PART ONE
Planning for growth

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Business models and competitive advantage

1.1

High growth depends on how you set yourself up to deliver value into the market. ***Colin Mason*** *at the Hunter Centre for Entrepreneurship, University of Strathclyde and* ***Ross Brown*** *at Scottish Enterprise report on how fast-growth enterprises design their business models*

The commercial landscape is littered with examples of firms with innovative products or services which failed because they could not achieve profitability – typically either they could not attract sufficient customers or were based on unsound economics. A good product or service is therefore no guarantee of success in the marketplace. Nor is the best technology. A company also needs to have an effective *business model*. In essence this describes the way in which companies are 'designed'. New business models can have just as disruptive an effect on the competitive landscape as new technologies. Consider budget airlines. By re-engineering the costs and revenues of running an airline they have undermined the competitive position of the so-called legacy airlines. Free newspapers, such as the *Metro*, have had a similar effect on the traditional paid-for newspaper industry. Direct Line's approach to selling insurance over the telephone transformed the personal insurance market, which until then had been sold through brokers. The Internet has facilitated new kinds of business models and the re-invention of older ones (eg auctions). Indeed, as products have become increasingly commodified and undifferentiated so business models are now a critical source of competitive advantage precisely by providing a source of differentiation.

Business models: a definition

At its most basic, a business model is the story of how a company operates. In slightly more detail, it describes how a company competes, uses its resources, structures its relationships, interfaces with customers and creates and captures value to sustain itself. The key elements in a business model include the following:

- The customer value proposition – how will the company create value, and for whom?
- The profit model – how will the company make money?
- The key resources needed to deliver the customer value proposition.
- The company's core competences – internal capabilities or skill sets that enable the company to manage the business in a way that delivers value.

There are various generic forms of business model. But ultimately every company's business model is unique because it is dependent on the collection of resources it controls and capabilities that it possesses. Copying another company's business model is unlikely to be successful. However, over time competitors will be able to emulate the distinctive features of an innovative business model. Changes in the external environment may also reduce a business model's effectiveness. Companies therefore need to continually review and refine their own business model.

Case studies of high-growth companies[1]

It is clear from our interviews with more than 20 high-growth Scottish companies[2] that innovative business models are a necessary – albeit not sufficient – condition for growth. They are a critical source of their competitiveness, providing a value proposition that is not based on price. Although every company's business model is ultimately unique, many features are repeated. These include recurring revenue streams, multiple revenue streams, partnering and close relationships with customers.

One of the most common generic types of business model is the tied-product model involving the sale of the basic product at low cost, or even a loss, as 'bait', then charging a premium for refills, replacements or usage. This model is commonly associated with razor blades, photocopying and printer ink. Optos, which is listed on the Stock Exchange's Main Market, operates on the basis of a novel variation of this model. The company designs, develops, manufacturers and markets retinal imaging devices to detect and diagnose eye problems. The resulting *optomap* exam can lead to early detection of common diseases of the eye. Its technology is leading edge.

The company operates on the basis of a pay-per-patient ('PPP') model, which it describes as 'a key component of its strategy'. Rather than selling these machines (which cost £150,000), clinicians typically enter into a fixed-term contract (usually for a 36-month term) during which time they pay a fixed minimum monthly payment (MMP) that allows them a minimum monthly number of *optomap* exams plus a fee for each exam conducted that exceeds the contractual minimum. They receive service, maintenance, patient support, and software and hardware upgrades. With this business model, ownership of the device does not pass to the customer. Clinicians therefore have no capital outlay.

These contracts provide Optos with a high degree of predictable recurring revenue from the MMPs over the contract term. Each device installed in the field records the actual number of daily exams performed and reports this back in real-time to the company enabling accurate billing for the additional *optomaps* above minimum levels. This business model provides security and visibility of future revenues. The company is also able to raise debt finance based around the security of the guaranteed revenue streams offered by these fixed-term contracts with third party finance houses, with the finance house taking ownership of the underlying device for the period of the loan as further security. Where appropriate, the company will also sell its devices outright. In this model, recurring revenue is generated from service, repair and maintenance and software upgrades through separate financial agreements with these customers. Underlining the dynamic nature of business models, the company has recognized that some potential customers are reluctant to enter into long-term commitments, so it now also offers a prepayment arrangement for a set number of examinations with ability to top up at a higher price than the standard contract.

Future revenue from recurring income is also at the heart of Craneware's business. Craneware, which is listed on the Alternative Investment Market (AIM), supplies a family of software products offering strategic, pricing, revenue cycle and supply management solutions for US hospitals that enhances their revenue capture process. These are sold on a subscription model per licensed user with each contract lasting seven years – the average age of their current contracts is 5.4 years, which indicates the scale of their future revenue flows. From an accounting perspective this revenue is spread over the duration of the contract rather than to the year in which it was obtained. The company's financials are therefore presented in terms of both annual revenue and future revenue under contract. Their consultancy arm helps to increase the market penetration of their software.

ProStrakan, which is listed on the Main market of the Stock Exchange, has developed an innovative business model within the pharmaceutical industry. The standard business model in this sector is based around drug discovery. Traditional 'big pharma' companies invest heavily in basic research to generate new blockbuster drugs. This model costs \$200 million from test tube to market (\$800 million if the cost of failures are included), has a 10-year timescale, and the chance of success with any new drug development is low. The 'biotech model' is based on developing new drugs from scientific discovery, usually in universities. It relies on raising venture capital every 18 months or so and ultimately selling out to a big pharma company if it is successful in developing a new drug.

ProStrakan's business model is very different. It takes existing drugs that are already on the market and reformulates them to be delivered in new ways that better suit the needs of patients. The patents for these drugs may have lapsed, or they are in-licensed from the companies that developed them. So, for example, it has reformulated a cancer drug developed by Roche as a transdermal patch that delivers steadily into the bloodstream for up to seven days, thereby avoiding the often-distressing side effects of chemotherapy. The company has a patent on this new delivery method. Another of its products is a fast-dissolving tablet for the management of cancer pain. The melt technology enables pain relief to be delivered promptly and efficiently. One of the company's skill sets is getting regulatory approval for these new products. The advantage of this business model is that it is much less capital intensive than the drug discovery model, hence much less risky. It is also much easier to grow from a small base. The trade-off, of course, is that the upside is lower.

A key element in this approach is partnering with big pharma companies around the globe. This takes two forms. First, it partners with other drug companies to acquire products that it can reformulate. This is primarily through in-licensing. Second, its commercial operations are focused on Europe and the USA, so it partners with companies in other parts of the world both to gain regulatory approval and to sell their products. It also out-licenses its reformulated products in Europe and the USA in situations where a specialized sales force is needed. It has also acquired companies in Europe for their infrastructure.

