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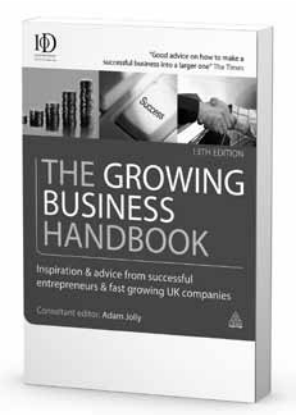

THE GROWING BUSINESS HANDBOOK

Inspiration & advice from successful entrepreneurs & fast growing UK companies

Consultant editor: Adam Jolly

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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.

Professor Colin Mason is based in the Hunter Centre for Entrepreneurship at the University of Strathclyde in Glasgow, Scotland where he engages in research and teaching around the theme of entrepreneurship and regional development. His specific research is concerned with the availability of venture capital for entrepreneurial businesses. He has written extensively on business angel investing and has been

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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:

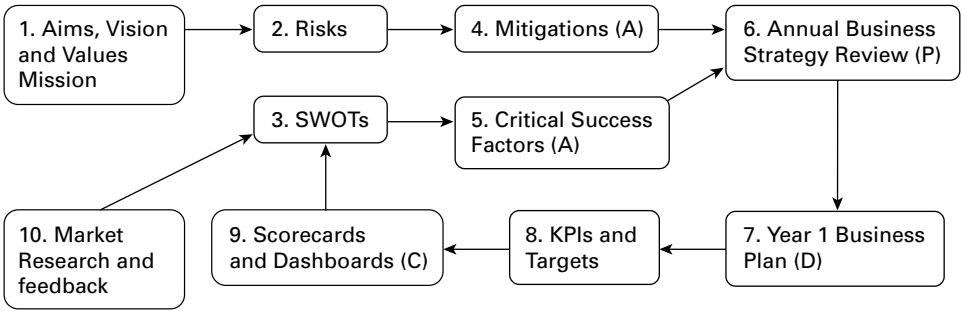
- **People in the business are not challenged, maybe not even permitted to make a contribution to the most important things within the business.** As a result less-helpful attitudes (lacking pro-activity, and pulling against the business) may be tolerated or even promoted. The result of this is genuinely 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

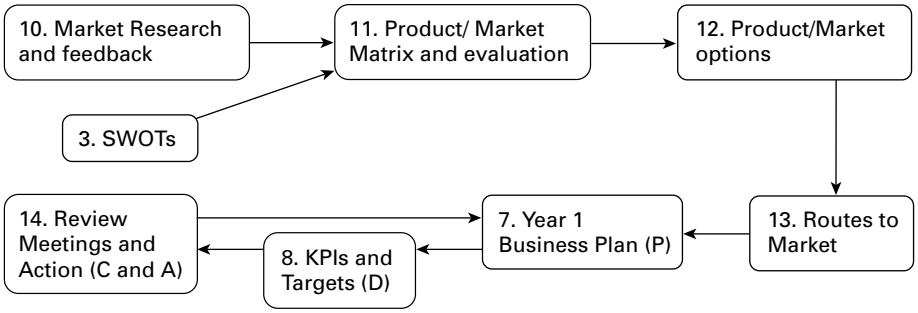
FIGURE 1.3.1 Business strategy review process



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

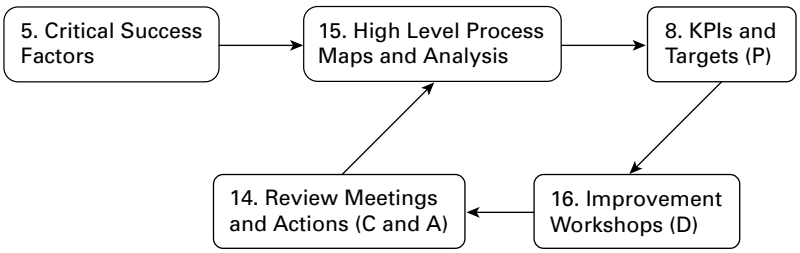
FIGURE 1.3.2 Marketing strategy review process



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



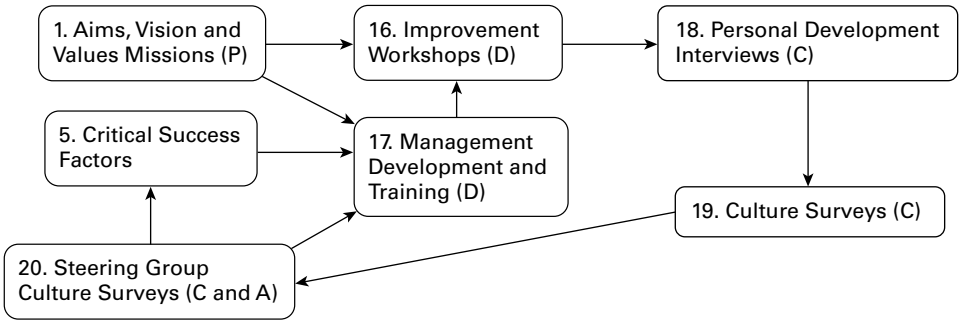
The greatest portion of the work of growth and improvement should be going on within this cycle in practice with meetings on most days in most areas and actions generated from two sources:

- 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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The SME economic outlook

1.4

***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.

Graeme Leach is chief economist and director of policy at the Institute of Directors. He can be contacted at: **Graeme.leach@iod.com**.

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.

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PART TWO
Ideas and innovation

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Whole company innovation

2.1

Innovation is becoming a group sport, says ***Garrick Jones****, a research fellow at the London School of Economics and a partner at the Ludic Group*

The collective knowledge in any commercial organization contains a wealth of contextual information – a vital source of ideas for innovation. Nobody knows more about the market, customers, issues, trends and opportunities than those who are working with these realities on a daily basis.

The question is how to best get at that knowledge in a way that takes maximum advantage of it and leads to real innovation in products and services?

We call this approach the whole company approach to innovation. It is a multi-layered, yet simple combination of people management, design events, product research and development, and lean continuous improvement principles that lead to rich, innovative outcomes. Through careful sequencing of multi-disciplinary events throughout the design process, new products and services are informed by the knowledge of those closest to the market. A model for this could be continuous cycles of learning, creating and communicating,

The nature of work is rapidly changing. Most innovation and production is project led, powered by workshops that disappear after its goals are achieved. This is becoming as true for aircraft production as it is for the development of new customer experience-based products in the service industry.

The rise of the Internet has also led to new conditions for work. On the one hand increased customer intimacy and knowledge, and on the other the loss of proximity between working teams. Teams may be working on components of a solution across geographic and time boundaries. The time that teams are able to spend together has become increasingly precious. How can the most be made of those interactions?

One response to tapping into the contextual knowledge resources of the workforce are Design Workshops (also known as Lab Events). No longer is innovation the domain of the specialist removed from the real world, cooking up new ideas in a distant lab. Innovation is the product of many stakeholders collaborating to create unique solutions to existing problems, or creating new markets, and new types of customer experiences.

For reasons to do with the growth of the knowledge economy, innovation and competitiveness, organizations require new skills, and are under pressure to be 'porous' using networks, strategic alliances and partnerships to achieve their aims.

Today, the economic and competitive pressures on organizations to grow are increasing, it is the means and the design process by which organizations innovate that makes the difference. The trend is clear – those companies who are shifting toward open, collaborative and multi-disciplinary practices have the advantage.

The design and innovation value advantage is clear to see in companies such as Apple Inc, who have a market capitalization 20 times the book value of the company. The same is becoming true for Samsung and LG, or the Scottish firm Linn who have focused on Design and Innovation as their key differentiators. All of these companies are defining the game as much as competing in it.

It is not only this commitment that creates the value, it is also their commitment to Design and Innovation as a whole company exercise that enables these outcomes.

Innovation is a group sport

There can be no doubt that bringing new products and services to market successfully requires the broad cooperation of many very different teams beyond just the ideas merchants. Marketers, product and service designers, programme managers, IP lawyers, distributors, advertisers, supply chain managers, producers and packagers all have to be factored in. In the most successful cases teams are working in parallel, kicking off processes that are vital to successful implementation long before the finished product has been decided. Boeing created the 777 and had it certified on both sides of the Atlantic simultaneously. It is no longer cost-effective to allow isolated design phases and research to hand over an idea in search of a market. Today, ideas are developed and refined in conjunction with multiple stakeholders – customers, retailers, users, salespeople. Trust and flexibility are vital. Successful organizations create cultures of trust and enable flexible networks that promote mutual understanding, rapid learning and the ability to change course mid-stream. Competitive advantage can be described as the ability to learn, innovate or continuously reposition with respect to the competition.

Complex programme management requires many threads to operate in parallel. Alignment between these parallel processes is enabled by interaction and communication. Successful organizations, whether formally constructed or networks of affiliated companies, need to work hard at enabling both the relationships and the communication required. The best managers actively design opportunities to do so. As we move to a networked economy the concept of the linear supply chain has transformed into that of the non-linear value web. Successful organizations are able to identify the members of their value web and create opportunities where all these resources are working in harmony, and focused on a single goal – getting the products or services to market on time, on budget and desirable to the consumer.

