor.”

70% of SME anticipated steady (40%) or slow (30%) industry growth and 60% were positioning their business to take advantage of future industry trends. While 40% did not anticipate any Government policy changes would impact their business, 29% of business owners were expecting either strong (9%) or limited (20%) negative impact from changes.

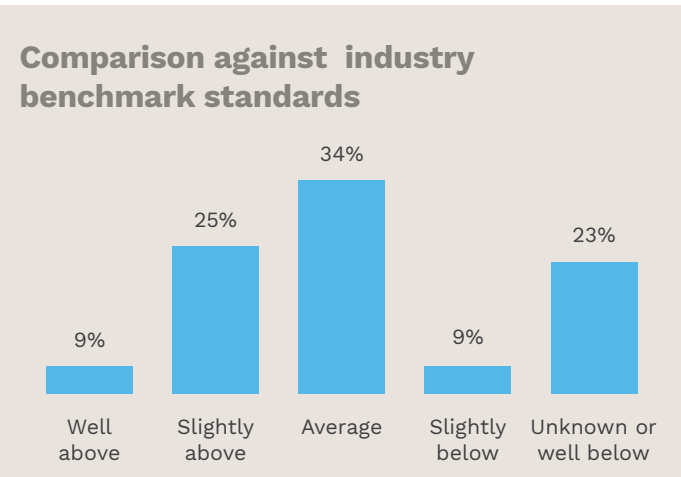
“How the future will play out from here is very uncertain. AI is trying to disrupt and automate much of what we do. Other agencies are diversifying into their own tech, which we may need to do to stay relevant too. We are unsure where to start on this.”

While 9% of SMEs described their business as an industry technology leader, a further 71% had started adapting the business to technological advancements, such as robotics or artificial intelligence.

“We are in a growing industry that is technologically driven - my main concern is that we don't keep up.”

Key idea: Industry

Identify trends affecting the future of your industry and analyse the impact on your business.



Source: RAVDA Data

2. Performance/Benchmarks

The majority (69%) of those surveyed were in businesses established over six years, with 19% established for more than 20 years. More than half (54%) had been trading profitably for more than 6 years, with 34% having more than 10 years of profitable trading.

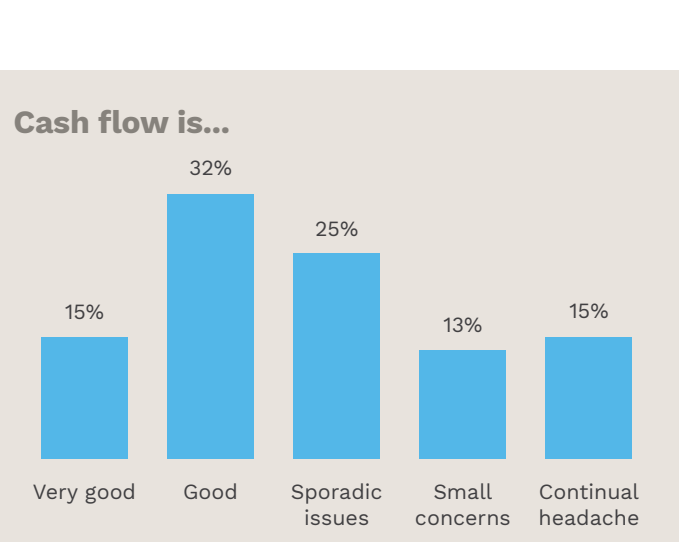
A majority (68%) were performing at or above industry benchmark standards (see graph), however, close to one in four businesses did not know how they compared, or were well below benchmarks, matched by 22% who recorded the highest level of concern on the issue.

“We recently implemented continual benchmarking and reporting, with monthly reviews and we are working to continuously improve net profit. We believe the business has not yet reached full potential and there are lots of opportunity to maximise profits.”

Cash flow remains a mixed issue with 62% reporting medium to high levels of concern. The 15% that reported it a continual headache was exactly matched by 15% who said it was ‘very good’.

“We have a number of excellent prospects which will significantly improve cash flow. We are currently over-staffed to prepare for this expansion. There’s a lag because it takes roughly 6 months to train staff.”

Current trading conditions are challenging and this is reflected in the 72% of business owners who recorded a medium to high level of concern (and 35% the highest level of concern) about gross profit margins. Only 13% of SMEs reported increasing gross margins of more than 20%. The majority (57%) of SMEs had margin growth of less than 5%, including 25% with shrinking margins.



“We are poised for growth, with arguably the best product and brand BUT the whole market is down and the top end seems to be hardest hit. Holding your own in a declining market is the first challenge - that's where we are now.”

However, concern over operating costs was lower, with the majority (71%) recording medium (27%) and lower (44%) concern.

Concern about wages showed a similar pattern. Only 21% reported high increases in wages and on-costs (as a % of sales), including 10% where increases were above 20%, however 56% had medium (27%) to high (29%) concern about wages, with 20% registering the highest level of concern.

Key idea: Industry

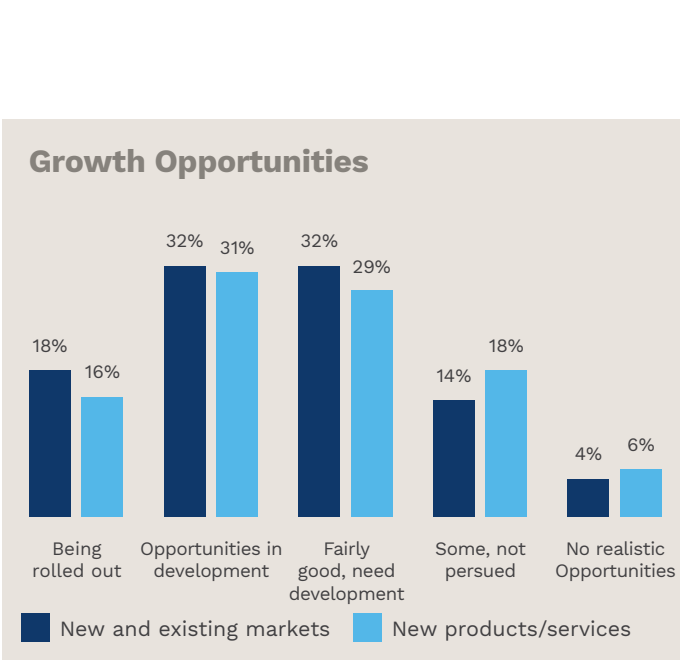
Complete a cost audit on your business to identify savings from efficiencies, restructuring and business systemisation.

3. Growth

“We have good growth opportunities but it needs focus and an overall plan.”

The majority of SMEs surveyed were interested in growth, with approximately half actively pursuing growth opportunities both for new products or services, or new markets (see graph). Over 70% of respondents rated Growth issues as of medium to low concern.

“For the last 10 years we have had a strong growth mindset and have been very successful. But our systems and processes haven't kept up with the growth. We have implemented some



Source: RAVDA Data

formal business plans but we need more around costs and budgets.”

The issues that raised significant high concern were Business Planning (36%) and Merger or Acquisition Opportunities (32%), with the remainder resonating with approximately one in four.

“We're in the process of buying new advanced technology, which will open up a whole new market for us. We will be able to expand into a new market as there is no similar equipment, and we should be able to dominate this area.”

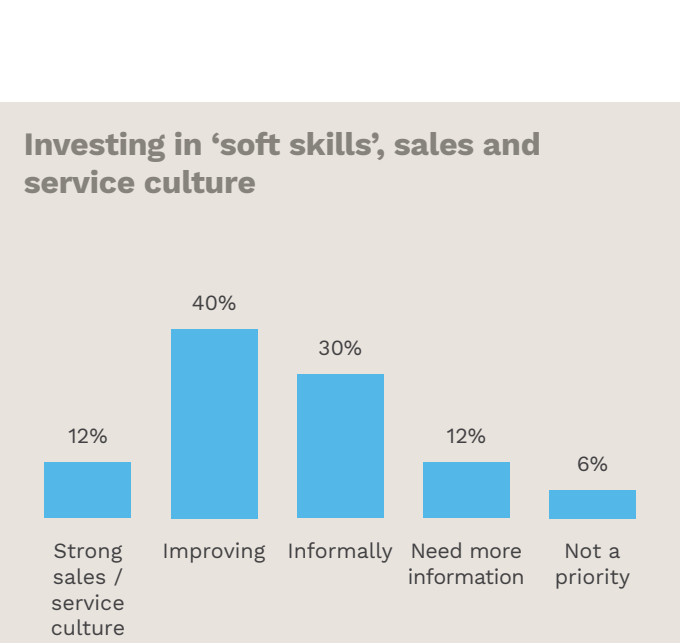
The approach taken to growth varies between industries and individual SMEs. Business owners rated their investment in developing three key areas: their online presence, soft skills and sales or service culture and research and development. The results are set out in our graphs.

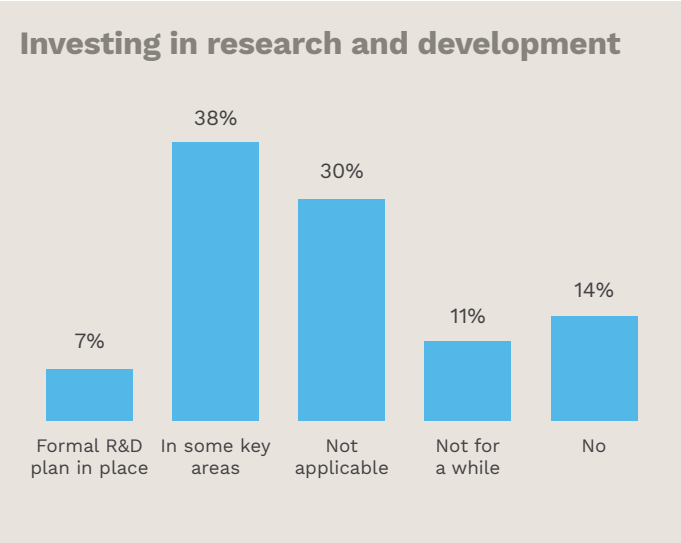
“Social media is going very well and our website is updated very regularly.”

“We definitely have great presence online, and have the best structured website when compared to our competitors.”