The importance of partnering to access complementary resources is highlighted by two companies in the recycling industry. Stirling Fibre focuses on their core business of processing paper and paper-based waste, where they have the knowledge and infrastructure, and partner with other businesses involved in other stages of the business, such as collection. It processes about 80 per cent of all local authority waste in Scotland. Its diversification into other forms of recycling (plastics, waste into energy) is through joint ventures. Redeem engages in the recovery, refurbishment and recycling of consumer electronic devices on a global basis. It started on the basis of recycling print cartridges and subsequently moved into mobile phones and is now moving into the digital camera, MP3 player, laptop and satnav markets. In the case of printers, their model is to partner with charities, schools, retailers and other organizations as a means of engaging with the public and businesses to give them cartridges. Redeem will either pay the source of the cartridge in cash or loyalty points or will make a donation to charity. Redeem then sells the cartridges worldwide to companies that specialize in mass refilling who then sell them on to retailers to market under their own labels. In the case of mobile phones Redeem has agreements with retailers to recover phones. They then data wipe and test them before selling them on to customers – these include African phone networks, insurance companies and traders.

Another type of business model is illustrated by two engineering companies that both present themselves as total solutions providers. This is Star Refrigeration's business model. It tries to avoid competing on the basis of tendering, which drives prices down, and instead seeks to 'engage customers on more than just price'. It does this by offering a total package comprising consultancy services, design, manufacture, installation and maintenance for all industrial cooling and heat pump solutions. Increasingly it also supplies ancillary features such as energy efficiency monitoring systems. The company's value proposition is based around its design and engineering skills, innovation and close engagement with the end-user. Barr + Wray provides a second example of this approach. The company began as filtration engineers but have now moved into the design and installation of swimming pools and health spas in hotels and leisure resorts. Barr + Wray's value proposition is its project management skills in organizing and coordinating a wide array of suppliers. It developed this model in response to the decline in its original business selling specific products (pumps and filtration equipment). Like Star, Barr + Wray recognize that they are not the lowest cost provider and so seek to engage with potential customers on more than simply price.

The final case is Goals Soccer Centres, another AIM-listed company, which has created a network of more than 30 five-a-side soccer centres across the UK and is currently expanding into the USA. It has positioned itself as distinctive from the 'beer and football' model of its competitors. Its business model is based around three components. First their centres are located on premier sites with a population catchment of at least 150,000 and in accessible locations. This ensures high utilization. Second, they invest substantially more than their competitors (£2.3 million per centre compared with £1.5 million) to provide high-quality 'next generation' facilities comprising the latest artificial pitches designed in collaboration with manufacturers to their specification (rather than bought off the shelf) and high-quality facilities including floodlights, superior changing rooms, licensing lounge, 9–14 pitches and car parking. This generates high returns. Third, they offer a superior service in the form of a bespoke IT booking system, support for leagues, Football Association qualified referees, and affiliation with Football Associations, features which create a competitive advantage, justifying a price premium. The company uses yield management pricing. With this model, Goals derives most of its revenue (over 75 per cent) from football, with the rest from food and drink, in sharp contrast to its competitors, who typically rely on food and drink for half of their revenues. The company's biggest problem is finding affordable sites. It therefore focuses on sites with lower values because of restrictions on their use, such as school campuses where it can partner with local authorities, offering school access during off-peak hours.

Conclusion

The business model attracts relatively little attention in discussions of business competitiveness and growth. However, these cases highlight the centrality of the business model to the underlying competitiveness of high-growth companies, creating product and service differentiation which enables them to compete on the basis of non-price factors. Entrepreneurs, in conjunction with their advisors, therefore need to consider whether their own business models are 'fit for purpose'.

Notes

1 Details of the full study are as follows: C Mason and R Brown (2010) *High Growth Firms in Scotland*, October 2010, Hunter Centre for Entrepreneurship, University of Strathclyde, Glasgow and Scottish Enterprise. [Online] http://www.scottish-enterprise.com/news/2010/11/high-growth-firms-could-be-key-to-economic-success.aspx

2 High-growth firms were defined using the OECD definition: enterprises with average annualized growth in employees or turnover greater than 20 per cent per annum, over a three-year period, and with more than 10 employees at the beginning of the observation period, should be considered as high-growth enterprises. The observation period was 2005–08.

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How to compete against fast-moving, innovative competitors

1.2

*Entrepreneurs are now having to learn to play by a different set of rules, says **Allison McSparron-Edwards**, Managing Director of Consultrix Ltd*

The strength of destabilizing forces such as digitization, globalization and deregulation are gathering pace and affecting all businesses, making it harder than ever to plan for the future. Competition from Brazil, India and China is intensifying all the time but in new and different ways. These new entrepreneurs are quick to identify market opportunities, do not feel tied to the old ways of doing things and seem able to motivate their employees in new and exciting ways.

CEOs must identify different ways of competing against these emerging, aggressive, innovative global entrepreneurs. They must develop not only appropriate strategies, but also the necessary leadership skills to deliver adaptive corporate cultures, management process and innovation. Without such innovation and strong leadership skills strategic initiatives will fail.

Successful companies continue to struggle

There are many reasons why Western companies are currently failing to compete successfully against these emerging markets. Many large, successful companies have become victims of their own success. CEOs were taught that, to achieve success and profitability, they should design and control their business environment, corporate cultures and resources. Although this enhanced profitability in the short term (by driving down costs) it created a culture of bureaucracy and an inability to cope with fast-paced change. They managed the world around them in a regimented manner using data analytics, scenario planning and predictive planning. Unfortunately, what they lost was the ability to adapt quickly to ever-changing environments.

Emerging from a recession CEOs now find that they have fewer resources than ever and that those they have are constrained and overly structured. They have since discovered that what worked in the nineties no longer works in the noughties; eg collaborative relationships with suppliers sounded like a great idea but in today's fast-moving markets these relationships may have become ties that bind and restrict fluidity.

Emerging entrepreneurs don't necessarily have a past to refer to, or rules to obey. They can innovate, make up the rules as they go along and allow intuition to direct them.

Adapt or die

Modern businesses, especially in emerging markets, use the Internet, Facebook, Twitter, e-mail, mobile phones etc to rapidly communicate with media-savvy customers all over the world. These technologies allow the customer to be in control of much of the purchasing cycle. They can try on glasses in virtual environments (virtual-try-ons), check whether they like design combinations of car trims and colours, or ask online communities for recommendations on what to purchase and for how much. Customers, rather than suppliers, are in control and CEOs need to adapt their companies with great speed to cope with this new paradigm or their businesses will retrench and ultimately collapse.