IBM, Sony and Toshiba are working together on new IT products, Sony-Ericsson have had to work together to stay in the market, and have been innovative as a result. The micro-projector (soon to be found in every mobile phone) is a joint production by multiple specialist technology companies. However, open innovation practices are not only limited to extending the traditional boundaries of the organization into its value web. Today, everybody within the organization who has a stake in the outcome

of a project has a voice. This requires a different way of organizing projects; and very large-scale events or Design Labs are where the work is being done.

Collaboration, both formally and informally arranged, has significantly increased within organizations as a tool for strategic development, innovation, corporate education, and problem-solving purposes. Alongside collaborative practices, action research, activity-based systems and participatory media development are being employed as organizational processes for enabling active employee engagement. We call such approaches collaborative authored outcomes.

Spaces for innovation

Physical and virtual environments are evolving to support these new requirements for knowledge-led innovation.

Collaborative Learning Environments (CLE) are fully flexible workspaces equipped so that groups of different sizes may actively engage in learning-based decision-support processes. As group-based tools and techniques grow in sophistication, so too do the demands made on the environments in which innovation is taking place. Ranging in a typology from the informal to the highly structured, the improvised and mobile, the laboratory to the socially integrated, the physically static to the highly ephemeral – these structures are providing opportunities for the combination, and recombination of ideas through generative and instrumental mechanisms. Some exist as centres of decision-making, others exist only for the period in which the groups come together for a specific purpose.

Spaces for innovation are constructed fundamentally as learning and production environments – places where groups from across the disciplines and functions are able to get together to exchange contextually relevant information, and to put it into production. The idea is to put ideas into action there and then.

A physical environment

Imaginative environments for innovation full of toys, puzzles and books have been around for some time now. Everybody has seen the pictures of the Google offices. However, the playful interior often masks a serious infrastructure that means business. These workspaces are designed for creative work – and they often work very hard indeed. They are essentially theatres for large group work, which also contain smaller spaces to work individually or in teams. It may be possible to draw on the walls, but more significantly, there is ready access to information and focused databases, which enable rapid decision-making. There may also exist a team of people who are dedicated to capturing everything you produce and placing it in an easy to access web tool, seconds after you have produced it. These environments contain a matrix of electrical and audio-visual sub-systems in order to permit multiple configurations for group work and to ensure that when large groups get together, the experience is potent, useful and enjoyable. Where film-making has pre-production, production and post-production facilities to successfully create in a highly networked

creative environment, so too does the innovation industry. The products may differ but the techniques are very similar.

A virtual knowledge environment

The collective knowledge inherent in any commercial context contains a wealth of information. Such a database exists physically, virtually and socially, both within our heads and within groups or teams. Paying attention to the knowledge environment in which a group is innovating enables more powerful decision-making. A support crew captures all the information generated by participants, in every format; documentation, video, sound, handwritten, photographic and the web. Making this generative knowledge-base available to participants seconds after its creation allows them to be used as powerful reflexive resources. The capture and display of information in multiple formats provides instantaneous feedback to large groups. Through ever-more increasing cycles of feedback, a group is able to navigate its way through labyrinths of information. Providing documentation and knowledge bases for large groups as they move through cycles of creativity, design and production creates a narrative of the journey of their development, as well as cataloguing both the end goal and the iterations that were needed to achieve it. Beyond a single project, these virtual records become powerful learning tools for the next set of programmes coming after. They also provide context-rich records, which enable those joining the teams later in the cycles to understand what has been going on.

Online tools exist that enable asynchronous development of ideas across geographies and time boundaries. Collaborative authoring tools, participatory media, project management tools and other social software are enabling very large groups to exchange information. Online 'jams' are being held as events across a number of days, to specifically generate vast numbers of employees focusing their ideas on a particular topic or set of prototypes. Video conferencing allows people to exchange ideas at their desktops.

However, despite the sophistication of online tools, nothing can substitute for the assiduous sequencing of events and information that leads to the successful development of an idea from conception through the launch in the market. This is a process that will always require careful design and nurturing.

Prototyping, simulation and play

When a large group is engaged in collaborative decision-making, it may be useful to construct all manner of models of conceptual ideas, and to test them. Simulation, the playing of games, the construction of small worlds, testing of hypotheses, questioning, the reordering of information, scenario testing are all tools used for innovation. A collaborative learning environment provides all the resources required to do so. These may include construction materials for modelling, spreadsheets for financial modelling, large surfaces to write on and iterate ideas, surfaces for moving information around the space, screens for running simulations between groups, areas for role play, break-out spaces for groups to work in parallel, video facilities for groups to

create scenarios. Networked technology is enabling parallel work by groups exploring the contextual field as they work through group processes of defining and refining options.

Essentially, whole company innovation is about connecting the right team with information, design resources, processes and documentation in a manner that enables deep understanding of the landscape of information, critical exploration of alternatives and opportunity to prototype ideas – and launch them into the market.

Flexibility and communication in a value web is directly related to the quality of interpersonal relationships – establish multiple opportunities for these to develop

As a system moves through the cycles from innovation, proof of concept, piloting, testing to production, marketing and distribution, the qualities and skills required of teams change. These phases have their own distinct personalities and qualities and it takes a savvy manager to promote the context, attitude and environment that are required for each team within each phase to be successful. During innovation phases, teams function best if they are:

- autonomous;
- configured with the best members for the task;
- connected to customers;
- connected to your value web;
- skilled in disciplines associated with innovation;
- incentivized;
- measured.

Each phase in the lifecycle requires different skills to take the lead – in principle moving from the unstructured to the structured. Even self-organizing teams need to recognize that the leaders of creative phases are usually different from the leaders of piloting, testing, production and distribution phases. An important thing not to lose sight of though, is that as the baton changes hands, the teams are still checking in with customers and the entire value web. Rapid iterations and feedback cycles are best at all phases. Empowerment is vital – understand the acknowledged experts in the teams and let them make the decisions. Let packaging experts decided on packaging, let the logistics specialists decide on distribution, let designers make the design decisions. Flatten the hierarchies, and enable decision-making.

Check in with your value web

The opinions of your clients, employees, suppliers, customers and learning networks continue to be vital throughout the inexorable march to market. Encourage osmosis of ideas. In addition to generating ideas, you also begin to mobilize the users of the products, creating the buzz around the new products long before they are launched, and creating an influential user community in the process.

Rapid iterations and feedback cycles

Creating opportunities for rapid iterations and feedback increases the sophistication of the product. IDEO create project spaces and displays for their products in design and they are open for conversation with anyone who is passing. The products are always visible; the teams are always in close proximity to each other. The same holds true for the design of services, process flows, video scenarios and use-case descriptions enable the communication of these ideas. Encourage teams to build formal and informal feedback cycles into their processes, throughout the lifecycle of development and production.

Empowerment is vital

Flattened hierarchies only work when roles are clear and everybody knows who takes responsibility for what. Making these roles visible helps. This is not to say that everybody is allowed an opinion on everything – the eureka moment may come from anywhere on a team! However, the final decision should rest with the expert on the team.

The enabling role of leadership

The role of leadership within fast moving, complex networks is to enable teams to achieve their ultimate objectives – through facilitation, arbitration and demonstration. Leaders are required to be sensitive to changing moods of the network, to understand what blockages exist and to facilitate the opportunities for teams to solve the problems. Arbitration is vital when differences of opinion exist – to ensure differences are tested and to ensure that decisions are made in order to enable progress. Fundamentally, leaders model the behaviours they desire to encourage within the broader context of the programme.

Acknowledge the programme phase

Sensitivity to the phase of the programme enables a large group to be clear about what needs to be done and who needs to take the lead. Film production is a powerful example of this because it's so visible. Studio time is costly, and everyone is aware of the phases of production – from filming, to editing, to screen testing and distribution. Acknowledge the programme phase and acknowledge the phase leader.

Incentives and measures

Although teams need to be autonomous, it is important that members of the teams feel rewarded for the work they are doing. Most learning takes place in failure and the design process honours failure. High volume, low-risk failure! However, business success is also a factor of time and budget – and incentives to meet these targets are vital. Measuring the success of teams against understood criteria, established clearly at the start, provides security. Getting things to market requires clear goals and deadlines. Healthy competition between teams allows the bar to be continuously raised on quality, outcome and sophistication. Teams find a sense of flow when they are challenged and tested in an environment that provides the skills necessary to achieve. All successful innovation, at the end of the day, is about people having fun.

The state of the art collaborative learning environment represents a complex ecology of support systems, environment, tools and technical systems, production systems, learning systems, project management and process support.

These represent the infrastructures required to enable a whole company approach to innovation.

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Innovating out of recession

2.2

Following the Dyson report on 'Ingenious Britain', ***Jacqueline Needle*** *at Beck Greener discusses the process for taking an idea and turning it into a winner*

The launch in the United Kingdom of the Apple iPad led to unprecedented scenes. Consumers, who had queued for hours, emerged from retail establishments holding their purchases high in triumph. Although the economy is in recession, and retailers are generally reporting poor sales, innovative new products still fly from the shelves. The new generation of HD, digital, flat screen TV is selling well, as is Dyson's bladeless fan. However, there is little interest in acquiring a new car, and why should there be when this year's model is indistinguishable from last year's?

