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**Our Observations Relating to Small Medium Enterprises**

There is no uniform definition of small medium enterprises in Australia.

- The Australian Bureau of Statistics (**ABS**) defines a small business as an actively trading business with 0–19 employees. Micro businesses are small businesses with 0–4 employees.
- The ABS defines a medium business as an actively trading business with 20–199 employees, and a large business as an actively trading business with 200 or more employees.
- The Australian Tax Office (**ATO**) defines a small business entity (and therefore eligible for most business concessions) to be a business with turnover less than \$10 m (post 1 April 2017 or \$2 million previously).
- The Australian Securities & Investment Commission defines small proprietary companies (for reporting purposes) as business with 2/3 of:
  - Consolidated Turnover < \$25 million
  - Staff less than 50 and
  - Consolidated Gross Assets < \$12.5 million.
- Fair Work Act defines small business (re unfair dismissal provisions) as less than 15 employees

Munday Wilkinson, Chartered & Forensic Accountants, values many Small Medium Enterprises (**SMEs**) each year for purposes including Family Law, Shareholder Disputes, Mergers & Acquisition and Tax Restructuring purposes.

Munday Wilkinson has valued over 2,000 SMEs since July 2000. We have therefore reviewed many SMEs.

**Our observations on SMEs include:**

- 1 Owners of SMEs tend to have close control of operations, undertake principal decision making and contribute most of the operating capital.**

- 2 **Many SMEs are operated by sole traders**, and are not legally distinct from their owners.

**Even when an SME is carried on in a separate legal entity** (company, trust or partnership), it is common for **the owners of the SME to be exposed to some personal financial liability**.

**Small business lending is often intermingled with the personal finances** of the business owner; particularly the residential property of the business owner. The Productivity Commission's (PC's) Draft Report into Competition in the Australian Financial System (2018), considered the proportion of SME lending by major banks that was secured, including the proportion that was secured by a mortgage over residential property. The PC's findings showed that around 80 per cent of SME lending is secured by some form of real estate (including residential real estate).

Where this occurs, the legal separation of the business owner from the business activity, which might exist from the use of a company or trust structure, is partially removed. This is one reason why SME businesses are typically valued on a capitalisation of Earnings Before Interest & Tax basis, ie; on an ungeared basis.

- 3 **Franchising is a popular form of business structure in Australia**. According to the Franchising Council of Australia, the most common type of franchising business model is the 'business format franchise'. The Council defines a 'business format franchise' as: 'a comprehensive system for the conduct of the business, including such elements as business planning, management system, location, appearance and image, and quality of goods'. Per ABS in 2015-16 around 7.7% of all business employing 5-19 staff and 9.7% of businesses employing 20-199 staff were franchisees.

**However, in our experience, many franchisees do not get a fair return on their investment and incur large losses**. This often leads to family law valuations of franchisee businesses.

The final report from the Parliamentary Fairness in Franchising inquiry was released in March 2019. The report took an in-depth look into the current practices and workings of the industry, with a particular look at the relationship between franchisors and their franchisees. The committee was overwhelmingly critical of the existing regulatory framework for the franchise industry, stating that it has "manifestly failed to deter systemic poor conduct and exploitative behaviour", and that current rules had also "entrenched the power imbalance" favouring franchisors.

The report did note that some franchises have achieved the right mix of balancing the interests and power balance of both franchisor and franchisee.

However, Retail Food Group Limited— owner of brands including Donut King, Gloria Jean's, Michel's Patisserie, Crust Gourmet Pizza Bar and Brumby's

Bakery — was used as a case study by the inquiry was single out for particular scorn by the committee.

“The committee recommends that the Australian Competition and Consumer Commission, the Australian Securities and Investments Commission and the Australian Tax Office conduct investigations into the operations and dealings of Retail Food Group, its former and current directors and senior executives and companies and trusts they own, direct, manage or hold a beneficial interest in,” the report said.

“With regard to matters including, but not limited to, the Australian Consumer Law, the Franchising Code of Conduct, insider trading, short selling, market disclosure obligations (including related party obligations), compliance with directors’ duties, audit quality, valuation of assets (including goodwill) and tax avoidance.”

4 It is our experience that for **SMEs with several stakeholders typically do not adopt a Shareholder / Unitholder / Partnership agreement.**

Such an agreement sets out the relationship between stakeholders and typically addresses:

- The relationship between the entity and the stakeholders
- Operation and management of the entity
  - What decisions require 100% agreement?
- Issuing equity
- Payment of dividends and distributions
  - What % of profit should be dividended / distributed?
- Selling of equity
  - What protection is place for minority holders?
  - What controls are on place for transfers of interests?
  - Is there a link between stakeholders and employment?
- How to deal with deadlocks and disputes.

Without such an agreement, unwanted litigation can occur in times or dispute.

5 **Many SMEs do not have a written business plan.**

A written business plan: forces you to think objectively about your business. It leads to questioning of past and future assumptions. makes it easier to communicate planning objectives and strategies to bankers, partners, employees, etc.

6 **Many SMEs do not prepare an annual budget.**

The process of creating a budget takes management away from its short-term, day-to-day management of the business and forces it to think longer-term.

- 7 **Many SMEs have large debit loans to shareholders** as a consequence of the shareholders taking out profit without issuing dividends. This creates SMEs to have to establish Division 7A loan agreements. To clear out such loans would create a tax liability to the shareholder (after allowance for franking credits).
- 8 **Many SMEs do not have a succession plan** in place.

Most organisations, especially SMEs, have an employee who is a key player  
If this person left the business they may leave that business with a big gap.

A succession (or exit) plan is a process where an organisation identifies and develops who could replace a key person in the business if an employee was to leave the business or retire.

Having a succession plan in place shows employees of that business that it values their development and can see potential in their ability to grow with the entity. This will help the employees see a clearer career path if they continue to work hard and develop their skills. It will also, act as a motivation for staff to work hard, while also increasing employee morale.

A SME with an annual budget, a business plan and succession plan in place, is likely to have a higher earnings multiple and therefore business value as there is likely to be less risks associated with the business.

### **Our Accredited Specialists**

Bruce Wilkinson & Russell Munday of this firm recently became recognised as Forensic Accounting specialists by Chartered Accountants Australia & New Zealand (CAANZ).

Bruce Wilkinson, Russell Munday and Victoria Wheeler are recognised as Business Valuation Specialists by CAANZ.

Sharon Olsen of this office has just sat her exams to become a Business Valuation Specialists.

### **Our Aim**

Munday Wilkinson, trading as MW Forensic, is a boutique business valuation and forensic accounting firm established in June 2000.

We offer the legal profession, and others, a quality, personalised, time efficient and cost-effective service.

## **Our Services**

We are well experienced in:

- Business, share and other equity valuations
- Quantification of economic loss
- Loss of earnings assessments /reviews
- Family Law – Single Expert Reports, review of Single Expert Reports, investigations, advising on tax and refinancing issues for proposed settlements
- Fraud Reviews and Financial Investigations
- Due Diligence Reviews
- Professional Negligence matters concerning accountants and directors
- Compulsory Acquisitions – claims assistance
- Due Diligence services
- Expert Determinations
- Expert Witness

We can provide forensic accounting services for a wide variety of dispute related matters from the small to the large.

## **Further Information**

If you would like further information regarding our services, please contact us:

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