Strategic insights v foresights

Part of the ability to survive is to create meaningful, differentiated strategies. Kim and Mauborgne in their book *Blue Ocean Strategies* explain how CEOs can begin to identify where the next big ideas are going to come from. They use the analogy of oceans to explain that Red Oceans represent all the industries in existence today and the known market space; whereas Blue Oceans denote all the industries not yet in existence and therefore unknown markets.

For Red Ocean companies the competitive rules are known, each tries to outperform the other and grab ever-larger market shares until eventually profits and growth are reduced for all competitors. Products, copied by all, eventually become commodities and cut-throat competition drives down prices leaving even less to allocate to research, innovation and development.

Red Ocean strategies were conventionally built on highly defensible positions within existing industry sectors. They were often based on a military heritage referring to corporate officers, headquarters, troops, front line, wars and constraints on limited terrain. Over time, as they and their competitors grew, supply exceeded demand. This was subsequently exacerbated by globalization, trade barriers being dismantled and information becoming instantly available so that in the end niche markets and havens for monopolies continued to disappear. The result was accelerated commoditization, increasing price wars and shrinking profit margins.

On the other hand Blue Ocean companies, like those in emerging markets, understand how to identify and develop untapped markets, where demand can be created and the opportunity exists for highly profitable growth. Most new Blue Ocean companies are created from within Red Ocean companies by expanding existing industry boundaries and are driven by competition-based Red strategists. They open new and uncontested market space. They understand that creating Value without innovation tends to focus value creation on an incremental scale, something that (while it improves the value) is not sufficient to make the products and services stand out in a global marketplace. Innovation without value tends to be technology driven, market pioneering or futuristic, often shooting beyond what buyers are ready to accept and pay for.

To be really successful innovation requires a 'leap in value' for both the buyers and suppliers. Red Ocean companies believe that the structural constraints are given and that firms are forced to compete within them (a structuralist view or environmental determinism). Instead Blue Ocean companies believe that market boundaries and industry structures are not given and that they can be changed by the actions and beliefs of the players.

Are we exaggerating this corporate ability to be innovative and to develop untapped markets? Proof that it is possible can be seen from the new industries that emerged over the past 100 years, including automotive, sound and picture recording, petrochemical, health care, management consulting etc. When everyone thought there were no new markets to create, radical new ones were invented, eg mutual funds, mobile phones, gas-fired electricity plants, discount retailers, express package, snowboards, coffee bars, home videos etc. Is this rate of innovation slowing? Not if the emergence of new products such as Twitter, Facebook, iPhone, iPad etc are anything to go by.

The future is in your company's hands; avoid fixating on analysing the past and predicting the future otherwise your company will remain a Red Ocean company and you will be left behind by emerging, nimble, intuitive Blue Ocean companies.

Creating Blue Ocean strategies

Kim and Mauborgne recommend that companies wishing to create Blue Ocean strategies understand in detail how their products/services perform against the market in order to understand what Value the ultimate customer derives from acquiring them. They encourage companies to understand what the trade-off is between differentiation and low costs in order to create new value curves. Ask what factors, which your industry takes for granted, could be eliminated, or could be reduced below the industry's standard; what could be raised above the standard; and what factors could be created that the industry has never offered. Their Eliminate-Reduce-Raise-Create Grid pushes companies to understand the opportunities facing them and to develop innovative strategies to find their very own clear Blue Ocean Strategies.

You can tell if your strategy is a good one if it has the following characteristics:

- clear focus
- divergence from the norm
- compelling tagline
- buyer utility (do people really want it?)
- an accessible price to the majority of buyers;
- deliverable at a profit;
- only sell what people want and need.

Doz and Kosonen in *Fast Strategy* point out that people are not interested in products per se but in solutions to problems. They note that IBM sells business ‘improvement solutions’ and Nokia sells ‘experiences’ not computer software or mobile telephony. CEOs must, therefore, begin by asking themselves whether they are selling products and services that customers *really* want.

Both Chip Conley who, in his book *Peak*, focuses on explaining how Maslow’s hierarchy of needs can be applied to Clients; and Barnes, Blake and Pinder, who wrote *Creating and Delivering Your Value Proposition*, have developed methodologies for analysing the customer journey to ensure that a company truly understands what psychological value the customer obtains from buying their products and services. Companies must be ‘tuned into’ customers’ needs and react amazingly fast to fill the gaps if they are to be successful. Remember; if you don’t identify the gaps then someone else will.

‘Stop doing’ v ‘start doing’

As Drucker wrote, in the *Harvard Business Review* (November 2009), not everything a company produces is actually wanted or is profitably produced. He recommended that to be more focused companies need to ask themselves what they should ‘stop doing’. Just because you know how to make something does not mean that someone wants to buy it. Companies shouldn’t try to offer everything to everyone. Instead they should focus on a few distinctive competencies, as suggested by Prahalad and Hamel, that can be redeployed and leveraged. They need to continuously redirect and/or reinvent their core business without losing momentum. To compete with fast-moving companies the new goal should be to make what people want (profitably) or stop doing it; after all, successful companies are unlikely to be making something that other people don’t want.

Talent

New ways of thinking are becoming ever more important. To deal with the fast pace of change fast pattern recognition becomes more important than the ability to analyse preconceived scenarios and historical datasets. CEOs are the people who have to create the future and shape the market and competitive forces to their advantage. They will need to employ people with different talents who see change as a challenge and can cope with it; who see competitors in emerging markets not as threats but as something to understand and potentially emulate.

Leadership and talent

In the past, to change cultural attitudes, managers would have followed Conventional Wisdom focusing on trying to align the attitude of large numbers of employees to new strategic objectives; often requiring steep resources, over long time frames. This is a Red Ocean strategy and it won't help deliver your new Blue Ocean strategy in a timely and convincing manner. Consider instead Tipping-Point Wisdom (as demonstrated by Malcolm Gladwell in his seminal work *Tipping Point*), which instead focuses on individual people, on acts and activities that can exercise a disproportionately positive influence on performance, achieving a faster strategic shift at a lower cost. To keep up with your competitors you need to change the minds of the few who can influence the actions of the many as fast as possible.

In the end, to be competitive, perhaps the most important strategy of all will be the ability to recruit and develop the very best of the worldwide talent. Seek new recruits from other cultures, and other markets; learn from their behaviours and incorporate the very best of what they do into your corporate cultures so that your company can become nimbler, more intuitive, innovative, commercial, competitive and profitable.