It is not sufficient to develop a new 'must-have' product or service. The secret to innovating out of a recession is also for the innovator to keep control of that product or service. This means acquiring and retaining appropriate intellectual property (IP) rights, such as patents, designs and trademarks.

Losing penicillin

Penicillin was discovered by Sir Alexander Fleming, and its curative properties were established at the University of Oxford by Sir Ernst Chain and Lord Howard Florey. In 1945 Fleming, Chain and Florey were awarded the Nobel Prize for Medicine. And yet, in 1948 civilians in England were dying of tuberculosis because penicillin was not available in this country. At that time, the drug was available to civilians in Australia, and had been available to the US forces since they entered the Second World War.

In the late 1940s and early 1950s there was a view among scientists in the UK, and certainly at the University of Oxford, that it was unethical to patent medical products. To this day, British scientists still assert that a failure to patent 'dedicates the invention to the public'. The fact that penicillin was available in the USA and Australia, where the manufacturing methods and the drug were patented, and not in the UK, where there were no patents, underlines the error of these views.

The Dyson report

In March 2010, at the request of the then leader of the Conservative Party, David Cameron, Sir James Dyson delivered a report entitled 'Ingenious Britain'. Dyson's stated aim was to present measures that the new government could adopt to encourage British industry to develop and export new technology, and thereby propel Britain out of recession.

Dyson identifies that there are failings in British education and in industry. He wants to encourage young people to take science and engineering degrees and then to seek to work in industry. He also wants to encourage British industry to innovate. However, his main solution to address these failings is for government to provide financial support to innovating firms through the tax system.

Dyson also recognizes the dire performance of Britain in patenting innovations. He quotes the 2007 figures from WIPO (World Intellectual Property Organisation) for patent filings, which are:

330,000 – Japan
240,000 – USA
17,000 – UK

However, although he has been a vocal supporter of the need to patent, and has all his innovations patented, in his report Dyson does not address the failure of British industry to patent.

Why avoid protection?

The underlying distrust of IP rights generally, and patents in particular, which was prevalent in the 1940s unfortunately still exists. IP is perceived to be expensive, irrelevant to small and growing businesses, and difficult, if not impossible, to enforce.

However, by his use of the patent system, Sir James Dyson was enabled to manufacture and sell vacuum cleaners particularly profitably, and in the process he became a millionaire. Dyson licensed his patents to companies in other countries – for example, to a company in Japan – such that the worldwide manufacturing capacity for his cleaners was substantially increased. Dyson also enforced his patents against competitors, most notably Hoover. This enabled him to keep Hoover's versions of the vacuum cleaner off the market.

Difficult and expensive?

Individuals and companies can succeed, and can make money, without involving themselves in IP issues. However, there are risks in such an approach, and it may prove a costly decision. There are many examples of companies who have ignored IP completely only to be accused of patent or trademark infringement. It is possible for the launch of a new product to be stopped in its tracks by a court injunction, and the

expense of dealing with such accusations will be significant, and against a background where there can be no income from the product. Even worse, this unexpected expense could probably have been avoided.

IP does cost money, and if the issues are not understood, it can appear difficult. However, without IP, creativity cannot be captured and protected and it is this protection that enables ideas to be turned into wealth. The difficulties disappear with knowledge and Mandy Haberman, the inventor of the Anywayup Cup, has criticized SMEs for not having at least one person in authority who has been educated in IP.

Free IP rights

Not all IP rights cost money. Copyright and unregistered design rights arise automatically. All a company needs to do is adopt 'good housekeeping' to ensure that it can prove that the rights exist and identify their owner.

Original software and design documents need to be kept in a systematic way so that the date of origination can be established, and the creator or author identified. The company also needs to ensure that it owns the rights it uses in its day-to-day business. For example, a company commissioning a logo design for its own use will not automatically own the copyright in the resulting logo. A specific agreement will be required to transfer the copyright from the designer to the company.

Any proprietary information of commercial value should be identified and kept confidential. Employees should be made aware that such confidential information must not be divulged. Measures may also be taken to restrict the availability of confidential information within a company. Both the recipe for Coca-Cola and the exact composition of the batter for Kentucky Fried Chicken are still known to only a handful of people.

Companies can also freely search Patent Office records on the Internet to ensure that they are unlikely to come into conflict with existing rights of others. The easiest records to search are those giving information about trademarks that have been registered. A company can avoid future problems by ensuring that their proposed trademark or logo is not already registered by someone else.

Patenting costs

A majority of those made rich with the assistance of IP, such as Sir James Dyson, and Ron Hickman the inventor of the Workmate, have had ideas or inventions that have been patented. A patent can only help if it is valid, and a valid patent can only be obtained if the patent application is filed before there has been any public disclosure of the invention. It is essential that any new idea of potential worth is kept totally confidential to the company during the early stages of design or development. At some time a positive decision should be made as to whether patent protection is likely to be required. If it is decided that patent protection is not warranted then public disclosure can be made, but it should be realized that putting the idea in the public

domain also dedicates it to the public as the right to obtain patent protection in most countries has been given up.

It does cost money to pay professional patent attorneys to register trademarks and to draft and file patent applications, but the potential rewards are high. For the price of one full page advert in the *Daily Telegraph* it would be possible to cover the fees arising over a five-year period to obtain grant of a patent for a new invention in the whole of the European Union, in the USA and in Japan. The newspaper advert may be available for only 24 hours or so, whereas the patent could provide a platform for profitable trading for 20 years.

What protection should be sought?

If an invention has taken time and money to develop, will take further resources to get into the market, and is forecast to have a future, it is wise to take professional advice as to its protection. In such circumstances there is a very high chance that the invention will be patentable. Alternative forms of protection, such as a Community registered design, may also be available and might be commercially useful.

Where products and services are to be advertised and developed it is generally a good idea to register the associated brands and logos. Now it is possible to file applications for trademark registrations that cover the whole of the EU or a raft of countries worldwide. This has made trademark protection across countries readily affordable. If an innovative product is placed on the market with a strong, and protected, brand, a reputation is built up in that brand and a competitive product might be seen by the public as an inferior imitation.

Patent attorneys are generally very conscious of commercial realities and can suggest ways to get some protection in the marketplace even where the budget is small. However, a company with forethought might devote resources to an IP fund. This growing amount of capital can underpin the cash flow of the company in early days, and finance IP costs at a later date. There are also grants and awards available for development and patenting. The British Government, for example, provides R&D grants for projects of different sizes and EU money is also available.

Enforcement

It is commonly said that patenting an invention is a waste of time because the company will not be able to afford to enforce the patent. However, less than 1 per cent of all patents are involved in any dispute, and it is the existence of the patent, rather than of the invention, that provides the wealth-generating opportunities.

If the new product is patented, or is the subject of a patent application, the majority of businesses will pause before rushing to develop rival versions. In any event, it is generally only the successful inventions that are of interest to those who wish to copy. If a successful product is copied, it is capable of providing an income stream to fund litigation.

Jacqueline Needle has wide experience of advising companies in the procurement and use of IP. She has managed extensive patent portfolios, and has wide experience of patent drafting and of patent prosecution in many countries. Jacqueline holds a Litigator's Certificate, which gives her the right to conduct litigation in IP matters in the English courts. Jacqueline has an Honours degree in Electrical and Electronic Engineering awarded by the University of Leeds, and an LL.M in Advanced Litigation from Nottingham Law School. She is a partner of Beck Greener in London and can be contacted at: **jneedle@beckgreener.com**; tel: 020 7693 5600; the Beck Greener website: **www.beckgreener.com**.

Exploring patent information

2.3

***Dean Parry**, technical director at Patent Seekers, discusses how to search patents to identify innovative products and reveal the competitive landscape within particular markets.*

Some of the most successful companies utilize patent information to gain strategic information about markets and competitors. They know expert patent knowledge can provide the key to success in today's highly competitive markets.

Patent database information

With over 50 million patents on worldwide patent databases, there is a wealth of information (much of which is not available anywhere else) for companies to explore and utilize. These databases provide information on patents at different stages (application stage, granted or dead) but they are all published for the public to view.

In general, patents go through a pre-grant stage where they are being assessed by a particular patent office via search and examination, and if successful, a post-grant stage where a patent has been granted by a patent office.

Understanding how patents develop can provide more accurate information on the patent strength of competitors and whether particular products are currently protected.

The following list details the different stages for patents:

1. If a patent is in the application stage this means it may or may not be granted (be put in force by a patent office) and there are many reasons why it may fail; for example, lack of funds, failure to meet statutory requirements (eg the invention lacks novelty and/or inventiveness). A GB or European patent (known as a patent specification or spec) in the application stage would have an A (or A1, A2, etc) suffix and the granted spec would have a B (or B1, B2, etc) suffix.
2. If a patent is granted, this means it has been put in force at some stage. *However, it does not mean that it is currently in force*: the patent may have subsequently died.