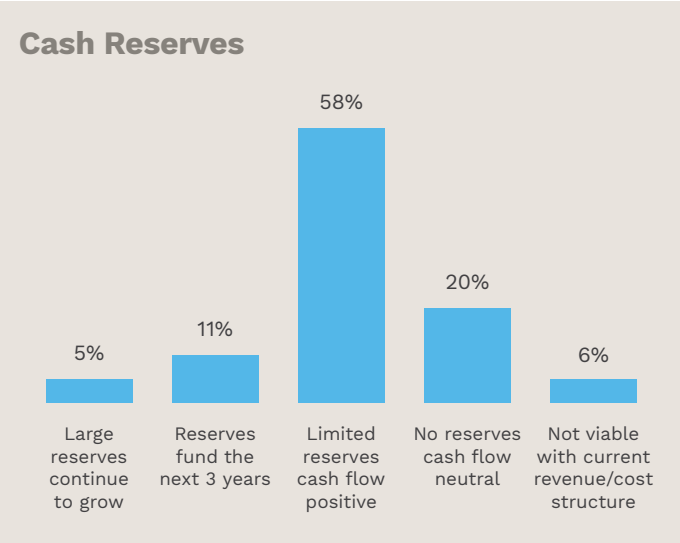
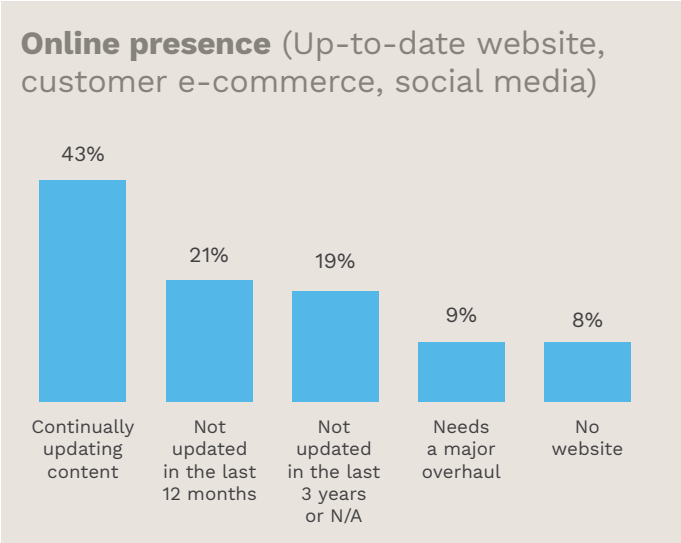
While having a plan is the most significant success factor to achieving any objective, only a quarter (26%) of businesses were engaged in regular planning, with only 6% having comprehensive current plans that were actively managed.

“Our business hinges on service and product innovation. We constantly research and analyse our key markets. We have a formal five-year R&D plan that is actively managed and updated.”

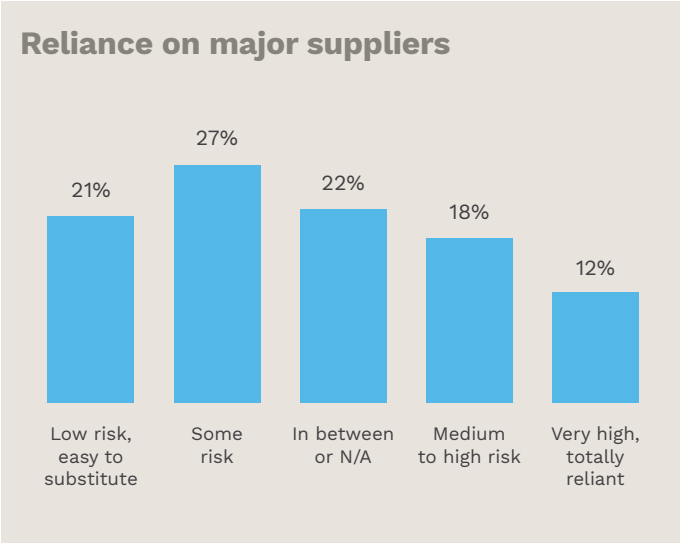




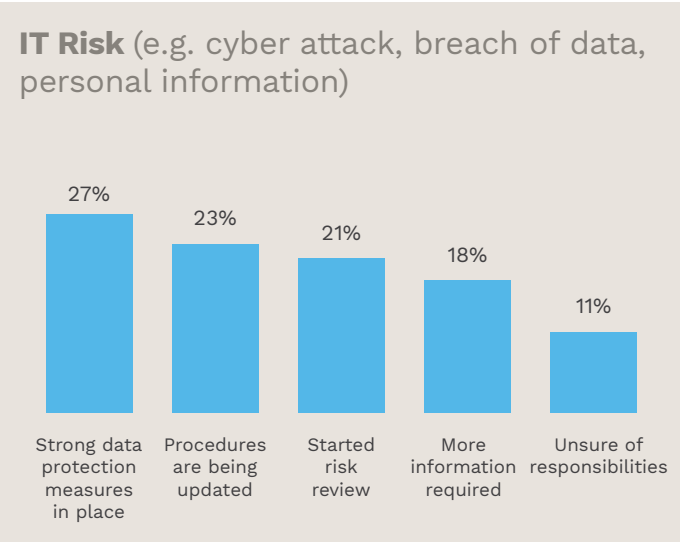
Source: RAVDA Data



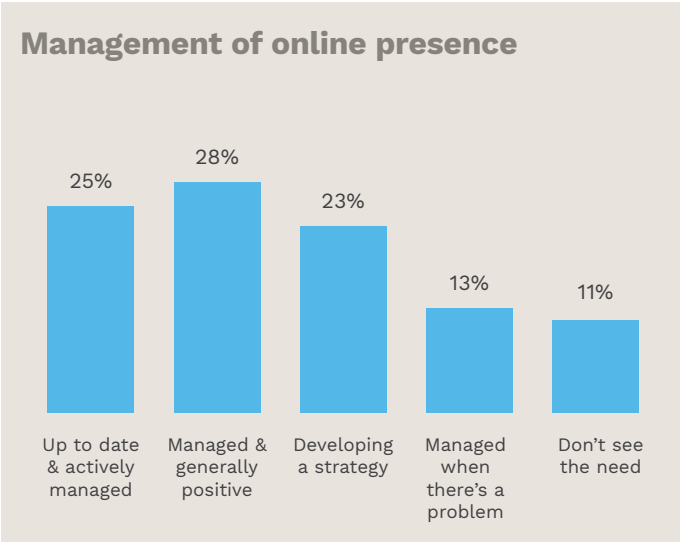
Source: RAVDA Data



Source: RAVDA Data



Source: RAVDA Data



“We make a lot of informal plans, and sometimes roll things out in hope more than anything. Some things work, and some things don't.”

Key idea: Growth

Determine your most profitable product/service lines and create a ‘one-page growth plan’ to expand your market share in these sales categories.

“Our main exposure remains our relatively low cash reserves and the seasonal downturn over Christmas.”

4. Risk

We asked business owners to rate a variety of risk issues that affect their day-to-day business operations. While many risks are being managed, a majority of SMEs did not have extensive cash reserves to deal with any shock or disruption, indicating either no reserves (20%) or ‘limited’ reserves (58%) – refer to graph.

“We need more planning around suppliers as the drought is impacting ingredient supply a little and we have recurring problems where we're 'out of stock'.”

It is positive that business owners are aware of, and taking steps to manage, significant risks such as their IT risk, their reliance on major suppliers and management of their business’s online presence – see graphs.

“Our top 5 customers make up 42% of turnover and top 20 customers make up 80% of turnover. Loyalty is low and customers typically buy from the distributor that has stock at the time of order. Thankfully, that has been us most of the time.”

Only 9% indicated ‘significant’ inflationary or exchange rate pressures on supply costs, and half of SMEs (50%) said it was of low concern.

“We know that suppliers are a key risk to our profit. We have fixed price jobs quoted in our system. If cost of supplies go up, profits come down.”

“We haven't reviewed pricing for a few years. Generally, price increases are due to exchange rate fluctuations - which is reflected in competitors

(mainly importers) pricing. We need to thoroughly review all pricing for both imported and manufactured product.”

The majority of surveyed business owners had low (57%) concern levels about threats from new technology or web based competitors. There was low (40%) or medium (27%) concern about competition from new competitors or imports, with only 13% believing their products or services were at significant risk.

“Our future focus is on reviewing our insurance arrangements and documenting contracts with suppliers.”

Key idea: Risk

Benchmark your risk score to identify your top 5 risks, whether financial or non-financial, internal or external, and prioritise action items to manage or reduce those risks.

5. Competition

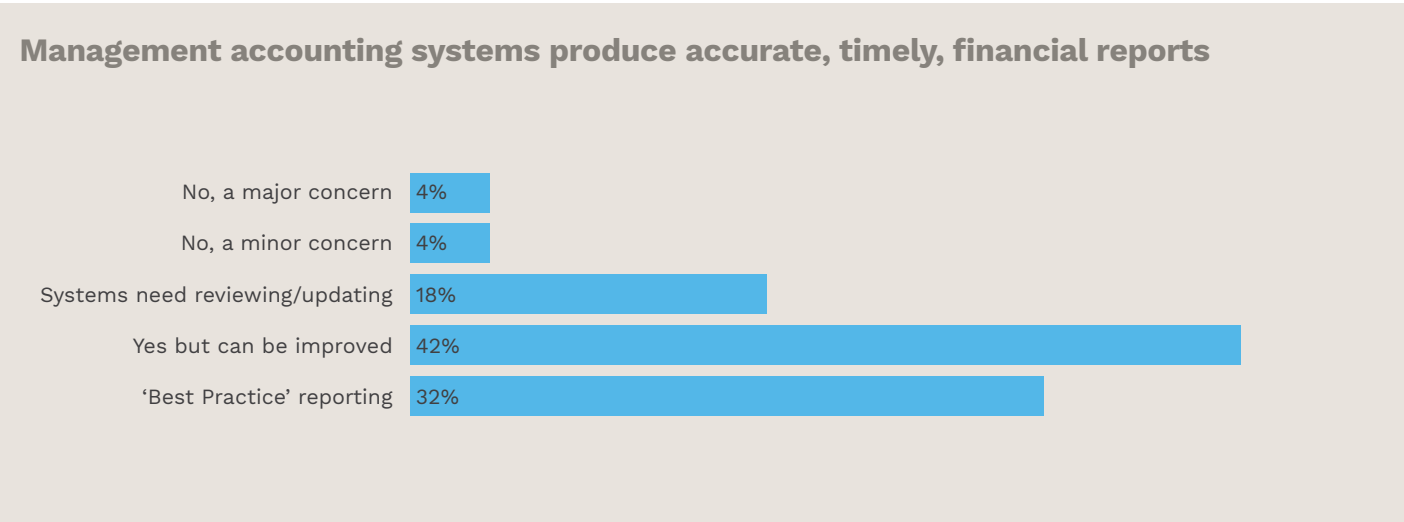
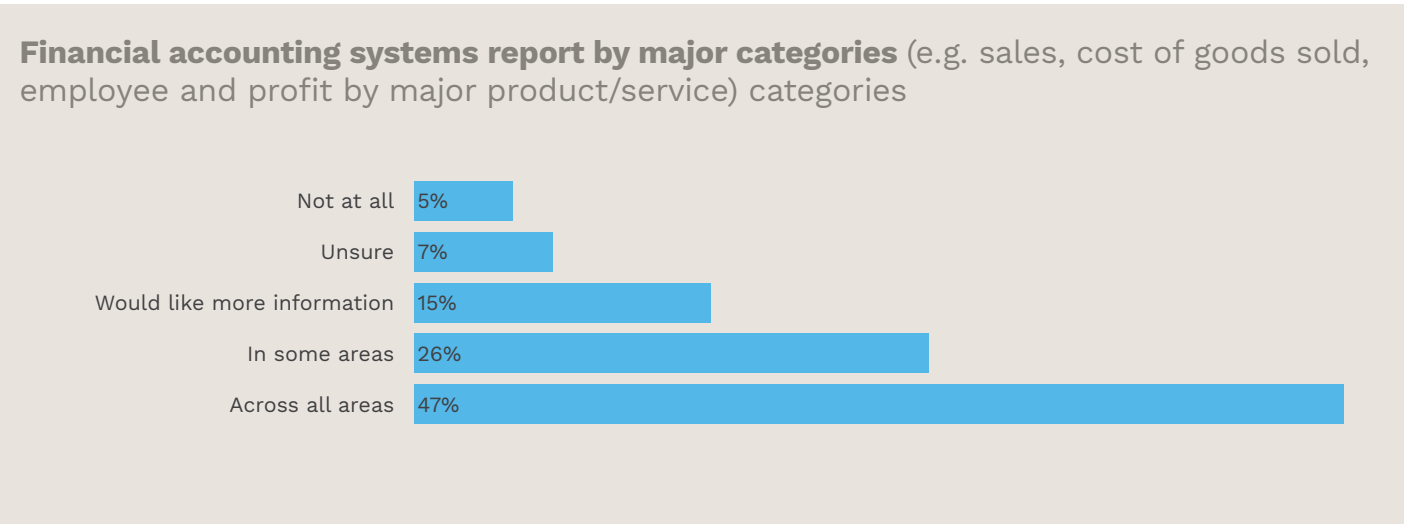
Business owners surveyed showed strong levels of confidence in their own business brand, profile and reputation. **63%** believed they were ahead of their competitors, with **25%** saying they were well ahead. Only **11%** believed they were behind competitors.