Allison McSparron-Edwards, managing director of Consultrix Ltd, began life as a chartered accountant before training to become a business psychologist. She has worked at board level in companies of all shapes and sizes using strategy and psychology to improve commercial returns. Allison combines a shrewd business sense with the ability to understand the human issues involved in leading and managing companies: honest and forthright, she tells it how it is. Consultrix Ltd works with creative and knowledge-based companies improving profits and capital values. For more information contact: Allison on **allison@consultrix.co.uk**; tel: 01793 726128; or see the website: **www.consultrix.co.uk**.

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How to build a growth plan

1.3

As well as being creative and motivational, you are going to have to be organized and systematic to maximize your growth, says ***Robin Tidd***

Background

For a small team of people who have created and established a business through hard work and creative talent, it probably doesn't seem a very enticing prospect to get into the habit of formality, of strategic planning, of financial forecasting and of formal management control. In fact, introducing this kind of methodology is an essential step on the way to securing the future. It works very much in harmony with the process of building a leadership team who share values and have their sights on higher targets. Strategic planning and other growth-enhancing formalities should actually prove to be very rewarding and motivating as an exercise.

This chapter is mainly concerned with the process of growth. The reasons that the 'professional advisors' recommend growth plans or strategic plans are firstly because they see failures that could have been avoided and most importantly because they know that all of the most successful businesses are organized and systematic as well as being creative and motivational as a philosophy.

The best-known and most accepted method of planning and review for almost any process is 'plan; do; check; act'. This method was designed to ensure not only control but also dynamism in the creation and delivery of ongoing improvements.

This chapter will give you guidance on the four planning and control processes that apply to growth. It is important that growth plans are effective and not lengthy and overburdened with spurious detail. I have called them 'the four cycles' and they concern:

1. business strategy and the overall health/state of the business (including identification and mitigation of risks);
2. sales and marketing strategy and planning;
3. day-to-day and week-to-week control of all business operations and functions; AND
4. people and culture.

The last of those cycles is often not formalized, but I believe it is at least as important as the other three and does lend itself to the 'plan; do; check; act' methodology. The last two of these cycles may seem to be operational rather than strategic, but the key trick is to ensure that 'monitoring systems' also produce improvement and growth… dynamism.

But first… some practical observations about growth

- Businesses become constrained if and when an owner/founder fails to develop a team around them. If the MD does not delegate and build a structure of trusted managers, change happens much slower, and is more painful.
- On the other hand, a strong management team adds significantly to both the growth potential and the value of the business.
- Having tangible growth plans takes you one step further still, in that you have a methodology which does not rely on organic growth but drives growth beyond that level. Again this increases the worth of the business to its owners.
- It is particularly important to see marketing and sales as two linked processes. They lend themselves to process analysis and interpretation, perhaps with the concept of funnels and pipelines or CRM database management (Customer Relationship Management). It is an obvious comment, but marketing and sales are at the pointed end of growth.
- It is helpful in a growth context to see marketing as an ongoing process that starts with feedback, identifying opportunities to increase sales based on the needs of the market. A great definition of marketing is advance thinking and preparation to make sales easy.
- Businesses that make a good job of involving the 'front line' in most of the important business issues are more likely to handle growth problems better, especially the 'people problems'.
- SWOTs (strengths, weaknesses, opportunities and threats) and Critical Success Factors (factors that will make all the difference between average and great performance) become more significant and more potent as the business grows. This is not so much a survival issue, but one concerned with gaining competitive advantage and beating the opposition.
- Financial planning and forecasting are reasonably common and quite well done in some small businesses, but all too often a once-off and static spreadsheet is created when this could easily be made into a dynamic model to be refreshed overnight when something significant happens. Formal risk management is much less common and should involve serious risks and their potential mitigation.

Next… typical roadblocks to growth

This is my own view of the most common roadblocks to growth, things that could hold a business back for some time, or even permanently. These issues or blocks *should* be successfully removed through the correct use of the four cycles:

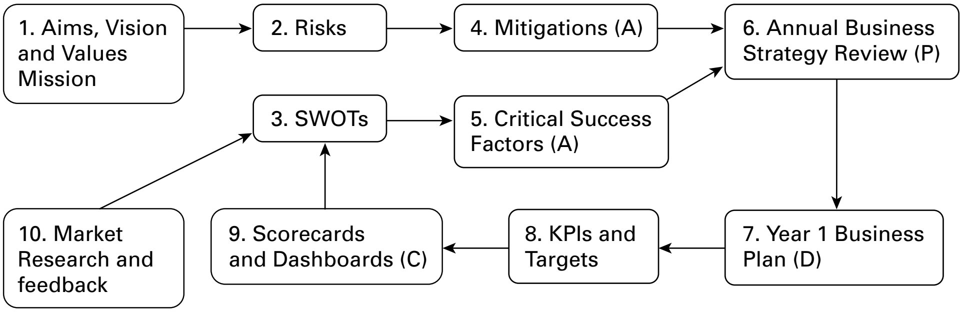
- **People in the business are not challenged, maybe not even permitted to make a contribution to the most important things within the business.** As a result less-helpful attitudes (lacking pro-activity, and pulling against the business) may be tolerated or even promoted. The result of this is genuinely all round under-performance.
- **KPIs… too much of the wrong information and not enough of the right information, produced too long after the event.** Information has a massive effect on the culture of the business through the consciousness and priorities of people in the front line. Performance indicators are different to results indicators in that they *do* have an effect on behaviours, but they must be simple and frequent and must pinpoint the key process issues. Otherwise, improvement is constrained.
- **The Strategic Review is dealt with on the hoof, informally and not using a robust enough process.** If the inputs are narrow, involving too few inside people and if there is too little research into market trends, the resulting strategy is less clear and confident. As a result the business carries on in the same direction at the same speed and misses opportunities to strengthen and grow.
- **Monitoring of market segment profitability and product or service group profitability.** If any part of the offering or any segment of customers is unprofitable, or does not look like promising profitable growth, this means that profit is being lost or resources are being sapped. The business could be making money with one hand and losing it with the other. The 'wrong' is to fail to monitor these factors on an ongoing basis.

The four cycles, the use of which will help organizations to achieve profitable growth

The Deming Cycle mentioned above as 'plan; do; check; act' involves establishing a process and operating it, but then crucially monitoring the success of the process at all points and identifying how the process can improve. The converse situation would be merely to operate the process and not to seek improvement unless something was badly 'wrong' with the process. This converse could be described as 'plan; do; do; do; do; and if the wheel comes off… firefight'. You can perhaps see what we mean by the pro-activity and dynamism of the Deming Cycle. I have shown below, in diagrammatic form, the four cycles.