3. A patent may have died for many reasons, eg its 20-year life has ended, it's been revoked due to evidence put forward against its validity, failure to pay renewal fees, etc. However, there are certain situations where a patent can be reinstated and certain inventions can get extended protection beyond 20 years via supplementary protection certificates (SPCs), eg pharmaceutical inventions.

The above information can give companies access to the latest technological innovations, market trends and the companies that have control over areas of particular technologies.

If a patent relates to a product of interest, a company can discover the owner and see whether the patent is granted and in force.

Searching patents

There are a large number of patent databases available to carry out different levels of patent searching and analysis. The best places to start a search would be Espacenet or the SIP databases and Google. These allow free searching to be carried out by using keywords, classifications and company names.

Any patents found through these databases may not give the full picture because each patent may have many patent family members, eg a UK patent may have other patents connected to it via countries outside the UK such as Germany, France and the US. These family members would need to be found for each patent. There may also be multiple patents relating to different aspects of a particular product.

Once all the patents have been found, eg for a particular company, the results can be displayed based on the number of patents for subject matter, countries, publication dates, etc. These can be displayed as a patent map or landscape, which show trends and how patents may be linked.

Making decisions based on patent information

Patent information, maps or landscapes can provide vital strategic information to companies:

- Trends for a particular technology, ie the number of patent applications for a particular subject matter over time.
- Potentially identify the next generation of products your competitors are developing.
- The companies most active within a particular field (and when they were most active).
- The countries that have granted patents for particular technologies (these give a good indication of where the best markets are for a particular product).
- Partnerships between companies working on a technological area.

- Areas of technology that have very little patents could indicate a good option for research.
- Areas of technology that have a large number of patents may indicate a high probability of litigation or a very high cost for due diligence (identifying any patents in force for a particular subject matter).

The above information can be used to develop a working strategy to either avoid potential problems and/or to identify new products and new areas for research.

The pitfalls

There are a number of problems associated with patent searching and subsequent decisions that are made off the back of the information found. The problems include:

- Delays in database updating of information.
- Data incorrectly stored on databases.
- Only partial information for particular patent territories.
- Partial or no language translations for foreign patents.
- Information stored in different formats for different databases.
- Particular assignee and inventor names can be difficult to pin down.
- Google allows third parties to buy the data you search on.
- Google statistical tools allow website owners to view the search terms used by third parties to navigate to their website.

The best way to overcome the above is to use multiple databases (including national registers, eg The Intellectual Property Office in the UK, the European Register, etc) to maximize coverage and make sure you properly research a particular company so that you know who their partners/subsidiaries are and who are the directors of these companies. For Google searching, you should not use undisclosed information when searching with this and similar search engines.

Final word

Be aware of the dangers of drawing conclusions based on limited or inaccurate information. There is no substitute for properly researched patent information and if you follow the above advice it can provide excellent information for you to be able to improve on your knowledge base with regards to competitors and current products.

Companies that regularly analyse patent information, in their area of technology, automatically have a big advantage over their competitors. They are able to see areas lacking in development and may even be able to identify where the next innovation should be. So the best advice, for companies developing a product and/or developing

a market strategy, would be to know your market, the patents that control it, the companies that own them and the patent applications that control it now or may control it in the future.

Useful links

Free Patent and Research Databases:

Espacenet
http://ep.espacenet.com/

Software for Intellectual Property (SIP)
www.patentfamily.de

US Patent Office search facility
http://www.uspto.gov/patft/index.html

GoogleScholar
http://scholar.google.com/

Commercial Patent Databases:

PatBase covers full-text on GB, EP, WO, DE, FR and US documents and covers more than 75 countries
www.patbase.com

Delphion covers full-text on WO, EP, DE and US documents and covers INPADOC
www.delphion.com

Dialog provides extensive worldwide information on patents and research papers
www.dialog.com

Classification information:

http://ep.espacenet.com/

http://www.wipo.int/classifications/fulltext/new_ipc/ipc7/eindex.htm

Dean Parry (BSc, MSc, MIMA, MIEEE) is Technical Director of Patent Seekers Ltd. He is an expert patent analyst and gives advice on technical research to small businesses and companies worldwide. He has helped build technical defences for high-profile patent disputes in both Europe and the US. This chapter relates to some of the important patent advice he gives to small and large businesses looking to source new products and gain valuable patent information about markets and competitors.

Mr Parry is a former cybernetics researcher and UK Patent Office examiner, and a member of The Society of Competitive Intelligence Professionals (SCIP). Since he founded Patent Seekers with Timothy Parry in 2005, it has become one of the leading suppliers of prior art search and analysis in the UK, supplying patent attorneys and multinational companies worldwide. It specializes in validity and infringement searching, regularly working on high-profile cases to help companies defend against infringement action in European and US markets.

Further details: Patent Seekers Ltd, Suite 53, Imperial House, Imperial Park, Celtic Lakes, Newport NP10 8UH; website: **www.patentseekers.com**; e-mail: **mail@patentseekers.com**; tel: 01633 816601.

IP challenges for technology ventures

2.4

At the start, your intellectual property can be ad hoc, but you have to become more systematic, as you grow, says ***Nick Sutcliffe*** *at Mewburn Ellis*

Intellectual property (IP) in the business world is the equivalent of the 'bagsy' in the school playground. It establishes exclusive rights to business's technology and brands that prevent other people from imitating them and allows a business to distinguish itself from its competitors.

As a business grows and the commercial stakes get higher, the exclusive rights that are provided by IP can make an increasingly important contribution to the success of the business.

Value of IP

IP can be valuable to a business in many ways. The ability to actively exclude imitators from the marketplace allows a business to reap the full reward for the development of a successful technology or product. By allowing a business to distinguish its products and services from those of its competitors, a business can build up the prestige and reputation of its brands.

A strong IP portfolio may also attract investors to the business and may even generate revenue streams in itself through out-licensing.

IP encompasses a number of different legal rights. However, the core IP of most growing businesses is likely to be the patents and patent applications that protect their technological innovations and the registered trademarks that protect their brands. Patents and registered trademarks are acquired through a lengthy and often costly application process, and most businesses will engage legal professionals, generally specialist patent and trademark attorneys, to handle this process.

Although some businesses have no dealings with IP in their early stages, others have a close involvement with intellectual property from their very beginnings. For example, many technology businesses are started-up or spun-out around a portfolio of patent applications protecting a key technology.

Whatever their beginnings, all businesses growing beyond their early stages should explore the possibilities and challenges presented by their own and other people's IP in order to maximize their potential in the marketplace.

IP management challenges

Growing a business presents management challenges in all kinds of areas, including IP, and a major challenge is to ensure that the IP which a business has accumulated in its early stages is effectively managed.

Most early-stage businesses own a relatively small amount of IP, which can be managed in an ad hoc way. Typically, one of the company directors puts his 'IP manager' hat on as and when decisions are required and there are costs to sign off.

However, in a growing business, the amount of IP and the time and resource needed to manage it also grow. Sooner or later, an ad hoc approach to IP management may need replacing with a more systematic and planned approach that gains the maximum value of the IP assets of the business while keeping costs under control.

Effective IP management

Busy executives with many demands on their time can find it easy to fall into a reactive style of IP management in which decisions are only made in response to a final deadline. However, by adopting a more proactive mindset, an executive can take a more strategic view of the IP portfolio. This strategic view can then inform each individual issue, as it arises.

Application procedures for patents and registered trademarks generally involve meeting a series of legal deadlines set by patent offices or other authorities.

Many (but not all) deadlines can be extended by paying governmental fees. For many businesses, the temptation to consign IP-related decisions to the 'too hard' pile until all the extensions are used up and the final deadline is looming is irresistible.

However, not only are the costs of this reactive approach likely to mount up over time, but also decisions made under pressure at the last minute may not always be consistent with any overall strategic vision.

Effective management usually involves meeting deadlines without taking extensions of time (or only with good reason). This avoids unnecessary costs and pestering from frantic IP professionals seeking instructions. Difficult decisions on IP matters do not go away for being put off. Fronting up and dealing with them promptly may save considerable costs over the long term.

Realistic expectations

Patent offices and other authorities only grant applications that comply with certain legal criteria and these criteria can be enforced rigorously.

In applying for IP protection, it is important to have a realistic view of what is likely to be allowable and what is valuable to the business as it moves forward.

For example, although exclusive rights to an entire technical field may be valuable to the business, it may be unrealistic to expect this level of protection. Unswerving pursuit of broad patent claims, in the face of obstinate objections, may be expensive and ultimately futile.

Conversely, while protection for a narrowly defined technical innovation may be relatively easy to acquire, this protection may be easily avoided by competitors and therefore have no value to the business. IP with no value is a waste of business resources.

Effective management therefore needs to set realistic expectations of what is achievable and possess a clear idea of where the value of the IP to the business lies.

Keeping IP aligned with the growing business

The commercial interests and activities of a business often change and develop significantly as it grows.

Effective IP management needs to prevent the IP portfolio from diverging from the current or future interests of the growing business.

Out with the old...