Competition was highly variable, based on the industry. Barriers to entry vary widely, as do the number of competitors, and the price sensitivity of customers.

SMEs surveyed were generally not highly concerned about market competition. **69%** were confident their market could sustain the current level of competition, and **48%** believed they benefited from barriers to entry in their relevant market.

Key idea: Competition

Understand your business strengths, and your strategic advantages when compared to your competitors.



Source: RAVDA Data

6.Management Information Systems ('MIS')

“We have good systems in place but we could use them a bit better.”

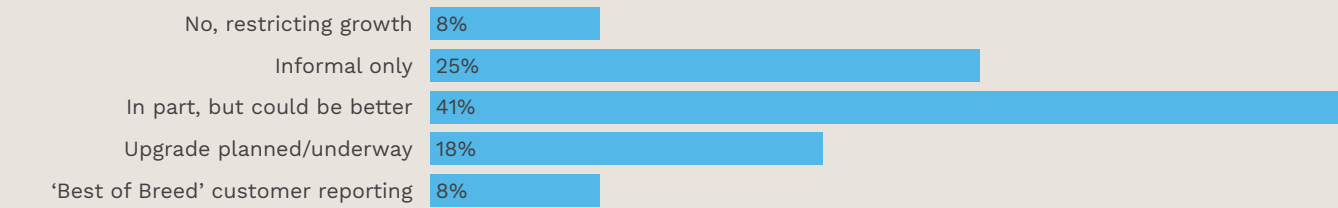
Use and understanding of Management Information Systems was a mixed area for SMEs. **47%** have financial accounting systems that are able to produce reports detailing areas such as cost of goods sold, employee and profit by major product or service categories, however **26%** were restricted, and could only do so in some areas.

“There is a lot of financial information that is available but it is not being used or analysed.”

20% of SMEs reported having totally up to date IT programs and infrastructure, describing IT as critical to their business.

“We need to really improve our systems to achieve monthly reporting, to assist the business to find out where and who to sell to.”

Using Data Analytics, CRM systems and processes for growth



Source: RAVDA Data

However, only **8%** are currently using best of breed data analytics, CRM systems and processes to manage customer relationships, grow sales and attract new customers. **41%** were doing so in part, but wanted to do more.

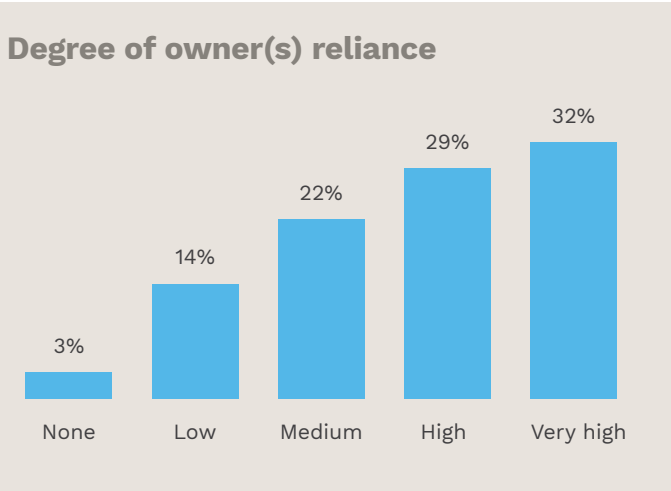
“We have plans to improve [MIS] but we haven't budgeted for it yet. This will hopefully get better when we can find the money, but is not there at this stage.”

Only **17%** of SMEs had a best practice operating manual and system in place. For many it is a ‘work in progress’ (**35%**) or requires updating (**18%**). Reflecting this, **59%** regarded it as a medium or higher concern, with **18%** recording highest concern.

“We involve external consultants to develop our company policies including best practice compliance policies and safety control processes.”

Key idea: MIS

Adopt an industry standard chart of accounts and data entry policies to receive accurate, real time, financial information and reporting.



Source: RAVDA Data

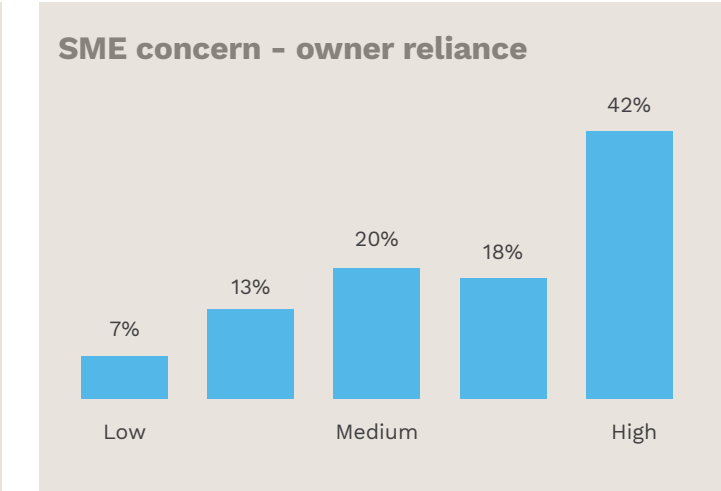
7. Owner(s)

“Plans are underway to owner-proof the business. 'Turnkey' manuals and systems are in place and key customers are all on 12 month contracts.”

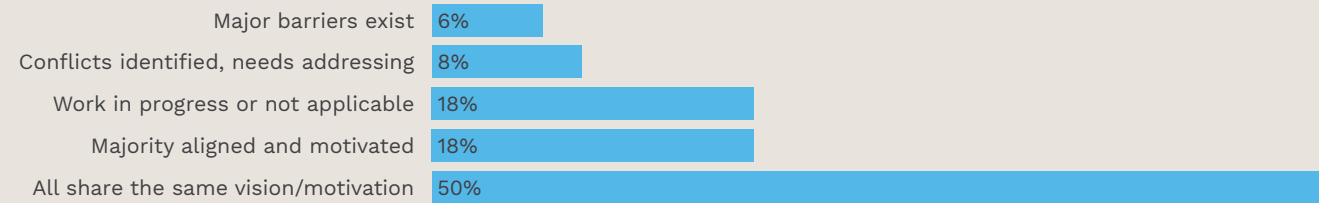
For many SMEs the business owner(s) are both the key to success and the source of the highest risk. A majority (**61%**) of SMEs report a high (**29%**) or very high (**32%**) degree of owner reliance. SMEs are aware of the risk, **80%** of respondents registered a medium or higher level of concern, with **42%** registering the highest level of concern.

“Owner involvement and reliance is still reasonably high. We are taking steps to reduce this, particularly by introducing a new website and ecommerce platform.”

Only **19%** believed that the owner’s departure would have no impact on the business.



Owner and Key Stakeholder Alignment



Source: RAVDA Data

“We have a succession plan which is currently working well. Directors are achieving their milestones and the exiting director is very active and is still bringing new work into the office.”

The extent of owner reliance can be seen when SMEs are asked about transfer of their business knowledge, systems and intellectual property. While **48%** indicated it was possible, but would require a planned approach a further **26%** indicated that transferring knowledge would be difficult.

“I would need to stay around for some time for full transition of IP and procedures to any buyer.”

60% of SMEs had strong internal management, leadership and financial skills, with **22%** reporting skills across all areas. **23%** were supplementing internal skills with external assistance.

“As working owner, I am needed at work a lot, but I have been taking steps to take a reasonable amount of time off, and I am using a replacement manager when I am absent.”

Maintaining a work/life balance is important to support the ability of owners to remain effective in their business and **28%** of SMEs reported that a positive culture was in place, with **21%** saying it was improving, with changes underway, and **27%** indicating it was not a current issue.

“We are a service business, and our biggest risk is having a capable and reliable team to carry out the day-to-day duties, along with minimal infrastructure (IT, facilities, etc.). We need high degrees of efficiency and productivity.”

“We put a lot of time into planning but we are lacking in implementing it. We don't have all staff fully aligned with the strategic plan. We lack the ability to communicate it for all to see and understand the detail.”

Alignment of all owners and key stakeholders on the future direction of the business is a fundamental building block to ongoing success however, only half (**50%**) of respondents indicated that all owners shared the same vision.

“I see a lot of room for growth in our products. The market is growing at a rapid rate and because I have focused my career on this for almost 15 years, I am in a great position to take advantage of it. But I don't want to do that with the business's current partnership.”