Business strategy review process

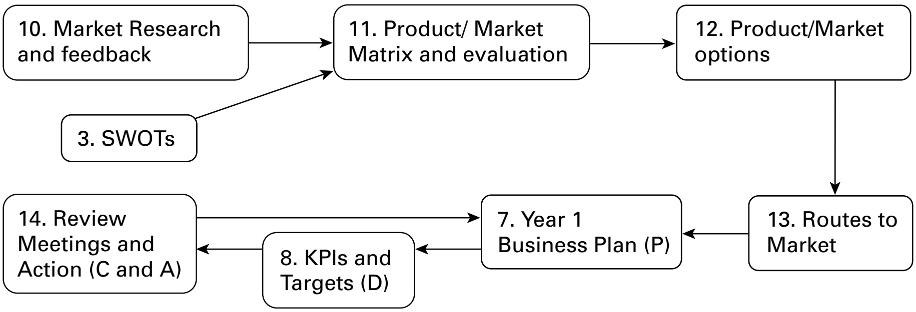
FIGURE 1.3.1 Business strategy review process



The process above shows the Plan, Do, Check, Act stages. It is an annual process whose objective is to keep the one-year plan 'relevant', which means in line with the outside world, the inside capabilities and the long-term aspirations.

Marketing strategy review process

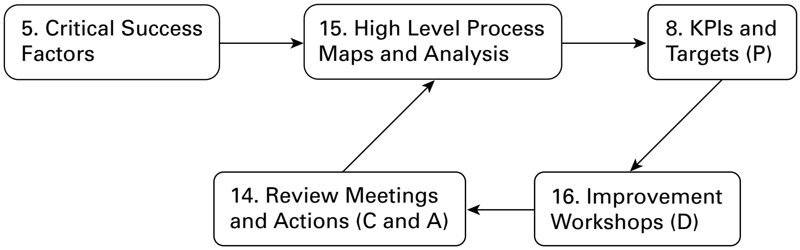
FIGURE 1.3.2 Marketing strategy review process



The Marketing (and Sales) plan is coordinated with the Business Strategy as regards the setting of Sales and Marketing Strategy and then targets for the year, in the Business Plan. You can see the common boxes 3, 7, 8 and 10 in both figures above. The above cycle *then* takes us down to the day-to-day monitoring of implementation of the plan and strategy via the Action Review meetings.

Operational effectiveness and continuous improvement

FIGURE 1.3.3 Operational effectiveness and continuous improvement



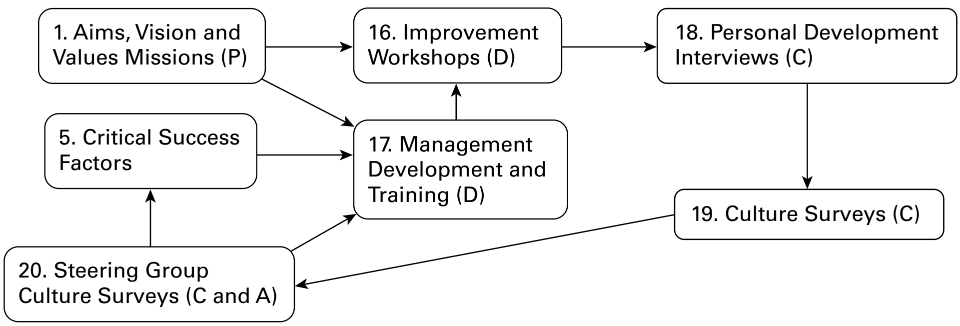
The greatest portion of the work of growth and improvement should be going on within this cycle in practice with meetings on most days in most areas and actions generated from two sources:

- from the Critical Success Factors requiring specific improvements as identified in the Strategic Review;
- from the constant process of holding Improvement Workshops following on from training in (eg) Lean Operations.

People and culture

This is a process (see Figure 1.3.4) that is in formal use in only the minority of organizations. In fact I feel it is potentially the most productive and generative cycle of all in times of growth. It is intended to bring about good attitudes and a good culture, which in turn will produce ideas, innovations, improvements and self-motivation among people at all levels. Like all of the cycles, it will work infinitely better if it is managed.

FIGURE 1.3.4 People and culture



Strategic risks

It is to be hoped that your organization, or alternatively its key strategies for success, could not be seriously threatened by a single event or a series of 'domino' effects. We have had some very serious examples in banking and oil impacting on the world economy and they serve to warn us that the threat is not to do with probability of 'the hit' but the consequence of the hit. I know this phenomenon has been described as 'a black swan', meaning that until we saw a black swan, we didn't believe it existed. Risk management is worthwhile when it allows us to mitigate the risk by imagining it and preparing a reasonable reaction to counter the effects 'just in case'.

A management initiative to manage strategic risk would be required to complete a simple table showing for each significant risk:

- the risk;
- its potential impact on the business, quantified if possible;
- the possible mitigations, to minimize or respond to the incidence of the risk.

Examples of some of the more obvious serious risks to the small business could be:

- the loss of a customer worth 15 per cent or more of the turnover;
- a bad debt worth 5 per cent or more of the turnover;
- the loss of a key employee, maybe along with intellectual property (which may go to the opposition) or with important contacts in the market, or with significant technical expertise;
- a physical event, such as a fire, especially if it is under-insured;
- change in legislation that de-values your services;
- death of a key shareholder that throws the funding or financial backing into turmoil;
- loss of MD where the management team would not be strong enough to cope, in the view of business partners.

You should consider all of these, even if they are deemed to be unlikely, and establish what you would do if they did happen.

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1.4

The SME economic outlook

***Graeme Leach**, chief economist and director of policy at the IoD, discusses the shape of the economic recovery*

We live in interesting times. Recent years have seen a global financial crisis and an explosion in public debt on an epic scale. Such events are most certainly not 'ordinary' and so it is important to recognize that any economic recovery in the wake of such events is unlikely to be 'ordinary' either. Economic recoveries in the wake of financial crises have a well-recognized tendency to be much weaker than standard cyclical upturns. The reasons are not hard to find. An impaired banking system is less able and willing to lend money. SMEs in particular are likely to find it more difficult to raise working capital for expansion. The damage to the banking system is such that we have embarked on very unconventional monetary policy measures, with the deployment of quantitative easing. This immediately highlights the contrast in financial circumstances between large and small firms. Quantitative easing has helped push down gilt yields and corporate bond rates. It has also injected liquidity into capital markets, which has clearly helped large companies raise funds at favourable rates. In contrast, your average SME, without access to capital markets and more bank dependent, has found itself in a very difficult position, often facing wide spreads on loan rates and/or onerous conditions on loan advances. This divergence between large and small enterprises is likely to continue for some time yet, given the funding gap in the UK.