IP can be expensive. However, despite the cost, many businesses cling on to redundant IP that does not provide any effective protection for their commercial interests. Often, this is a result of ineffective management. For example, it may simply be that no one has noticed that the IP is now redundant or no one is prepared to make a final decision to abandon it.

Some businesses may see redundant IP as having 'trophy' value. A large IP portfolio enhances prestige regardless of its quality or actual value to the business.

In other cases, redundant IP may be maintained for sentimental reasons. For example, the IP may cover the original technology of the business, even though the business itself has moved on. Sometimes, only an obstinate determination to show the world that the technology is protectable keeps IP alive long after it has lost all its value to the business.

There are situations however, where there are sound reasons to maintain redundant IP. For example, the IP may be licensed to a third party and provides a revenue stream that justifies maintenance of the patent applications. Alternatively, a business may take a strategic view that a technology is sufficiently close to its current activities to be worth keeping out of the hands of competitors.

For IP management to be effective, IP that has become redundant to the business needs to be identified and culled, if it is not providing real value to the business.

... In with the new

As a business grows, new projects and activities may provide opportunities for extending its portfolio of IP.

Communication within a small company is not usually a problem. However, in a growing business, business and technical functions may be split between different offices, buildings or even continents and lines of communication may need to be actively established to identify IP opportunities. For example, staff working day-to-day on technical projects may not recognize IP opportunities in their work and bring them to the attention of those responsible for IP. Regular meetings between business and technical staff may be needed to tease out innovations and assess their value to the business. Innovations that have commercial value may then be taken to an IP professional to see whether IP protection is feasible.

Opportunities for IP protection may be lost if information is publicly disclosed before the appropriate applications are filed. To manage this risk, businesses may require staff to submit manuscripts and other disclosures for review before submission.

Other people's IP

As a business grows beyond the start-up phase, awareness of the other players operating in the marketplace becomes more acute.

Disputes over IP are invariably costly and time consuming. Having an awareness of the IP landscape allows a business to steer clear of competitor's IP and avoid disputes. Similarly, an awareness of the IP landscape may allow the identification of licensing opportunities to bring new technologies into the business to drive growth.

A business with effective IP management is likely to search IP databases regularly to identify these threats and opportunities.

Running the IP portfolio

Very few early-stage companies employ an IP professional and the IP management hat is generally one of many worn by one of the company executives.

As a business grows, the amount of IP management increases, while the amount of executive time available to deal with it decreases. Many growing businesses employ an IP professional to manage their IP portfolio. A legally qualified attorney may be an attractive hire in order to save on the costs of employing external legal professionals. However, a qualified attorney commands a high salary and, if the attorney will in fact be spending his time on in-house IP management tasks, it may be more cost-effective to employ a non-legally qualified IP manager.

Other growing businesses may delegate IP management away from senior management. For example, project managers may be responsible for the IP relating to their particular project. This makes it easier to keep the IP and the technology

aligned, but the fragmentation of IP across the business may present other management challenges.

Conclusion

As a business grows beyond its start-up stage, IP plays an increasingly important role in providing a competitive edge. When efficiently managed and focused on the demands of the business, IP can be as powerful a tool in the marketplace as the 'bagsy' is in the playground.

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Nick Sutcliffe has a BSc in Biochemistry from the University of Bristol and a PhD in Biochemistry from the University of Leicester. Nick spent four years working in industrial research and development before joining Mewburn Ellis in 1997. He qualified as a chartered patent attorney and European patent attorney in 2001 and became a partner at Mewburn Ellis in 2003. Nick's work is mainly in the biotechnology field.

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Making open innovation work

2.5

Open innovation creates partnerships that give early-stage ideas speed and scale, but it can turn into a free-for-all. ***Maxine J Horn****, CEO at British Design Innovation, reviews the terms on which the creativity of professional originators can best be released*

Open innovation is widely considered to be the ideal business growth model going forward. Unfortunately, many people also appear to believe that it denotes a completely open free-for-all, where ideas can be purloined at will. For that reason, professional originators – those industrial designers, inventors, scientists, technologists, design engineers and others whose living depends upon creating new-to-market products, processes and propositions – have always felt threatened by open innovation's poorly regulated remuneration structure. Until now.

It is already accepted that knowledge transfer has a tradable value: universities consistently trade and transfer knowledge commercially with industry – an activity encouraged, promoted and funded by the government. (In some regards knowledge-based professional originators are little different from universities, apart from the fact that they have the know-how to take the knowledge further and translate it into market applications in the form of user-led products, services and propositions. To commercialize it to its maximum, in other words.)

But amid rising confusion about what the differences between 'open innovation' and 'open source' actually are, misconceptions abound – with major implications for the intellectual property (IP) sector, innovation and industry if things are not ironed out.

Professional originators utilize their know-how and expertise to progress unrefined ideas to a state of applied knowledge, yet current IP protection is incapable of drawing a distinction between ill-defined early-stage ideas on the one hand, and fully-rationalized knowledge- and solution-based business propositions on the other. A new intellectual property right (IPR) that protects pre-patent concepts created by professional originators would stimulate open innovation on a truly massive scale, so it is a hotly debated topic.

Put simply, open innovation is where industry seeks external sources of innovation. In a world of widely distributed knowledge, companies cannot afford to rely entirely on their own research, but should instead buy or license processes or inventions (eg

patents) from other companies and individuals. In addition, internal inventions not being used in a firm's business should be taken outside the company through licensing, joint ventures, spin-offs etc.

In fact, open innovation can be broken down into five distinct areas: open source, consumer- or user-led crowdsourcing, expert knowledge-led crowdsourcing, proposition sourcing (involving entrepreneurs), and concept sourcing (involving professional originators). All are outlined in more detail below.

1. Open source

New and shared knowledge, enabling reputation and status-building

Open source is a practice most common in software development and digital productions, where enthusiasts (of music, for instance) share knowledge, code and digital files to build reputations or contribute to end products.

Software companies use open source to encourage web developers to build on their platforms in order to make money from upgrades and end-user licenses for support products, and thus have a vested interest in free shareware. In this sense, 'free' does not mean valueless.

Shared ideas can become valuable if those ideas make a contribution to a greater end product that is worth money. In a structured framework focused on a common goal and with profit-share agreements in place, this is considered co-creation. In an unstructured open source environment, enthusiasts or new practitioners are often more interested in enabling and reputation-building than making money.

The results of publicly funded university research discoveries are made freely available through journals publication, allowing open source access to all who purchase or download them. However, although universities are strongly encouraged to commercialize results using traditional IPR and knowledge-transfer methodologies, small discoveries and new technologies are chasing problems to address but lack any real market application. So this is a form of open source, though not necessarily an immediately practical one.

IP structure: A Creative Commons license was introduced some years ago to denote materials that are free to use without seeking permission. Open source can build new knowledge; spawn innovation, new products and businesses. It serves a purpose to those who make a personal decision to work in such a way.

2. Consumer- or user-led crowdsourcing

User insights, ideas-based competitions, PR, no defined problem, no safety or quality control

User-led crowdsourcing is a modern form of consumer insight research that has replaced the small focus groups used by traditional market research firms. Large corporate brand owners launch competitions, often through PR firms, to source new product ideas and improvements from a consumer or user base; an expert panel sifts

the ideas and declares a winner. Although the ideas submitted are of variable quality the PR value can be beneficial. Occasionally a good submission can lead to a commercial payback.

IP structure: In general these types of competition do not attract professional originators due to the negligible IP terms, where all commercial advantage is often assigned to the brand owner running the competition as a condition of entry. Rewards rarely exceed a small cash prize, free product samples or a little PR.

3. Expert knowledge-led crowdsourcing

Intellectual knowledge, web-based, proprietary data and defined problem, solution-driven, quality and safety-based

This type of crowdsourcing, often promoted via a web portal, seeks to attract professionals, academics and subject enthusiasts. It relies upon proprietary knowledge and a defined problem being placed in the public domain for problem-solvers to find and resolve. Speculative knowledge-sourcing of this kind is less successful than that which offers significant monetary reward to the problem-solvers.

One of the more successful examples of expert knowledge crowdsourcing is offered by Gold Corporation, a Canadian gold-mining company then in financial difficulties. The company knew they had more gold on their 20,000-hectare property, but didn't know where. The cost of searching for gold was going up, while successful finds were going down. The CEO decided the only way out of the crisis was to admit the problem and mount a competition, with a major financial incentive to attract as many external parties as possible.

The Gold Corporation Challenge was launched with prize fund of $500,000 to be awarded to those who provided the methodology for finding gold, and required the company to publish 45 years of proprietary geological data online. Responses from 1,400 interested parties in 50 countries were received, the majority of whom understood geological data. Gold Corporation's 14 geologists reviewed the online proposals, filtered the submissions to 25 semi-finalists, then sifted down to three finalists who were asked to submit sophisticated proposals.

The solvers identified 110 sites, 50 per cent of which were new and 80 per cent of which produced gold. Eight million ounces of gold were found. Gold Corporation's value before the competition was $100 million and after the competition rose to $9 billion, and the company now owns the world's richest mine.