As an indicator of the possibility for disputes between owners, only **9%** of SMEs had formal policies in place that clearly stated each owner's remuneration and incentive structure, areas of responsibility, outputs, lifestyle rewards and how the business would be managed (communication, budgets, targets etc.).

“Business performance for the last two financial years has been impacted by a breakdown in the relationship of the two company directors. Performance has also been impacted by arguments over payments made outside of the business which has reduced the funds we need to support growth.”

Key idea: Owner(s)

Create a vision for the future direction of your business, and ensure buy-in from all owner(s), staff and key stakeholders.

8. Customer and Market Demand

“The solutions we offer are highly specialised. We only have a small number of customers so pricing needs to match the capacity of the customer to pay.”

When it comes to customers and markets, responses show the diversity in SMEs. However, a minority of businesses have customer concentration risks that need to be carefully managed:

- **36%** rely on their top 10 customers for more than **40%** of sales;
- **18%** have **80%** of their profits generated by less than **10%** of customers;
- **17%** have no significant level of recurring sales or annuity income (**20%** or less).

“We have a couple of big clients. If we lost one in particular we would lose half our turnover and need to immediately reduce staff. It has been a concern of mine for more than 15 years.”

40% of business owners did not know how sensitive their customers were to a price increase of **10%**, while **33%** anticipated losing sales if prices increased.

“We know prices increases need to be gentle. We can only get away with 4 - 5 % increases.”

Only **18%** were providing essential services to customers. **15%** were providing luxury (**5%**) or other easy to reduce (**10%**) products or services which were expected to be price sensitive.

“We have a differentiated product, which drives customer loyalty. However, customers can be price sensitive, and drop us like a hot potato if things change.”

Other SMEs were unable to raise prices at all, due to contractual limitations, pricing set by tenders, government bodies, regulations or markets. Others were conscious of price competition or undercutting in their industry.

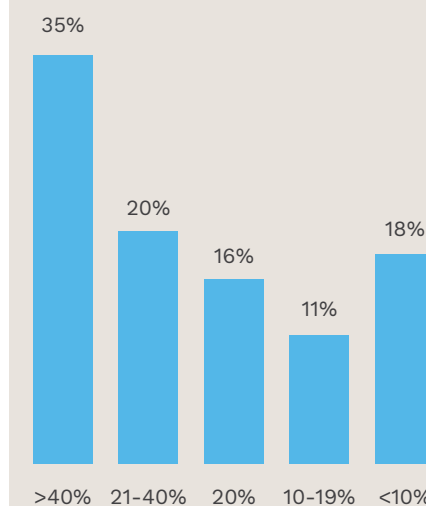
“The industry is very price sensitive. Our pricing strategy is constantly changing, depending on the customer's budget. If it allows, we will increase the quote, however when we are building a relationship we try to meet the needs of the client. Short term loss for long term reward.”

Key idea:

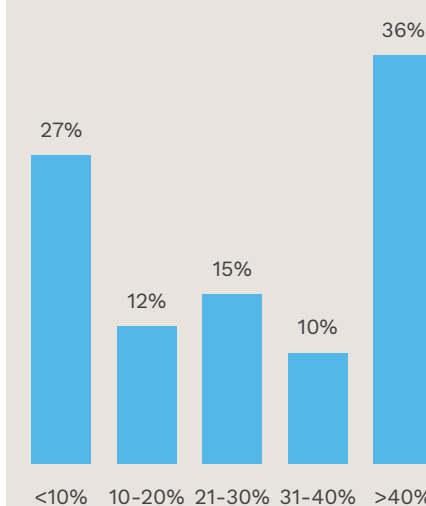
Customer and Market Demand

Use data analytics and customer relationship management systems to deepen existing customer relationships, enhance brand loyalty and investigate new sales opportunities.

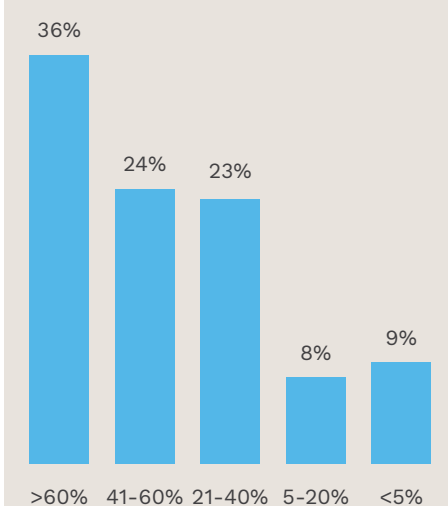
% customers that generate 80% of profits



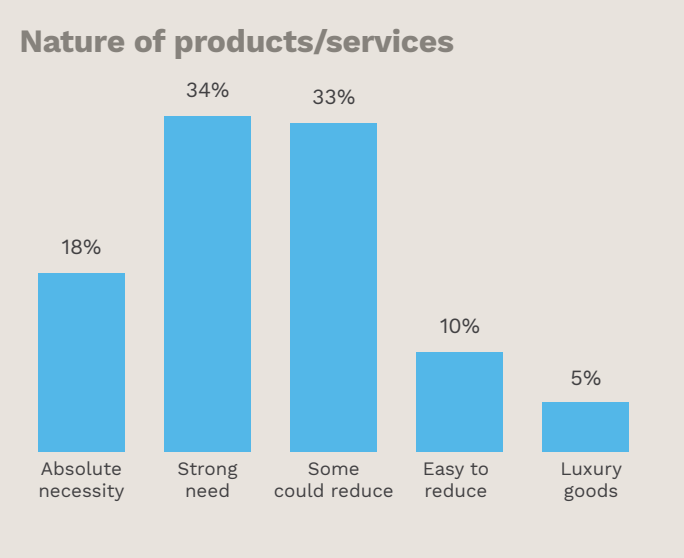
Top 10 Customers % of total sales



Sales Mix % recurring or annuity income



Source: RAVDA Data



Source: RAVDA Data

9. Staff

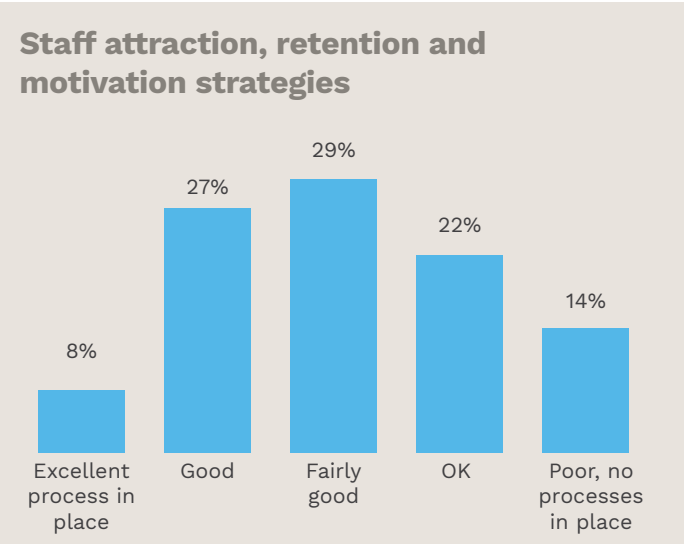
“We are a service industry and human capital is our single most important asset.”

Staff are frequently a business’s most important resource, yet staff engagement remains an issue. Just over half (**57%**) of SMEs reported strong staff commitment to the goals and visions of the business.

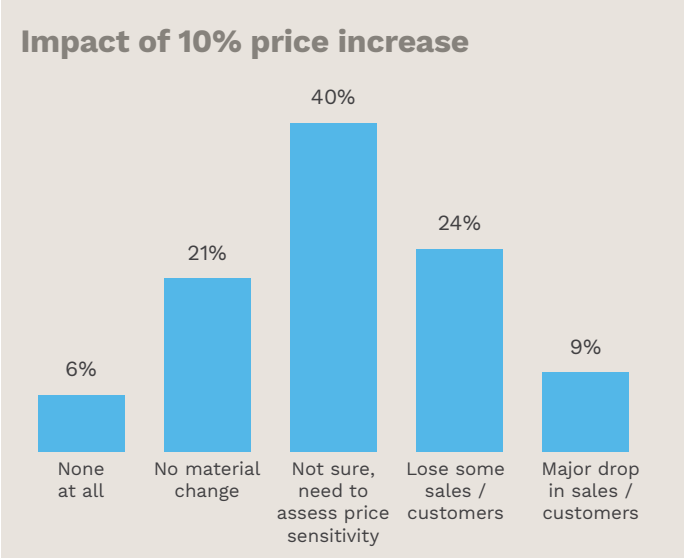
“It’s very hard to attract young staff to our location. We tried using outside contractors and this proved very expensive and training contractors took workers away from their own work. It’s impacted profits.”

There is considerable room for SMEs to improve staff management in many areas and **35%** of SMEs had high levels of concern on this issue.

“Our risks are finding good staff, staff retention, wage rises, back office support structures and OHS management.”



Source: RAVDA Data

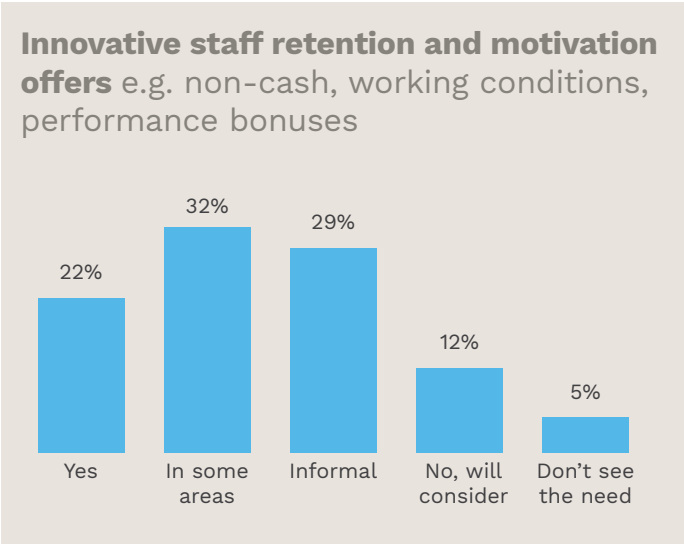


“We just lost an awesome staff member which could have been prevented if we had formal staff strategies in place. I would love to be better in this area.”

Only one third of SMEs rated their processes for staff attraction, retention and motivation as excellent (**8%**) or good (**27%**), and **14%** had no processes in place.

“Staff retention has been difficult in past couple of years. Finding staff who are the right fit for the company has been difficult and there is a high burnout rate in this company and the industry.”

22% of businesses had put in place innovative ways to retain and motivate all their key staff (such as non-cash incentives, flexible working conditions or, performance bonuses), with **32%** reporting measures in some areas.