So what are the key drivers of economic performance over the coming year and what shape is the recovery likely to take? For some time we have argued that the economic recovery in 2011 would take one of two forms, an L or square root-shaped cycle. The 'one L of a recovery' scenario foresees relatively weak quarter-on-quarter growth (although obviously not zero) with a long drawn out slow upturn in sharp contrast to the V-shaped bounce back seen in normal cyclical recoveries. The square root-shaped cycle is very similar. The depth of the recession and the size of the output gap permits a limited V-shaped bounce back, but the constraints in the financial system and the accumulation of debt in both the public and private sectors soon results in a levelling off in output growth.

The key drivers of performance can be divided into two groups – growth enhancing and growth restraining.

The growth-enhancing drivers are:

- the relatively strong financial position of the corporate sector as a whole, with a surplus available to fund business investment;
- the impact of quantitative easing on the exchange rate and a weaker pound;
- the improvement in world trade and manufacturing export performance;
- the maintenance of near zero interest rates;
- the potential for an extension in quantitative easing – QE2 – and the impact on asset prices;
- the bounce back in construction output in 2010;
- the theoretical/practical possibility of an expansionary fiscal contraction (when public spending cuts stimulate economic activity by transforming household and business confidence).

The growth-restraining drivers are:

- the legacy of the financial crisis – an impaired monetary policy transmission mechanism in the banking system;
- the funding gap across the whole economy, potentially intensifying due to refinancing needs;
- continued bank de-leveraging and very weak growth in the broad money supply – insufficient to be confident that recovery can be sustained at a firm rate;
- the potential impact of the fiscal squeeze – if standard Keynesian fiscal multiplier effects apply, ie there is no expansionary fiscal contraction as described above;
- the squeeze in real take-home pay – from higher inflation and taxation – weakens consumer-spending growth;
- the potential stimulus to consumption from a falling savings ratio is weakened by its already low level;
- further weakening in the housing market undermines consumer confidence and wealth effects on consumption;
- the increase in the regulatory burden of employment policy over the past decade helps create an environment of 'jobless recovery';
- the lack of 'oomph' seen in previous recoveries, when consumer and business confidence was fuelled by falling short-term interest rates during the upswing;
- the permanent loss of output in parts of the financial services sector slows the rate of overall UK recovery;
- the constraints imposed by the accumulation of debt in the household sector;
- the ongoing risk of some form of financial shock;

- the possibility that inflation will move further above target and force a tightening in monetary policy (although our view is that the size of the output gap and weakness of monetary growth mean that inflation will fall back below target by 2012, but not before, owing to the VAT hike in January 2011);
- the potential for widespread industrial unrest across the public sector in response to the Spending Review.

The economic reality is that no econometric model can fully capture all these effects. Indeed, many of the standard models employed by governments and Central Banks omit any facility for incorporating the effects of unconventional monetary policy – quantitative easing. Consequently any forecasts come with an added health warning at present. SMEs need to be aware of the scale of uncertainty surrounding the economy.

Clearly the Government's Spending Review has dominated political and economic discussion over the 2010–11 period. So what are the key lessons for SMEs? Well for those with a large share of turnover in the public sector, the squeeze is probably bad news. But this shouldn't deceive SMEs into believing that the Spending Review is uniformly bad for business. Far from it. We have actually been here before, and more recently than people imagine. During the 1990s there was a very sharp spending squeeze. First, under Chancellors Norman Lamont and Ken Clarke and subsequently under Gordon Brown during his first two years in office. Over the course of the 1990s public spending fell by 7.4 per cent of GDP. Over the course of the current squeeze up until 2015–16, public spending falls by 7.9 per cent of GDP. Was the 1990s an era of very weak GDP growth? Most definitely not. It was a period of strong growth when the longest upswing on record became established.

It is almost certain (as acknowledged in our L- or square root-shaped cycle scenarios) that GDP growth in the 2010s won't be as strong as in the 1990s, but this does not lead to the conclusion that it will be all doom and gloom. The truth is that the economy will probably find a middle way with average growth over the coming decade closer to 2 per cent than 3 per cent. Not great, but not as bad as it could have been without the Spending Review. But if the Coalition begins to unravel and the Spending Review falls apart, all bets are off. In such circumstances the UK economy could get stuck with a high level of tax and spend and the negative consequences for GDP growth would be severe.

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The growth opportunity

1.5

Manufacturing enterprises have long experience of turning adversity to their advantage. ***David Baggaley*** *at Locate in Leeds picks up some lessons on how to seize the moment and overcome the risks*

Manufacturers know all about survival. Despite a steady decline in numbers employed over the last 30 years, the UK remains the world's sixth largest manufacturer by value. How have enterprises kept themselves in the game when conventional wisdom suggests that they will continue to struggle against low-cost competitors? By being innovative, nimble-footed and entrepreneurial.

As the UK struggles to emerge from one of the deepest recessions for decades, there are lessons that enterprises in other sectors could learn from manufacturers who have found ways to seize opportunities, whether they happen by accident or by design.

Create an opportunities network

Soeren Vonsild, head of engineering at dairy products manufacturer Arla, describes entrepreneurs as people who are quick to spot an opportunity, quick to commit and determined to see an idea through.

The danger in larger organizations, he feels, is that structures and processes can become opposed to innovation and entrepreneurship. Incentives become too tied to where someone sits in the hierarchy. Too little weight is given to taking risks or challenging the way things are done. It is often easier to make an acquisition than to create a business from scratch like an entrepreneur.

So how do you encourage a spirit of innovation, which Vonsild describes as 'the pursuit of opportunity beyond the resources you currently control'? His answer is to create an 'opportunities network' within the organization, thereby giving everyone ownership and responsibility for implementing new ideas.

Put effort into developing new products, of course, he says. But remember that often more value can be created by innovation in processes and delivery.

Wetherby-based supplier to the automotive industry GSM Group has also focused on innovation as the key to growing a manufacturing business. Serial entrepreneur and CEO Barry Dodd emphasizes the importance of looking up and down the value and supply chains to identify opportunities for innovation and growth. Combined with a nil borrowings policy – that means no overdrafts, loans or leases – the strategy has ensured financial security and year on year growth for a company that now has operations around the world.

Spot your opportunity

All well and good but opportunity often comes about by accident rather than design. The original Eureka moment for Sue Taylor at Craftwork Cards in Leeds came when she popped into a demonstration on making greeting cards. Already saddled with debts from an earlier and unsuccessful business venture, and with a background in graphic design and print, she had found herself balancing freelance design with working in a local card shop. Hence the invitation to the card-making session.