Open crowdsourcing of this nature was unprecedented in a sector as commercially secretive as mining, but was a risk the CEO was willing to take to enable expert problem-solvers to identify gold deposits and save the company. Although Gold Corporation risked open access to its proprietary mining data for the Challenge, the expert-led problem-solving it attracted literally paid dividends.

4. Proposition sourcing (involving entrepreneurs)

Every year, thousands of entrepreneurs spot a gap in the market and develop new business propositions. But while the digital age, the Internet, social networking and so forth have arguably made reaching the customer easier and more cost-efficient, business start-up costs are now at a minimum of £5,000 for an individual operating on cheapest options and £40,000 to £100,000+ for start-ups seeking to launch a professional brand. Costs include website creation and, for online transactions, a bank account, a payment system, telephone lines, brand and supporting infrastructure, while some require a terrestrial retail space as well.

Those who lack the financial resources, creativity or know-how to bring their propositions to market unaided are reliant upon partnering with other businesses, so need to be assured of confidentiality when seeking to negotiate deals at pre-commercialization stage. However, although open innovation is a good way to harness the knowledge, know-how, skills and ideas of large numbers of people, if ideas are considered to be free to be commercialized by those with the wealth and resources to grab them themselves, what motivation exists for entrepreneurs to participate?

A proper IP right with a regulated rewards mechanism needs to be in place if open innovation is to attract entrepreneurs in this situation.

5. Concept sourcing (involving professional originators)

Professional marketplace, user-centered, creatively articulated concepts to proof-of-concept stage

Here we arrive at arguably the most mutually rewarding of open innovation partnerships – but also the most contentious on the IP front.

When professional originators (who predominantly work in the creative industries) are commissioned by brand owners on a fees-for-services basis, they are paid for their knowledge, know-how and skill in creatively executing a brief. In this model, brand owners generally own or buy-out any IP arising. In open innovation calls, however, or where professional originators generate their own concepts without a formal brief, brand owners do not pay fees. Instead the originators seek to trade fully articulated propositions based on their customer- and sector-led knowledge and know-how with brand owners on a shared risk-and-reward basis.

In order for originators to communicate the value of such propositions, it is often necessary to also communicate a good deal of the knowledge supporting them. And quite often the propositions are not subject to patents, but might instead be proposed brand extensions, a new business model, the evolution of an existing product or service, or a new product, packaging or service proposition.

The problem confronting professional originators in these situations is that their knowledge-based propositions are often treated in the same way as ill-defined early-stage ideas proposed by those without the know-how, creativity or resources to take

an idea to proof-of-concept stage. In situations where brand owners refuse to sign non-disclosure agreements (in case they impinge upon concepts the owner could potentially already be working on), originators are totally unprotected from misappropriation of their propositions by those who believe that *all* pre-commercialized or pre-patent ideas are free to use as they choose, regardless of the stage they are at or the expertise put into formulating them.

Pre-patent concepts, including unprotected designs, 3D applications, service design, business models, propositions and processes, are consistently purloined by others on the basis that 'ideas cannot be protected'. It is as if some companies believe business meetings are held under a Creative Commons license, which denotes that a piece of work, code, image or file is open source and may be utilized by anyone for any purpose without requiring permission.

But professional originators' propositions are tradable knowledge-based solutions developed by industry experts with requisite know-how – in effect, proprietary but unprotected information. And these originators do not in the main set up competitive brands and companies, but more often seek to transfer knowledge and license concepts to brand owners.

I have personal experience of presenting propositions to organizations under non-confidential terms in order to enable negotiation to take place under normal conditions of business confidentiality – only for the same organizations to later assert that such exposure is in the public domain. But public domain is exactly that – ideas that have been fully exposed on public platforms such as a journal, conference or website.

It is disingenuous to assert that a one-to-one business meeting is in the public domain. All businesses are subject to a duty of confidentiality and most modern businesses have a Corporate Social Responsibility policy in place. They are duty-bound, if not legally constrained, from acting in an unethical manner through the misappropriation of innovative works brought to them by the owners with the express intent of negotiating a mutually agreeable purchase of such works.

So where do we go from here?

A new trading model is required that respects proposition ownership and value

If open innovation is ever to reach its full potential, a new trading model is required that respects the ownership and value of pre-patent concepts and propositions devised by professional originators and described in commercial negotiations with route-to-market businesses. Such a trading model needs to be based on unimpeachable business ethics, best professional practice and permission-based commercialization. And it needs to hand some semblance of pre-patent IP protection back to the professional originator.

As noted above, the bad news is that the market cannot rely upon ethics alone. The good news is that a new digital barcode system that could prevent the misappropriation of confidential new ideas and proprietary information is to be rolled out. Creative Barcode™ denotes ownership of propositions and concepts that require the owner's permission to exploit them, and offers prospective buyers the route to collaboration,

purchase or licensing of any given proposition idea. And no element of the proposition, however relayed to the interested party, may be commercialized without the written permission of the originator.

This innovative business model bridges the gap between walking naked into a business negotiation and a non-disclosure agreement. It removes any doubt about whether and when route-to-market businesses are free to utilize an originator's idea, and also comprises a beneficial co-creation and innovation management tool for brand owners, protecting them from litigation.

The misappropriation of originators' previously unprotectable work has been the biggest single issue affecting industry and the IP sector, and has become an enormous barrier to open innovation and knowledge exchange.

Luckily, the new rules of engagement in the trading model outlined above are not complex: 'Do not commercialize the work of others without their permission and an agreed commercial remuneration on mutually agreed terms.'

Clear enough? I think so. Now let's get to work trading propositions and generating wealth.

Maxine J Horn is CEO of British Design Innovation (BDI), the trade association for designers and innovators. She initiated Creative Barcode and hand-picked the co-creation team. With over 20 years' experience in the design, innovation and knowledge transfer sectors of the creative industries, she is a member of the UKIPO B2B Strategy Group, a pioneer of open innovation and an acknowledged opinion-former and author. Maxine was a runner-up in the First Women Awards 2010 for business pioneers.

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PART THREE
Gaining market share

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Taking your brand to the next level

3.1

Could your brand make an explosive step-change? ***John Robson*** *at Sparkler looks at how you could make it happen*

There are thousands of brand owners in hundreds of markets happily breathing a sigh of relief that they have survived the recession, now hoping for stability or perhaps a few percentage-point year-on-year increases in the next financial year. Usually this sort of steady brand growth comes from the good old-fashioned organic variety; several satisfied customers pass the word on to their friends and sales increase a bit.

Directors and marketing departments looking for this sort of organic growth should focus on gentle encouragement of this natural word-of-mouth phenomenon; ensure that your product or service is excellent, make sure availability is not a problem, and then look after your most loyal customers. Organic growth requires careful tending, pruning and fertilizing. It is about keeping a successful and natural equilibrium intact.

But what about directors and marketing departments for whom an Alan Titchmarsh approach is simply not enough? Perhaps you are looking for explosive growth in a youthful, unpredictable market. Maybe you are the rising star in your company, tasked with doubling sales of the Rising Star brand in your portfolio. Or you might be a brand still sailing in nasty storms whipped up by the recession, rudderless and sinking fast.

If you need this kind of explosive step-change for your brand, then how to go about it?

Be bold

Organic growth is often associated with compromise behaviour – the natural internal ecosystem of the sales team, production, finance and marketing must be kept in balance at all times. And the recession has, understandably, muted expectations in some quarters.

If you are looking for step-change though, then delicate compromises will likely need to be swept aside. You will need to make some bold calls, and follow it up with some bold conversations. There is a reason for this. In the outside world of the marketplace your brand has probably settled into a nice, cosy position. All your customers think they know everything about it.

You need to change all that – make it stand out, jiggle it about a bit, wave and shout and make new customers notice you. The only way you are going to make your brand stand out again in the marketplace is by changing something that, internally, seems radical.

Look at the big numbers

We often encounter directors and managers who obsess about small increases in small numbers – has brand awareness gone from 62 per cent to 64 per cent this quarter? Are our retention figures higher than last year? How can we squeeze more out of our strike rates? This is understandable – they are the metrics of organic growth and directors are evaluated on such measures. But they don't help with brand step-change.

You will never create brand step-change without stepping back and observing the bigger numbers. Here are some suggestions for things you should check:

- When was the last time you looked at your basic, headline sales figures? Graphed over the last 10 years, by volume, and by value? Notice anything blindingly obvious?
- Now do the same again, split by sub-brand or product variant.
- Now, split by large geographical markets (globally split by market perhaps, or nationally, north versus south).
- If you had to split your entire customer universe into three groups – what would those groups be? Which of those three are getting bigger? Which is getting richer or more influential?
- At what level is awareness of your brand? Just because everyone in your private circle of friends has heard of it, don't assume everyone in the country has. You might be surprised at how low spontaneous and prompted brand awareness levels can be for seemingly big national brands.
- What do your best customers think of your brand? Why do other people reject your brand? If you have no brand rejectors, this is probably a bad sign. Good brands have lovers and haters. Why haven't you got any brand haters?
- Are there any macro cultural or economic dynamics affecting your post-recession marketplace? Do interest rates or the state of the housing market impact on your sales? Or perhaps macro health or green issues?