Source: RAVDA Data

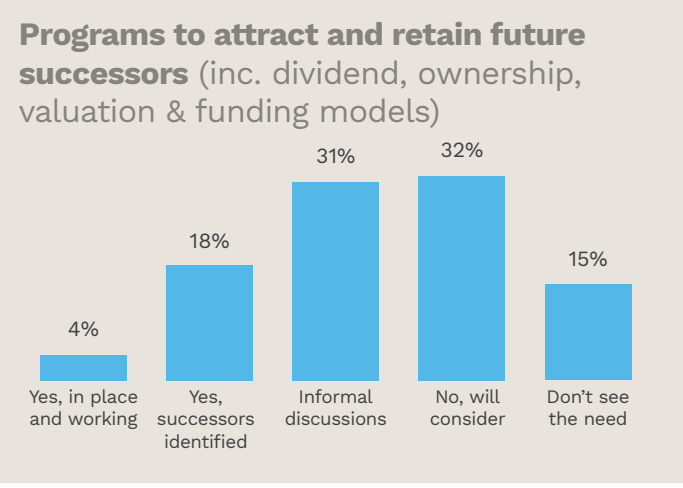
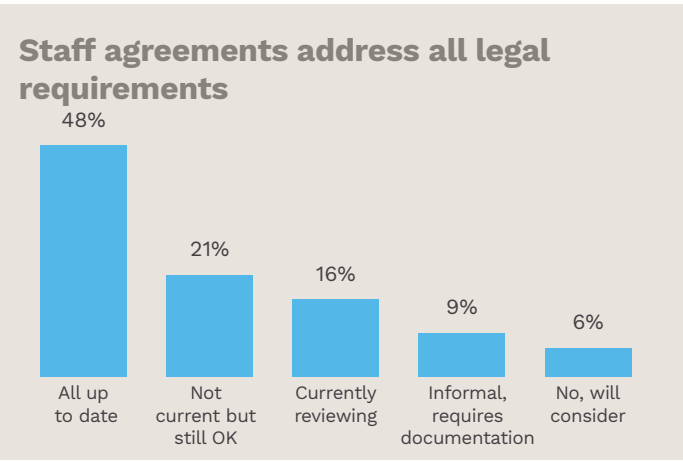
“We do not have formal methods to motivate staff. I find this stressful as I see the need to keep our staff happy and engaged.”

Less than half (**48%**) of staff agreements were reported to be up-to-date and to adequately address remuneration, superannuation, insurances, taxes and other commercial issues such as restraint of trade. This represents a considerable area of risk, given growing concerns about systemic under-award payments, and increasing regulatory attention.

“It would be good to have staff agreements in place. I am not sure how to talk to our staff in regards to formal requirements and what they should know. ”

Only **18%** had identified successors, and a mere **4%** had gone further and taken steps to attract and retain successors for their business.

“All the owners are over 60 years, and no-one in the families wants to step into the business. We are starting to discuss an exit plan, but there's nothing in place now.”



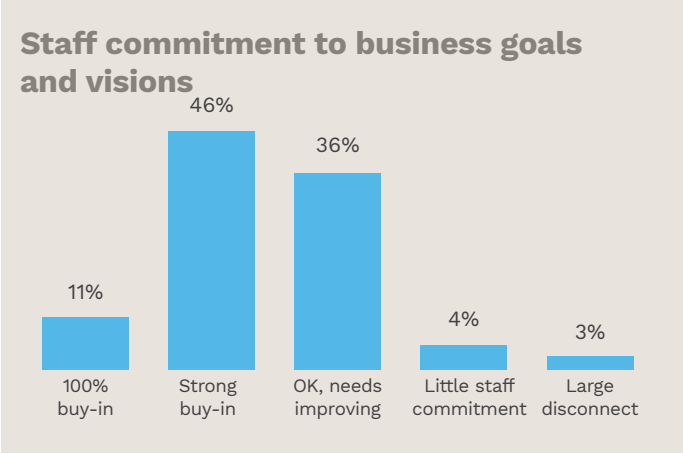
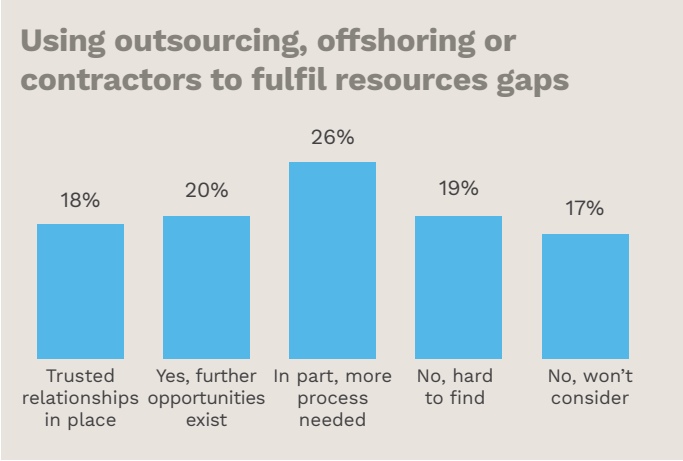
Source: RAVDA Data

Two thirds (**64%**) of SMEs reported making some use of outsourcing, offshoring or contractors to meet and fill resource gaps but only **18%** had trusted relationships in place with providers.

“We have a good offshoring relationship with a Philippines based company which is proving successful.”

Key idea: Staff

Conduct a review of your current employment arrangements, agreements including surveying your staff to improve staff attraction, retention and motivation.



Source: RAVDA Data

10. Finance, Valuation, Succession and Estate Planning

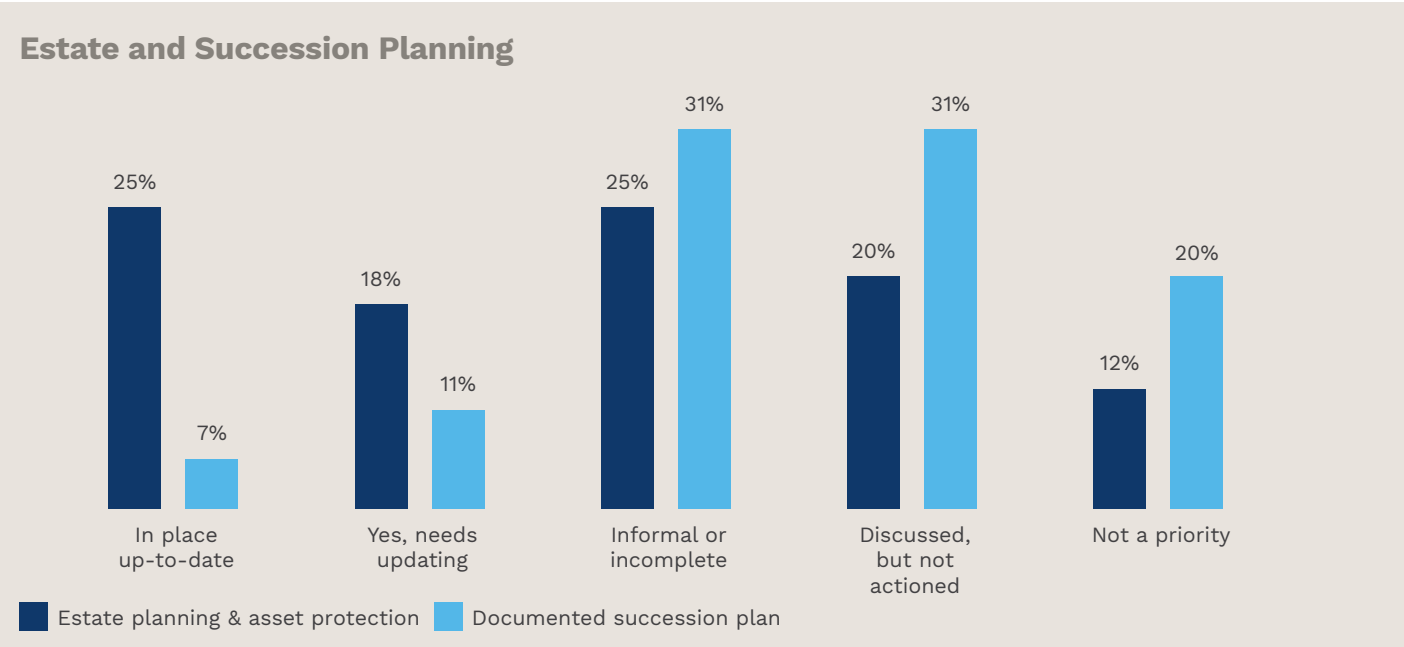
“I don't know what to do. Selling the business [for a high price] sounds like a dream. I would take my half and spend my days reading, traveling, skiing, spend time with my parents and kids, and get fit. When I am re-energized I could look at starting something new - maybe a digital business and consulting.”

When asked whether they had surplus assets to fund their retirement or next business venture, **40%** were unsure of their position while **69%** described a medium to high level of concern around their position.

18% had plans in place to grow their business value, and increase the assets available to meet future plans.

“If I died, my right hand man could take over short term. Existing staff could ensure the business kept going, but there is nothing formal.”

Less than half (**43%**) of business owners have made personal, family and business arrangements for asset protection and estate planning from common trigger events such as business disputes, relationship breakdowns, ill health or death. A further **25%** indicated that arrangements were in progress.



Source: RAVDA Data

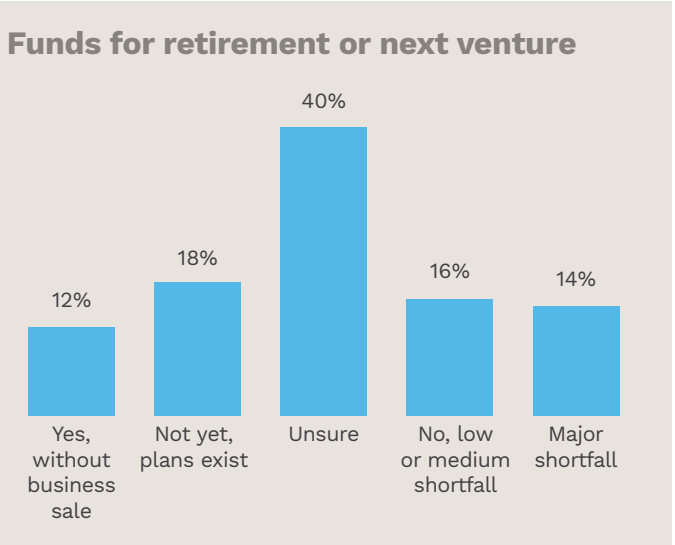
“I don't know what the future holds, and I'm not sure where my marriage is heading. I have been working to build the business for the last 30 years. Do we keep it going for our teenaged kids, who may not want it, or do we sell?”