Straightaway Taylor spotted the opportunity for a new venture producing bespoke greeting cards: 'I realized immediately I could source the materials much more cost-effectively and decided to set up production in my spare bedroom. A small ad in a crafts magazine produced 50 responses and the business was up and running, with further sales building from the shop, which agreed to stock my card designs.'

Twelve years of steady growth have seen her bespoke greeting card company approaching £1.2 million turnover this year and a 15-strong workforce recently relocated to cope with increasing demand. The new premises are a virtual Aladdin's cave of everything required for making greeting cards, personalized invitations and associated stationery. Cutting, foiling and embossing are all handled in-house, with printing carried out on a row of vintage Heidelberg machines.

As a hobby, card-making is far from cheap: some card packs costing up to £30, assuring healthy margins and strong cash flow. But product quality is essential to maintaining a loyal customer base and so too is innovation. As Sue explains, customers are buying ideas and original designs, as well as the individual components for making cards. Here Craftwork Cards has benefited from its extended family of customers who are more than happy to add their own imaginative ideas to the company's creative designs.

Switching from a catalogue-based mail order business basis to trading wholly online was another innovation that ruffled the feathers of more traditionally minded customers but Sue has no doubt it was the right decision. Approaches from major high street chains have also been considered and rejected as the business has grown. Strict credit control and avoiding the temptations of borrowing to fund growth have been hallmarks of Sue's approach to business.

Rethink your credit terms

However, a recent deal with TV shopping channel QVC promises to deliver up to 40 per cent of new sales for Craftwork Cards. As well as increased sales to individual hobbyists there's been further interest from the retail sector as a result of TV exposure. The company is also looking at franchising to further accelerate growth.

To make the most of these opportunities, Sue Taylor is having to rethink her attitude towards credit: 'Following my early business experience, I was determined to control expansion and my accountants have been very helpful in managing that process.'

Previous company policy had therefore been that no orders leave the premises without pre-payment. But the sale or return policy and payment terms of QVC has meant a rethink of the way credit is handled. Taylor thinks the risk is one worth taking in order to grow the business to the next level and the accountants assure her that it's a risk the business is now in a strong enough position to withstand.

Live with risk

Another Yorkshireman learning to live with risk is Mike Briggs. Until recently, Mike managed a 30-strong team of service engineers for a German manufacturer of laser cutting machinery. As the company restructured its UK operations he faced relocation to the Midlands with all the ensuing upheaval for him and his family.

Fortunately, a reunion with two former engineering colleagues who had successfully established their laser cutting operation in the Midlands opened up new opportunities and the idea for a northern operation was born. Now Mike is heading up the new division of Accurate Laser Cutting in Leeds, with a £600,000 investment in the latest laser metal-cutting technology behind him that promises to create up to a dozen jobs.

The operation was set up in just a few swift weeks although, at one stage, an unsuccessful trawl of potential premises threatened to jeopardize the investment. With only days to go before the finance deal expired and still looking for premises with the power supply needed to run the equipment, Mike found a former industrial unit where the landlord had maintained the up-rated power supply for heavy machinery at his own cost. A tough lettings market meant the landlord was also willing to discuss flexible rental terms as well as refurbish the office space within the unit.

Mike and his partners have since driven other hard bargains. As a result they've been able to negotiate extended warranties and flexible payment terms on equipment, which will help ease demands on cash flow as the business gets off the ground. Ironically, with UK lenders still reluctant to take risks on new businesses, financial backing has been secured from French bank Société Générale.

Embrace change

Circumstances also conspired to create new opportunities for managing director Mark Wray who set up Power Engineering Services 10 years ago. The firm specializes in refurbishing and supplying high-voltage switchgear and transformers, to a list of blue chip clients ranging from British Steel to leading supermarket chains and regional power supply companies.

At the beginning of the year Mark's partners, who owned the PES premises, decided they not only wanted out of the business but that they also wanted the premises the business operated from as well. 'When our partners told us they wanted out of the business, it came as a bombshell', Mark recalls. But he and his wife quickly regrouped, pulling together the help and £400,000 worth of finance needed to organize a management buyout and relocate the business from South Yorkshire to bigger premises nearer their home in Leeds.

Preferred supplier status with many major organizations means 90 per cent of sales are repeat business, although recent projects have included power supplies for a by-pass tunnel for a hydro-electric plant on the mountainsides of Loch Ness. Keen pricing and a spotless health and safety record are hugely important but Mark attributes much of the success of the new venture to a great team spirit and a golden rule – he never asks anyone to do something that he isn't prepared to do himself: 'We really do pull together – who sweeps up after a job depends who's nearest the broom at the time and that includes me.'

Like many other entrepreneurs such as Mark Wray, Mike Briggs and Sue Taylor have turned adversity and being in the right or wrong place, depending how you look at it, into an opportunity. All three share the courage of their convictions and a determination to make it work.

As enterprises grow into larger organizations, it's this spirit they have to retain, one that challenges the status quo and encourages anyone with get up and go to spot opportunity, take risks and embrace change.

Leeds is one of the UK's most successful cities and the council provides a range of support and assistance to companies looking for new premises, whether to relocate or expand their operations. Telephone: 0113 220 6350; e-mail: **info@locateinleeds.co.uk**.

Managing setbacks and turnarounds

1.6

Do not let a setback become a failure. ***Mike Wellard*** *and* ***Alex Nowak*** *at Mazars look at how to make the right response*

All businesses, regardless of their size, complexity or the industry in which they operate will suffer setbacks from time to time. However, the measure of a successful business is one that recognizes the root cause of a setback and implements an effective turnaround plan to mitigate against the risk of business failure. No business wants their latest setback to be its last.

By its very nature, a setback is where something has not gone according to plan. This may be as a result of factors within the control of management or where external factors have had a detrimental and lasting impact on the business. Given the current economic environment, it is probable that businesses are experiencing more than their fair share of setbacks on a continuing basis. Management need to be very conscious of whether the situation can be recovered and what their available options are and must then evaluate the associated costs of recovery action.

What is a setback?

Setbacks come in different shapes and sizes. Management need to be alert as to whether the current setback is either:

- Temporary – a short-term timing problem where a situation is expected to reverse in the near future – such as an increase in the length of cash collection from customers. Management need to consider whether this temporary situation can be recovered and at what cost. If it cannot be recovered, the likelihood is that the setback will become permanent.
- Permanent – these setbacks can be detrimental to the underlying performance and sustainability of a business. Examples may include the loss of a major contract or finance. In such instances, management may be required to make some difficult choices to compensate for these setbacks, such as the closure of

a division or subsidiary to preserve the financial position of the group. Inevitably such actions may have associated incremental costs and a potential loss of contribution to the remaining business.