Having answered those questions you will probably now know, in your heart of hearts, where the step-change might perhaps come from. No? Oh yes – we forgot one thing…

Pricing

What is the true elasticity of pricing in your marketplace? How do you know?

Ask the un-askable questions. Just quietly to yourself. What would happen if you doubled the price of your product? What would you need to change to be able to justify that premium? Are there any customer segments who have a strong need for that kind of product or service? And could they afford the new price?

Does that help open any new step-change doors? Perhaps, perhaps not. But these are exactly the kind of questions that can begin to show you a route through to significant brand growth.

Iconoclasm

In searching for step-change you will likely come across false idols and received wisdoms that you will be aching to question. It might be that 'under no circumstances can the production line make round ones, only square ones', or 'you'll never sell a healthy product in this marketplace', or 'the trade will never buy that argument'.

In our experience, it is only when those false idols are shattered that step-change actually happens. And the best corporate cultures not only allow iconoclasm, they actively encourage it.

Global equine dentistry

The day before writing this guide, I was driving down the A1 and saw a van at a service station. On the side of the van was written 'Global Equine Dentistry'. Wow! Are there that many horses' teeth in the world to sustain a global equine dentistry industry? Seems like it.

The point is this – in developing your brand, you cannot be too specific in defining your speciality or product niche. You are much more likely to create a step-change if you keep narrowing and narrowing the definition of what you do. You have to, to create impact and be noticed. How many Bloggs & Smith removals vans passed me by unnoticed on the A1 yesterday?

Social engineering

Other than the continued march of new digital distribution channels, perhaps the biggest shift, and biggest opportunity, in the world of marketing in the last two or three years has been the rise of social media. To create step-change in 2011 you should be seriously considering the integration of tools such as Facebook, Twitter, blogs and mobile apps into your marketing and public face. Whatever the size of your business, and whether B2C or B2B, an effective and social ECRM programme can

offer you super-organic, viral growth. In many ways there is no special magic to it – it is about creating a 'sense of community', and being more transparent about your business and ideas.

In an ideal world, you and your customers should be interacting continuously, in real-time, and looking towards co-creation opportunities. This has probably been true for centuries – it's just that social media now make it much more realistic and easy.

Urgency

OK, so you've got your step-change plan in your heart of hearts. You've looked at the data. You've talked to your customers. You've smashed a few false idols. You've checked out Facebook.

How and when to go about it? Prevarication never helped create step-change. The best way is to start putting your plan into action right now. Today. Why spend any money tomorrow on activity that is, at best, going to have an organic effect on your brand.

Press on urgently and boldly to create that step-change.

John Robson is a founding partner at Sparkler. Sparkler is a brand strategy consultancy that specializes in next generation businesses and brands. Established nine years ago, Sparkler has developed brand strategies for clients such as Nokia, Tesco, Universal Music, Microsoft, LOVEFiLM and Cadbury.

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Market intelligence

3.2

***Nick Hague**, managing director of B2B International, discusses three steps to powerful market intelligence*

Take a minute to think what it would be like if you had just a handful of customers and you intimately knew everything there was to know about them from their names and personal background through to their differing business needs. Just like a market trader who has a continuous finger on the pulse of customer preference, direct contact with customers allows a business owner to quickly evaluate what he is doing right or where he is going wrong. Such informal feedback is valuable in any company, but hard to formalize and control in anything much larger than a corner shop.

However, it is also just as important to have information on your competitors and potential customers as it is to have information on your existing customers. Having intelligence on your enemy is a key to winning military battles and so it is in business.

Market intelligence can be used to assist with more or less every decision faced by a company (whether they are operating on a local, regional, national or international level). The overriding purpose of most market intelligence is to help the company grow – to increase revenue, profit, or market share. Good market intelligence can therefore have a huge return on investment; just £20,000 to £100,000 spent on intelligence can generate or save many times that amount in extra customer revenue or the avoidance of a bad investment decision.

The problem is that with the advent of the Internet and so much information at our fingertips, sometimes the difficulty is in knowing where to start. The purposes of this chapter are to hopefully make your life easier in knowing how to go about gathering market intelligence and what types of market intelligence will deliver useful insight.

Step 1: Don't reinvent the wheel

There is no point reinventing the wheel if the information we are after is already under our noses. However, the problem normally is that very often people either don't know the information exists or they don't know how to locate the information in the particular format they are looking for.

The best starting point for any project is to get key personnel from different backgrounds of the business to take part in a workshop-type format (from board level down, encompassing marketing, sales, operations, HR, technical, logistics – the whole business). This type of meeting can be very rewarding to assemble knowledge on customers, potential customers and competitors that otherwise would be held in individuals' heads. Using this workshop format also helps clarify what external information has been collected previously and therefore obviates the need to spend money on collecting the information again (gone are the days of Market Research Managers within large corporates who used to know what primary research had been commissioned in the past). A huge amount of learning can be gathered using workshops, especially if guided by a skilled external moderator.

Following this workshop output there will no doubt still be gaps in intelligence but there is no need to spend vast amounts of money on primary research. The expert desk researcher can quickly and inexpensively dig out data from a wide variety of sources to answer many of the questions that have already been asked. With the recent explosion of social networking, this too has resulted in a lot of information that can be quickly gathered inexpensively. This is not to say that it will definitely be correct, but information that is in the public domain has at least been subjected to the test of public scrutiny and it can be then challenged internally to help judge its accuracy.

Step 2: Choose your battleground

Desk research can be very fruitful. However, it has its limits and it may only provide part of the information sought in a project. Where a mix of desk and primary research is used it therefore means that more expensive primary research techniques are used only where essential.

The next step is to clearly state what your key objective is for your business plan and the actions you will take as a result of gathering the market intelligence. In Table 3.2.1 opposite you can see the different types of information that can be gathered to deliver different types of market insight.

Information can be gathered from speaking with many different respondents including:

- **Interviews with customers** – these are arguably the most important interviews of all as they are the lifeblood of your company. There is no more effective, reliable or valuable source of competitor intelligence than customers. Buyers have never been so willing to say exactly what they want, and how they want it, nor so willing to complain or take their business elsewhere if their requirements are not fulfilled. Customers often display a remarkable level of candour when talking about their suppliers, even those with whom they have a close and collaborative relationship. Issues as diverse as price, service, contractual details and technical information can be discussed, as well as information on the competition and future needs.

TABLE 3.2.1 Examples of market intelligence studies

Type of information needed	Type of study that would meet that need
Help to enter a new market, or expand presence in a market	Due diligence, market entry and market expansion studies
Minimize the risk of an investment decision being wrong	Market assessment or acquisition studies
Keep ahead of the competition, obtain first-mover advantage over competitors	Competitor intelligence study, needs assessment study or customer satisfaction studies
Give the customers what they want, expand market share	Needs assessment studies, segmentation studies or customer satisfaction studies
Establish and maintain a distinctive corporate identity	Brand positioning studies
Tailor products and marketing effort around customer needs	Segmentation and customer satisfaction studies

- **Interviews with potential customers** – these interviews are often very important to see what market perceptions are like 'on the other side of the fence'. Potential customer interviews can be used to ascertain brand perceptions in the marketplace, why they choose the supplier they do and what could make them switch to another supplier. These interviews are also useful to ascertain how much demand there is for a product/service so that market sizing estimations can be made
- **Competitor interviews** – competitor interviews are a difficult, but valuable means of gaining competitor intelligence. Clearly senior management such as Marketing VPs are particularly useful sources of information, if they can be persuaded to talk. Gaining cooperation with such groups is one of the most difficult tasks carried out by research and intelligence agencies. If the agency can avoid revealing the sponsor of the survey (this is very rare), a financial incentive may gain cooperation. Far more commonly, the respondent is happy to take part in an 'information exchange'. This usually results in the respondent receiving a synopsis of the overall market research findings in return for a face-to-face or telephone interview. It should be highlighted that a competitor interview does not necessarily need to target a high-level respondent in order to be useful. Mid-management employees such as sales managers can be an extremely useful source of information on products, innovations, overall strategies and a host of other topics. These employees are

trained to talk and persuade and tend to be less circumspect than their colleagues in other departments.

- **Interviews with suppliers, distributors and industry experts** – in every industry it is worth mapping out the supply chain in order to assess who might be able to provide valuable market intelligence. Those at the centre of the supply chain – intermediaries such as distributors, agents and importers – are often those that know most about the market, as they are in frequent contact with manufacturers and sellers alike. Most markets have a number of 'experts' of some kind who are independent and willing to share the information they possess. Industry associations and journalists at industry publications are typical examples.

The means of gathering market information varies according to the objectives of the intelligence – are you looking for insight and understanding or are you looking for robust quantification of market size and segments, brand shares or purchase frequencies? Also, the type of methodology depends on who your target audience is. For example, it is easier to use e-surveys when speaking to customers due to the already existing relationship you have with your customers and therefore the response rates of completion are greater, but also the fact that you have at your disposal an accurate e-mail list. However, even from customers, the depth that is gathered through e-surveys is often not as detailed as an administered interview over the telephone or face-to-face. Focus groups (both online and face-to-face) are still used in abundance in business-to-business research to capture qualitative insight, but other methodologies are also utilized that call on different skills such as observational skills in ethnographic research.