However, only **18%** of SMEs have documented management and ownership succession plans for their business, with more than half of those plans (**11%**) needing to be reviewed and updated. **62%** had discussed, or started informal arrangements, with **70%** recording medium to high levels of concern on the issue.

“We need to work on identifying potential partners or opportunities so that we don't end up simply closing the business in 7 to 10 years and walking away with a debt to pay out.”

16% of business owners indicated there was no surplus capital in the business available for future growth and succession, with **19%** indicating it could be an issue. **66%** of respondents registered medium to high level of concern on this issue, indicating higher uncertainty about the future. Only **15%** of SMEs were generating surplus capital from their trading operations.

“We are currently struggling to break even and there is no surplus capital. I do not believe the business has any intrinsic value as costs of running it are so high.”



“Our business is very volatile and it would be difficult to get any real value on sale.”

Only **10%** of respondents believed their business model and prospects were attractive to prospective buyers. **23%** said their business was not ‘sale ready’ and **26%** believed modification would be required to prepare their business for sale.

“We are now discussing exit strategies. We need external input to provide some guidance on how different timelines can be achieved without disrupting our business growth opportunities.”

Probably reflecting that most business owners are not contemplating immediate exit or sale, **66%** of respondents had medium to low levels of concern on this issue.

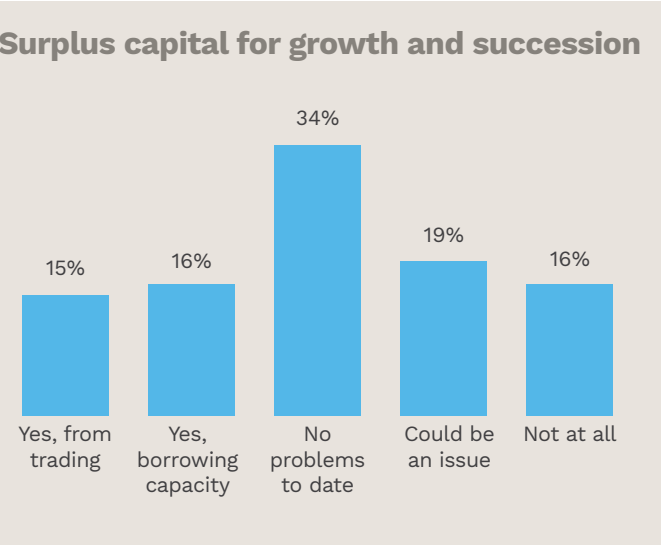
“We are in a growth phase with the intention that the business would be sale ready in 5 to 7 years.”

Key idea: Finance, Valuation, Succession and Estate Planning

Find out what your business is really worth and then prepare a plan to reduce the risk of a value shortfall and achieve your future personal, family and business life goals.

Risk and Value Driver Assessment Benchmarks

Business owners who complete a Risk and Value Driver Assessment are able to benchmark their score to the industry average and top performers (the average of the top **20%**). They can use changing RAVDA scores to measure their improvement over time.



“After we completed our RAVDA, we were able to go back and do a ‘what if’ analysis. We can see the change in the RAVDA score if we make these changes in our business and the potential for improving the value of our business.”

The table below lists the average RAVDA Score for ANZSIC divisions⁵.

ANZSIC Divisions	RAVDA Score*
Financial and Insurance Services	8.02
Rental, Hiring and Real Estate Services	7.51
Accommodation and Food Services	7.51
Health Care and Social Assistance	7.44
Electricity, Gas, Water and Waste Services	7.32
Wholesale Trade	7.25
Transport, Postal and Warehousing	7.11
Manufacturing	7.10
Education and Training	7.09
Agriculture, Forestry and Fishing	7.06
Retail Trade	7.04
Information Media and Telecommunications	7.02
Administrative and Support Services	6.92
Mining	6.91
Construction	6.82
Arts and Recreation Services	6.80

Source: Bstar RAVDA benchmarking data.
*The RAVDA score represents the maximum period (years) an owner is prepared to wait to receive a total return on capital/funds invested in the business. A stronger/higher risk score indicates a business has lower risks and will generate a higher valuation multiple.

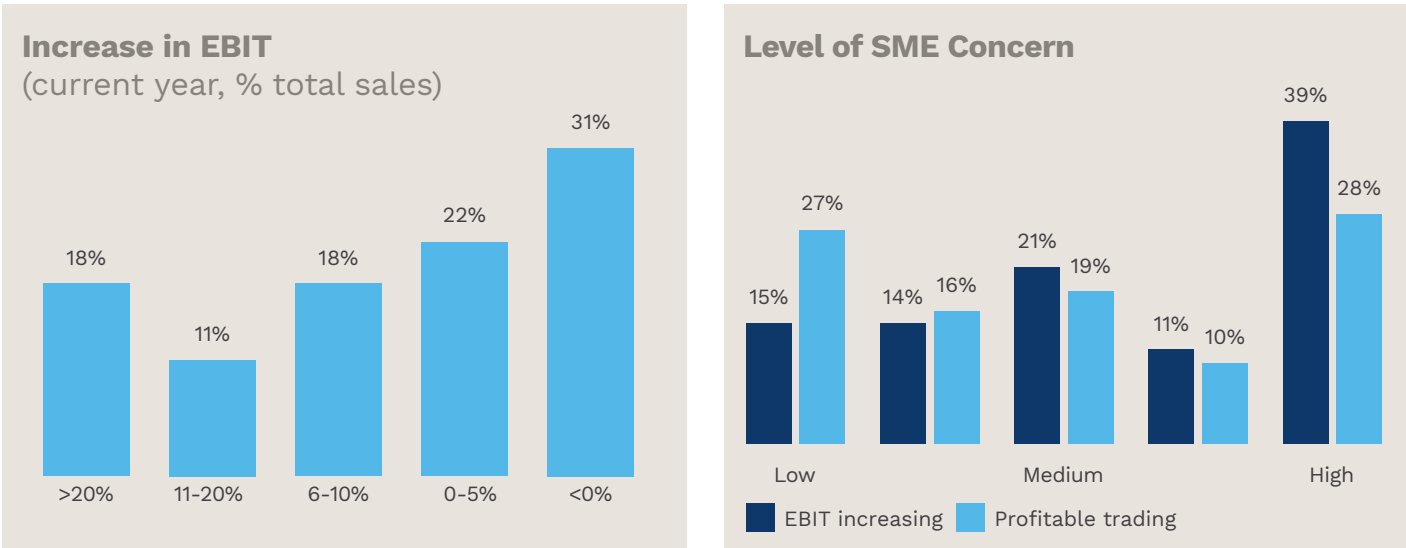
5. Australian and New Zealand Standard Industrial Classification (ANZSIC) refer to www.abs.gov.au for more information.



Most Profitable SME Businesses

Helping our clients improve their **business profitability and cash flow** is a key outcome of our CFO Service (Refer to the Appendix on Sounding Board Relationships).

31% of SMEs had **no growth (<0%)** in their EBIT (earnings before interest and tax) performance in the current year. **39%** rated EBIT performance as a high concern and **28%** rated profitable trading with the same degree of concern.



Source: RAVDA Data

Profitability Benchmarks

When determining profitability benchmarks, profit benchmark calculations must include adjustments for owner’s notional salaries and benefits, abnormal and extra-ordinary items. For example, many business owners may not be paying themselves a market based or commercial salary, and if not adjusted, would result in an overstatement of their profit benchmark.

We have access to the most accurate source of industry profitability benchmarks and the table below lists the average profitability benchmarks organised by ANZSIC divisions⁶. They are rated from the ‘most’ to ‘least’ profitable business segment.

ANZSIC Divisions	WANEBIT % of trading income*
Financial and Insurance Services	26.0
Rental, Hiring and Real Estate Services	23.5
Construction	18.1
Education and Training	16.6
Professional, Scientific and Technical Services	16.4
Health Care and Social Assistance	16.3
Arts and Recreation Services	16.2
Transport, Postal and Warehousing	15.1
Accommodation and Food Services	11.4
Manufacturing	11.1
Wholesale Trade	10.6
Administrative and Support Services	10.5
Retail Trade	8.5

Source: Bstar benchmarking data (*WANEBIT refers to weighted average notional earnings before interest and tax as a percentage of trading income).

6. Australian and New Zealand Standard Industrial Classification (ANZSIC) refer to www.abs.gov.au for more information.



Most Valuable SME Businesses

Helping our clients **grow the value of their business** is a key outcome of our Board of Advice Program (refer to the Appendix on Sounding Board Relationships).

Value Gap Risk

Only **12%** of SME owners were not intending to rely on the sale of their interest in the business to fund their retirement or next business venture.

While the majority of SME owners were not contemplating an immediate sale, only **11%** of businesses were ‘sale ready’, with owners indicating that they had been approached to sell.

“The objective is for the business to develop its own identity and brand and grow so I am not required to be involved in the day-to-day. This will improve market value and improve opportunities for sale or succession at a good value.”

The ease of transitioning to a new owner is a key indicator of how saleable a business is. Low owner reliance and strong operating procedures make businesses attractive to prospective buyers.

“We are still a small business that relies heavily on key stakeholders. To reduce this, we have built up a team of experts around us, and we have really good operations manuals and systems.”

A comprehensive Operating Manual is a key element in obtaining the best value for a business, particularly on exit of the owner or founder, yet less than half (**43%**) of SMEs have a manual in place, with only **24%** describing it as up-to-date and actively managed.

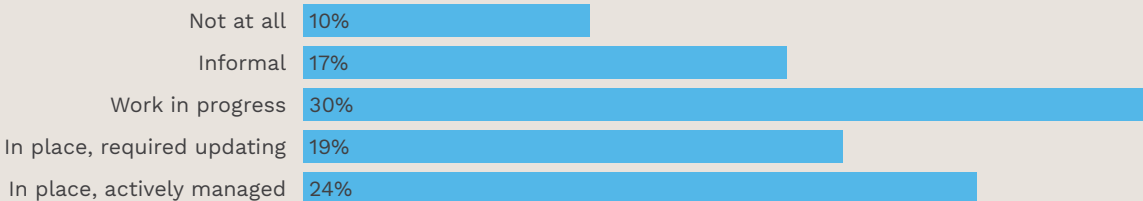
“The business has to be more than me. We have just engaged a brand strategist and our website is currently being renewed to improve presentation and update content.”