Management need to understand the key causes behind each setback and also assess the degree of impact on the business. This will ensure that any remedial plans are adequately formulated and sufficient resources are made available to return the business to financial health. If it is decided that the setback is too severe to allow the business to continue to trade, the directors should ensure that they seek immediate professional advice on the options available to them in an insolvency scenario.

Stakeholder impact

To a varying degree, all setbacks will impact a number of different stakeholders – both internal and external to the business. Key stakeholders may include:

- the bank or other finance providers;
- staff;
- customers;
- suppliers and creditors;
- HMRC; and
- shareholders.

Once management have identified the cause and impact of a setback, it is imperative that any turnaround plan addresses the needs and concerns of all stakeholders within the business. If a turnaround plan is to be considered viable, management will need to enter into open dialogue with stakeholders to ensure that they are fully on board with regards to the proposed strategic realignment. If stakeholder support is not forthcoming, the business is unlikely to be able to succeed in achieving its objectives either in the short- or longer term. Effective communication is paramount. In addition, management should be realistic in respect to their turnaround strategy in order to maintain stakeholder confidence and support of the business.

Building a robust turnaround strategy

Where a setback has been detrimental to a business's financial position and future working capital requirements, immediate action will be needed to address the cause of the setback and to develop a turnaround plan.

A turnaround plan needs to be underpinned by realistic, tangible and commercial initiatives based on the current position of the business. Management should revisit their existing business plan and consider how much, if any, is still relevant. Management may benefit from engaging professional advisors to undertake an Independent Business Review (IBR). An IBR identifies financial, strategic and operational issues that are critical to management, lenders and investors with a priority to develop practical and appropriate commercial solutions for the benefit of all stakeholder groups. This independent exercise will help provide management with an insight into their business and draw out commercial opportunities, perhaps not considered fully or overlooked when dealing with the day-to-day strains of running the business.

A robust turnaround action plan should include the following key elements:

- identify areas of priority and critical path dependencies;
- clearly allocate responsibilities and deadlines;
- be challenging yet realistic;
- be adequately resourced and supported internally;
- identify key risks including contingency planning; and
- include a dashboard to measure Key Performance Indicators to monitor progress.

Developing an action plan is merely the start of the turnaround process – the challenge is in delivering it successfully.

Practical steps

For a business experiencing a cash squeeze and considering working capital options, a clear and concise turnaround action plan provides a very useful tool when negotiating with lenders and other stakeholders. There are five key steps all businesses can take to maximize the potential for a successful outcome when faced with a recent setback:

1. Robust profit and cash flow projections need to be rooted in reality and stand up to close scrutiny. Financial models should reflect achievable cash flows and not simply reflect what the business feels its funders may wish to see, regardless of whether or not this shows a potential cash need. Remember, ‘cash is king’ and this may demonstrate a harsh reality of the business’s true position. Revenue assumptions should be realistic and based on sound commercial expectations. Interest charges and loan repayments all too often are given little prominence, while an element of contingency needs to be included. This should be higher if existing bank borrowings are not fixed.
2. A clearly documented, practical and achievable strategy should help transition the business from its current position to a stable position and beyond. Ensuring that there is a management team and external professional support in place to help deliver this is key. This may involve some difficult decisions, but if the business is to progress beyond the inevitable economic upturn and provide credibility and confidence to its lenders, it is crucial it has the right leadership team.
3. Payment and sales terms should be reviewed and negotiated to ensure the business is maximizing its cash cycle from purchasing through to sales.

Companies will need to have tough and timely discussions with their suppliers and customers to enhance their cash management processes. Renegotiating supplier agreements, exploring opportunities for co-operative purchasing and entering into realistic repayment plans will get critical creditors on side. Management of problem debtors should be a priority with an immediate focus on cash collection and a sensitive realignment of credit terms reflective of the business's current working capital position.

4 Quality management information, systems and reporting frameworks will illustrate the business has a clear understanding on what is important, is monitoring its recovery regularly and can respond quickly to business opportunities or threats. Outdated financial information, inappropriate performance measures or an under-skilled finance team will only undermine the viability of the business in the eyes of its creditors and may be hiding further setbacks.

5 Performing a detailed analysis of cost base and revenue streams will ensure existing and future revenue opportunities can be pursued effectively, supporting a cost base that is appropriate for the business and aligned with its aspirations. Market and competitor trends should be identified and considered as part of the overall strategy.

Addressing these key practical steps will go a long way to ensuring viable businesses have a clear road map for success, keep key stakeholders and decision makers fully informed, while providing confidence that the business can alleviate its working capital pressures.

'Cash on the table' initiatives

All too often businesses in crisis overlook simple initiatives to realize cash in the short term. Slow identification of underlying problems, a disenfranchised workforce and a reluctance to change will simply compound the setback.

The following initiatives are equally relevant, whether the business is experiencing a setback or not:

- Stockholding levels – can these be reduced? Carrying old and obsolete stock is of no benefit and is a cost burden on the business.
- Suppliers – is there an opportunity to centralize the procurement process to benefit from economies of scale for supplier renegotiations (eg utilities and telephony) or can payment terms be stretched within reason?
- Staff – is the business supported by an appropriate number and pool of adequately skilled staff? Drastic cost-cutting measures in the absence of any gap analysis or scenario planning can adversely impact the turnaround plan. An incentivized and informed workforce is more likely to support such a plan.
- Crown debts – open discussions with HMRC and exploring options on their Time to Pay scheme, may help reduce short-term working capital pressure.

- Customers – far too often businesses continue to trade during times of difficulty on the same basis as before the setback. Opportunities for reducing credit terms and focusing on improved debt collection may generate immediate cash benefits.
- Idle assets – are there opportunities to sell unencumbered non-critical assets?

Conclusion

Being alert to possible setbacks on the horizon and tackling the difficult decisions that can be associated with business turnarounds usually pays dividends. Turnaround plans are not an exact science, however in more cases than not they are often underpinned by common sense during a time of great uncertainty and panic.

Building a clear and robust turnaround action plan, supported with strong internal and external channels of communication, will go a very long way in providing clarity, stakeholder confidence and increasing a business's chances of success.

Mike Wellard, partner, and Alex Nowak, senior manager, work for Mazars Business Recovery Group in London. The team have extensive experience in advising different companies in a turnaround situation and on the unique challenges they face.