Assets and Income to fund retirement or next venture

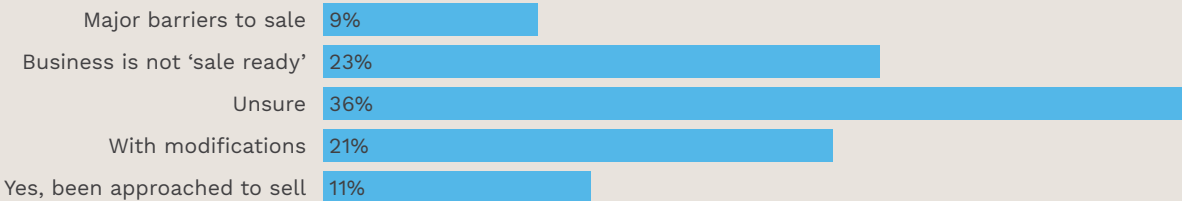
*other than sale of business

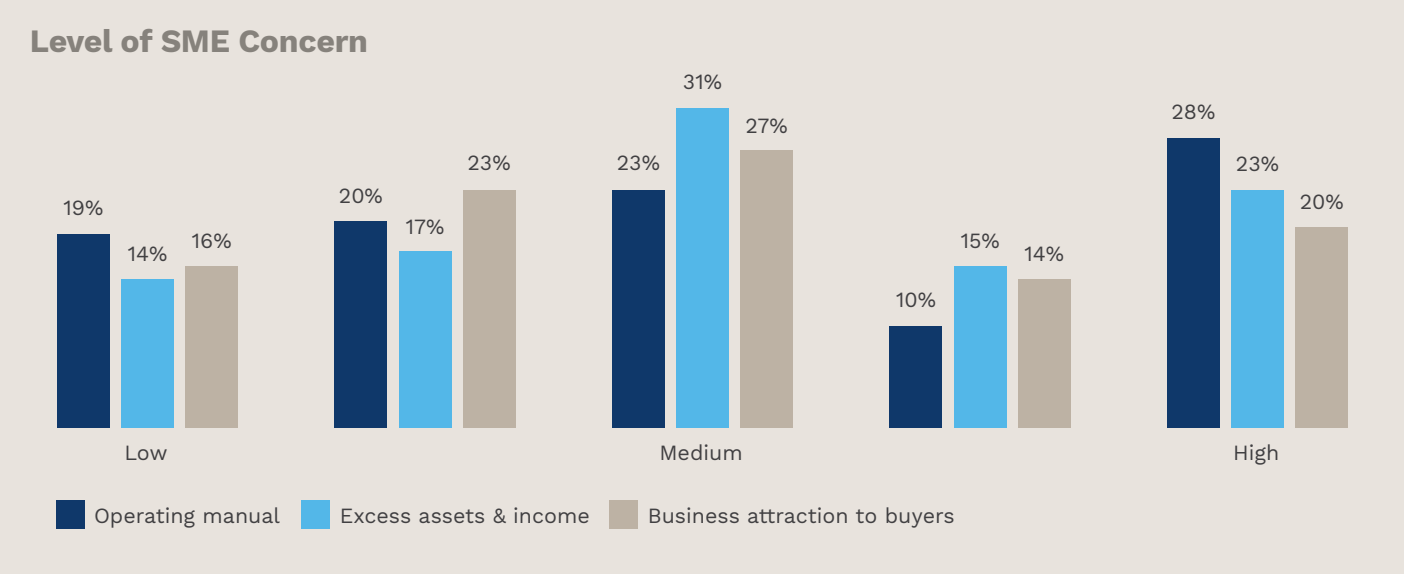


Best Practice Operating Manual



Business Model and Growth Prospects Attractive to Buyer





Source: RAVDA Data

Profit Multiples/Business Capitalisation Rates

We have access to the most accurate source of industry valuation benchmarks and below is a table listing industry average profit multiple/business capitalisation rate benchmarks for ANZSIC divisions⁷.

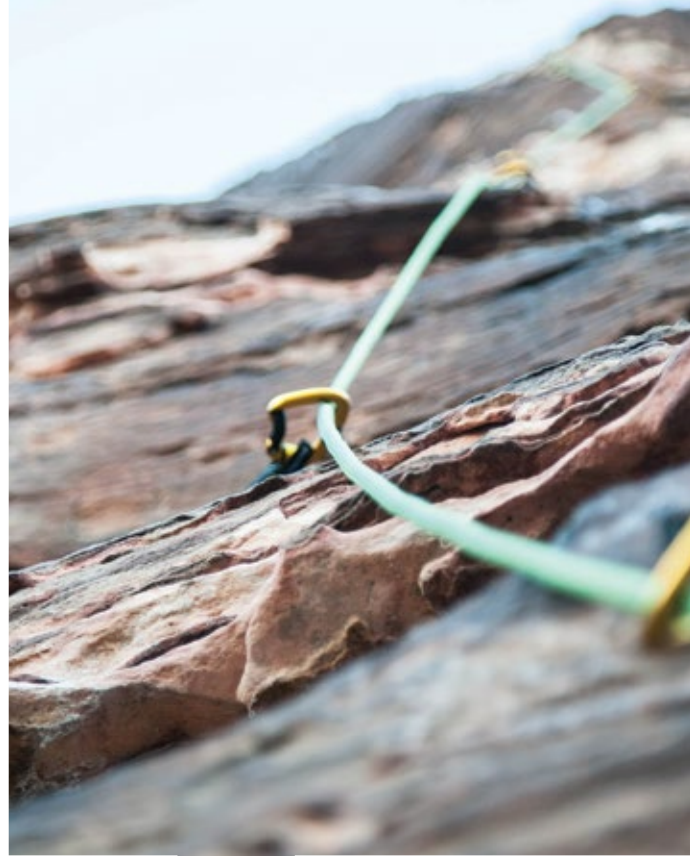
They are rated from the ‘most’ to ‘least’ valuable business segment.

ANZSIC Divisions	Business Cap Rate*
Financial and Insurance Services	5.60
Accommodation and Food Services	3.86
Rental, Hiring and Real Estate Services	3.78
Administrative and Support Services	3.74
Transport, Postal and Warehousing	3.73
Education and Training	3.68
Health Care and Social Assistance	3.59
Professional, Scientific and Technical Services	3.46
Retail Trade	3.39
Manufacturing	3.36
Wholesale Trade	3.22
Construction	3.17

Source: Bstar benchmarking data (*Business cap rate refers to the calculated business capitalisation rate, or discount rate of the expected return from the investment in the business given the risk of that business.)

7. Australian and New Zealand Standard Industrial Classification (ANZSIC) refer to www.abs.gov.au for more information.





3 Steps to Success

STEP 1

Understand the risk and value drivers in your business

After reading this Report we encourage our clients to complete a **Risk and Value Driver Assessment** on their business (or update their existing RAVDA with us). Our goal is to use our client’s responses as part of an annual review of their business performance.

“The costs and consequences of poorly handled non-financial risks can be immense and, at an extreme, catastrophic.

However, establishing the structures and information flows within your control, getting the people and practices right so as to seek out the ‘known unknowns’ that might otherwise endanger your business, is a very achievable objective.”
(James Shipton, ASIC Chair)⁸

Goal: De-risk your business
We previously⁹ highlighted the emerging trend of business owners seeking to de-risk their business. This trend has grown.

Business owners are increasingly aware of a wide range of risks, more than just financial issues and as individual as the SME itself. They are looking for ways to manage those risks.

Business Planning continues to be the key solution to address risk concerns. Planning needs to deal with both financial numbers and identify the Non-financial Risks that could threaten a business. In essence, planning needs to address the concerns that are keeping the **business owner awake at night**.

8. From a keynote address by ASIC Chair James Shipton made 2 October 2019 to launch the Director and Officer Oversight of non-financial risk Report of the ASIC Corporate Governance Taskforce (see www.asic.gov.au for the speech and report)
9. Refer to our 2017/18 SME Research Report - contact us for a copy.

STEP 2

Collaborate to improve business performance

There are many different pathways our clients can choose to use these Insights to improve their business. We encourage our clients to share the Insights with their staff and key stakeholders. We will be contacting you to get your feedback and discuss next steps on how we can help you.

Our **Masterclass** is a new initiative. Attending the Masterclass provides you with practical insights on how to improve your business performance and enables you to share ideas with like-minded business owners to help future proof the growth of your business.

STEP 3

Select a partner to support success

We know the power in bringing together key stakeholders with a common purpose and plan. Our Partners, Directors and Staff are committed to fully supporting our clients to grow and improve their business.

We are investing more resources in developing skill sets and expertise to deliver sounding board services. These services are essential in becoming the **sounding board our clients turn to and trust**.

Appendix: Solutions

Advisory Solutions
Our **Business Risks Survey** includes 10 qualitative risk questions. We are integrating the **Business Risks Survey and Scorecard** in our general tax program to:

- Enhance our quality assurance advisory process;
- Raise awareness of the full range of advisory services available to our clients.

The Solution Matrix highlights how for each question in the **Business Risks Survey** we have identified a risk reduction objective, matched advisory solutions we can offer (directly or in partnership with our trusted team of experts) and the profile of our clients that would most benefit from these services.

Risk Reduction Objective	Advisory Solution	Business Profile
Identifying top 5 business risks and how to manage them	Risk and Value Driver Assessment (RAVDA) and Scorecard	SB, SME, ME
Producing accurate financial information, by product/service category for sales, costs and profit margin	Chief Financial Officer (CFO) Service	SB, SME
Documenting a business growth plan	Better Business Program	SB, SME
Developing management and ownership succession plans, to reduce owner reliance	Board of Advice (BoA) Program	SME, ME
Analysing impact of future changes in technology	Technology Audit	SB, SME, ME
Understanding business performance, compared to industry benchmarks	Benchmarks Analysis	SB, SME, ME
Keeping up with changing customer demands for products and services	Customer Marketing Review and Plan	SB, SME, ME
Increasing staff engagement and productivity	Staff Value Program	SME, ME
Ensuring enough income or assets to fund next business venture or retirement	Business Valuation Service, (including assessment of any value gap)	Business Owners
Protect personal, family and business assets from common trigger events	Advice for Asset Protection and Estate Planning	Personal and Business Clients

Key: SB: Small Business (<\$1M in turnover), SME: Small to Medium Enterprise (\$1M - \$5M in turnover), ME: Medium Enterprise (\$5M to \$50M in turnover).

Sounding Board Relationships and Services

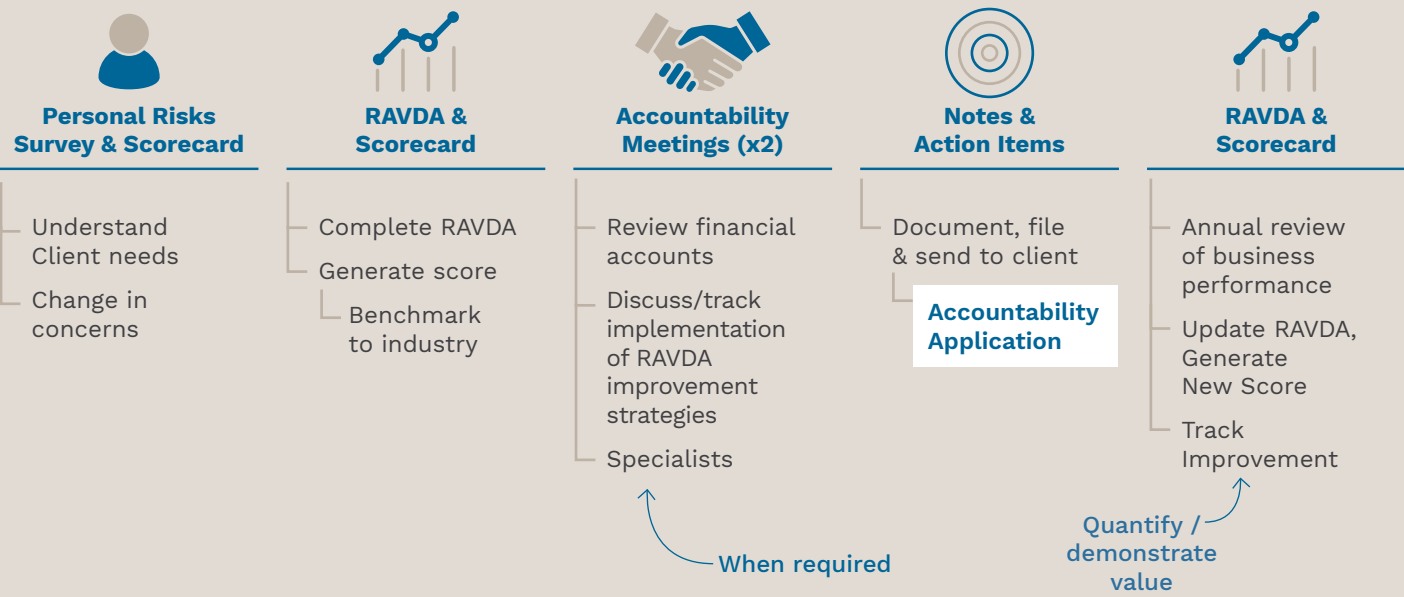
We offer our clients a range of different sounding board services tailored to their individual needs.





Business Planning Mentoring

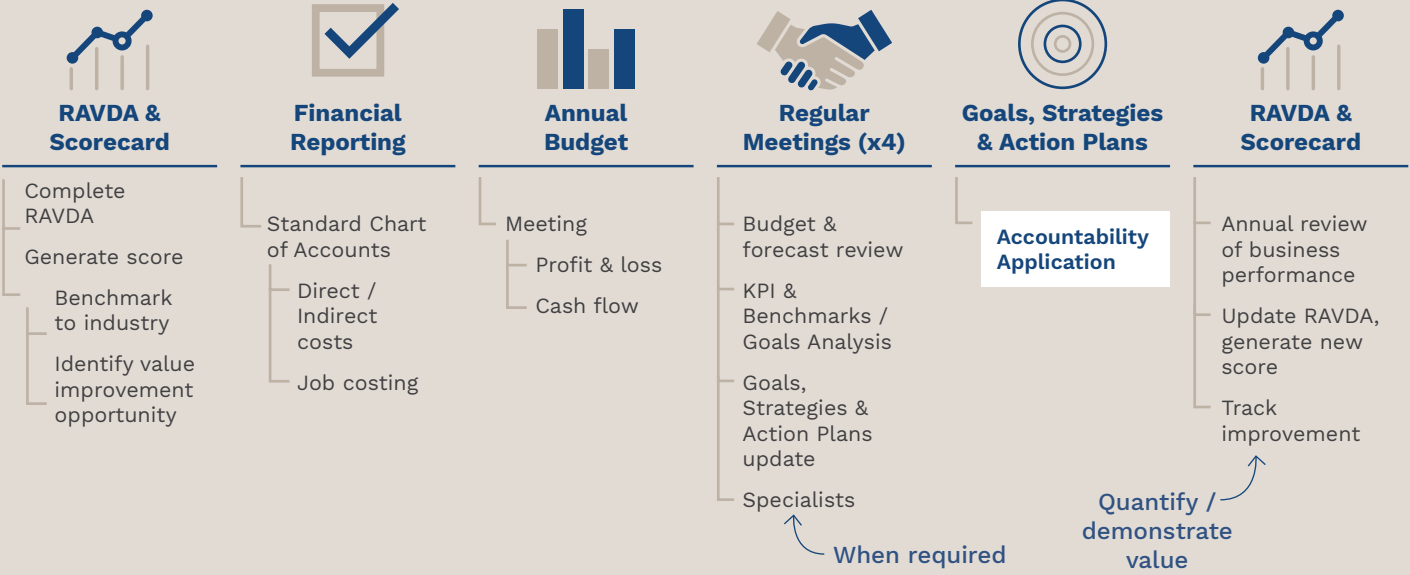
Small businesses who need help to formalise/document a business plan are best suited for our **Business Planning Mentoring**.





Chief Financial Officer (CFO) Service

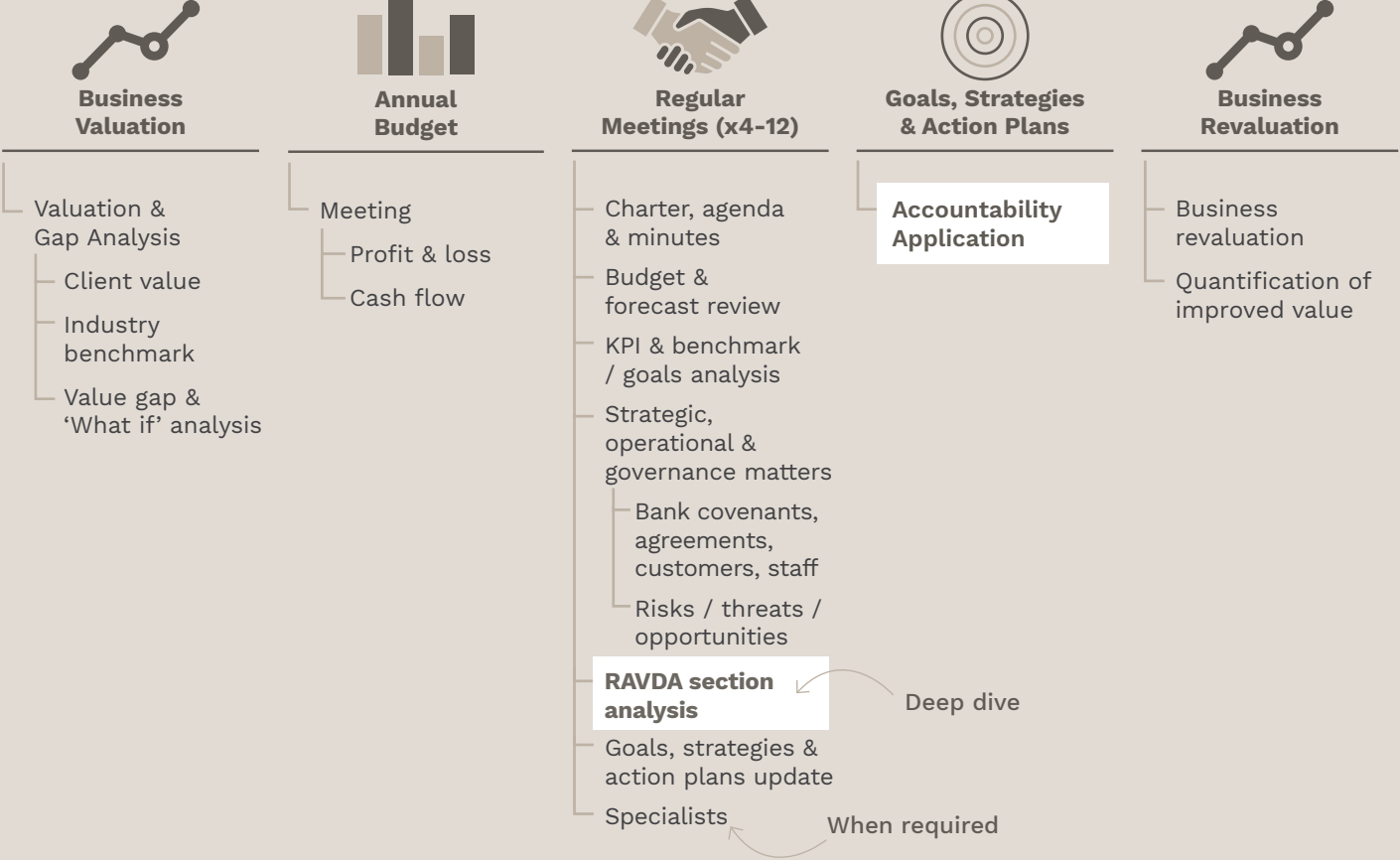
SMEs wanting to grow sales, improve their profitability and cash flow are best suited for our **CFO Service**. They are an established business but need to improve their financial performance by accessing accurate financial information with the support of a 'virtual' or external CFO.





Board of Advice (BoA) Program

A mature business that has got through the pain of profit and cash flow uncertainty is best suited for our **Board of Advice Program**. They are generating sustainable profits. The focus is on growing and transitioning the value of their business to reduce an owner(s) personal value gap risk.



Our Sources and Approach

This SME Research Report has been prepared to provide an opinion on SMEs in Australia and the views of SME business owners. It is for general information only. The 2020/21 SME Research Report updates and expands on the 2015 and 2016/17 and 2017/18 Reports.

The content in the report is taken from a range of sources. These include Business Risks Surveys and Scorecards (1,311 responses to a 10 question online survey of business risks, from January 2018 to 31 December 2019 of SMEs and other industries including Financial Planning, Building and Construction and Tradies), Personal Risks Survey (responses by 200 individual respondents to a 10 question online survey of personal risks from 23 June to 31 December 2019) and Bstar’s Risk and Value Drivers Assessment (RAVDAs) questionnaire (2,071 responses from SMEs in various industries to a detailed RAVDA questionnaire from 1 January 2018 to 31 December 2019). Respondents were not paid for their involvement.

Quotes used in this report are sourced from interviews, notes, RAVDAs, email, surveys and other comments from SME business owners. Quotes are paraphrased or amended for clarity and to de-identify the individuals involved. Statistics are based on standard questions and sample sizes of SMEs across a variety of industries may vary within the data groups. The data is not represented or intended to include all SMEs or all industries. Where data is sourced from other Bstar research and insights reports those reports are quoted, and available from Bstar on request. Other sources, such as public statements by the Australian Securities and Investments Commission, Australian Taxation Office or Australian Bureau of Statistics, are referred to in footnotes.

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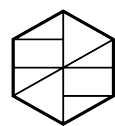
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