Clearly, scoping out who you are looking to target very much dictates what methodology is chosen. However, there are few real methodological differences when it comes to obtaining market intelligence in different countries. When it comes to data collection, it is true that Asian markets, for both cultural and logistical reasons, often require more face-to-face data collection than Western markets. It is also true that market intelligence can be more difficult to obtain in developing countries. A key reason for this is that economic records tend to be less well-established. However, a market intelligence provider with well-educated employees and a multilingual capability should be capable of obtaining intelligence across different markets. Indeed, this skill is increasingly essential as the requirement for multi-country intelligence increases.

Step 3: Don't stop digging

One of the most important things to remember is that the gathering of market intelligence is delivering insight into a market at that specific moment in time. Many of the issues that affect a customer's buying decision today will most likely evolve in the future. Also, in this global marketplace in which we all play, change is constant and so not only will needs change but suppliers, prices and products will also change. Therefore, it is not only important that intelligence is acted upon when it is collected

but also that a constant review (or feedback loop) is put in place so that a continuous review of market intelligence is at the centre of all business decisions made.

In conclusion

For many companies, the first place to look for more sales and therefore growth is among existing customers. Current customers have already made the ultimate gesture of approval and paid money to buy your products. A bit more persuasion and they may buy more. Also, existing customers know and trust the company sufficiently well to do business. So much so, they may give serious consideration to buying a new product or service from the company. However, every company has a product that can travel. New markets wherever they are – new countries or new segments – carry risk and the gathering of accurate market intelligence is a must in making all these decisions.

Nick Hague is a founder member of B2B International. He has extensive experience in the design and execution of market research projects across a wide variety of industries. He has carried out dozens of surveys on business excellence and has managed research projects that have spanned over 30 countries. Further details: tel: 0161 440 6000; website: **www.b2binternational.com**.

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Web marketing

3.3

What's the point of having a website if it doesn't generate you any business or more importantly profit? asks ***Tony Mackenzie*** *at Web on High*

With major improvements in technology over the last five to seven years, it has now become easier and quicker for the vast majority of the UK populous to go online to look for required products and services. Speed of data access and quicker hardware platforms combined with easy search parameters and the global monster that is Google means that people are comfortably aware that they can find the right solution by simply typing in 'plumber in Westminster', or 'hotel in Newbury' for example. With a staggering 57 per cent of all businesses now being found for the first time using the major search engines, having a visible online presence in the current business climate is not only useful but critical. An effective online strategy can transform a business, even in a downturn… but only if understood and planned correctly.

The following rules and guidelines form the starting point for a successful website and online presence.

Search engine marketing

Sadly a high proportion of sites that exist miss the point entirely when it comes to effective and productive search engine optimization (SEO). Many web-design companies simply do not understand the amount of time and effort needed or more importantly what the major search engines such as Google want to see on your site.

This is where the critically important areas of accurate analysis, research and planning play an important part. It is essential to understand in great depth your overall business model, prior to even starting to think about the creation/design or promotion of a website. This fundamental research and analysis is the foundation to creating a website that targets the right audience and market and will ultimately make a big difference to your online productivity and visibility.

Why aim your website at a market that no one is looking at and will not produce enquiries or orders?

Thoughts and considerations – web design

When beginning to think about developing and creating a website, it is absolutely critical that certain design basics are adhered to because these are the building blocks towards successful promotion and conversion as your website has less than a few seconds to retain the attention of a prospective customer or client once they find you. Aspects such as design, speed of page loading, textual positioning, colours, font, ease of navigation and placement of images all play a major role in how someone will interact and interpret a site. There is no point in having a website that does not convert visitors to customers or orders because they do not like what they see or more importantly cannot find what they want.

When looking at the performance of any website, there are a number of statistics worth considering – and although statistics may be misinterpreted or manipulated, the logic behind these particular statistics is sound:

- People are intolerant of slow websites – 28 per cent won't bother opening a website or wait for it to open if it takes more than seven seconds to do so.
- These same people will spend no more than four seconds determining whether or not a website (and therefore the company it represents) can fulfil their needs.
- Over 69 per cent of the UK population now enjoys access to the Internet and over 90 per cent of those use the major search engines to search for a product or service.

The likelihood of a website becoming successful is far greater if the site is easily found, simple to navigate, and provides ample information in a clear and direct way while driving a potential customer to make contact or buy! Any site developed to attract enquiries would need to take into consideration a number of key points in its design to maximize the potential for attracting and retaining a prospective client and encouraging them to make an enquiry.

Sales message

Bearing in mind that the average potential customer will not visit the site as many times as you will, the placing of the words on the site is critical. Furthermore, with a well-constructed site that is promoted on the major search engines a visitor could enter from any page, which makes the placement of your sales message in the right location imperative.

A company can therefore benefit from a very clear sales message on the home page as well as other pages and of equal benefit are (what we refer to as) 'calls to action' such as 'click here to speak to an advisor'.

Speed

Speed is absolutely crucial, as the majority of users wait no longer than seven seconds (or maybe less) for a page to load. More recently search engines have chosen to add a

considerable amount of weight and ranking value to websites based on their speed and access performance and they will not favour a site that is slow. Speed of access can be affected by both Internet connection and size of page (in terms of megabytes), which is, among other things, affected by pictures and graphics.

What this means in simple terms is that you should be very, very mindful of the overall style used to design and develop the site.

Navigation

Simple and effective navigation of a website is equally important – you must allow users to concentrate on the content of your site rather than on how it should be used. Let's face it, the English-speaking world reads from left to right, therefore navigation placed on the left of the site is intuitive, whereas navigation across the top will effectively lower the text of the site and give less opportunity to promote your sales message.

Colours, text, font and layout

Once opened, the average prospective client will spend no more than four seconds determining if they like your site (ergo, you!) and want to use your services. Clearly you have to make it very easy for them to decide.

We would strongly recommend using black text on a white background, which will give the greatest possible contrast, thus making reading your sales message easy. Using strong colours and branding for the borders of the site will lend itself to good aesthetic balance.

Summary

Given the background to these thoughts, you should remember the whole aim of a website should be to increase sales revenue and profit – a simple desire, but a desire that needs careful planning to attain.

For the purpose of structuring thought, you should divide the project into three main elements: portraying the right image; attracting the right people (via search engine prominence) to the website; and encouraging those prospects to make a purchase or contact you.

The right image will be achieved through embracing these principles of design by creating a 'look and feel' that does three things:

- presents an aesthetic image that gives the feeling of professionalism;
- gives a succinct sales message;
- encourages users to progress.

If you get these fundamentals correct, you are well on your way to having a site that generates fantastic results and plays a major part in the development of your business for years to come.

Web on High was created in 1999 as a result of a vision that saw the Internet as a truly powerful promotional tool for business. The founders were adamant that the Internet would be the most important method of business promotion and marketing for years to come – and time has proved them right.

Web on High's core focus has always been based on search engine promotion in a bid to drive business to client websites. Behind the scenes, Web on High can boast a huge wealth of marketing and solid commercial experience as well as a variety of sound IT skills. With a 22-strong team that includes designers, programmers, SEO engineers, customer account managers and experienced management, Web on High can ensure that clients get exactly what they what – and that it is delivered with dedication, speed and professionalism. For further details visit the website: **www.woh.co.uk**.

Winning new business

3.4

In a downturn, you have to adopt the right state of mind, says ***Renee Botham*** *at Touchstone Growth*

Running a business is a challenge, like no other. Chances are you spend more time at work than you do at home; you can at times be more in touch with your colleagues than with your friends; and with modern technology, a need to know what is going on when you are not at work, may give you little space for 'you' time!

Who said it would be easy? And to compound it there is the 'R' word! Recession is very real; however it can also be a mantra for failure! Some of you will recall the recession 20 years ago, I certainly do. Can we compare this with the last? It certainly didn't have the global implications; personally I think it is a very different kind of recession, however, just like then, there will be survivors – those who don't just make it through, they also use this as a way to grow their business – and losers. I recall Lord Kalms, founder of DSGi, saying that he used the time when things were tough economically to really push ahead, because once the waves calmed he was way ahead of his competitors. I consider this to be sound advice from one of the UK's most pioneering, formidable and successful businessmen.

So my call to you is: what is your *plan* to be? Because make no mistake, it is about planning.

Plans don't stop at reducing headcount or wishing/hoping for a pick-up in your profit margins. What is required is careful consideration of what you want your business to look like. How big do you want your business to be – the shape of it, what are your plans for the business; grow to sell, plan for an MBO? Whatever this is, it must be in the forefront of your mind, should shape your actions and be actively discussed with your colleagues and stakeholders.

I thought it might be a good idea in this chapter to provide a checklist of just some of the important considerations needed to win new business.

What's my plan?

Here, I would recommend you think about the following:

- Who are our current clients?

- What sectors (if appropriate), geography, size/turnover do we currently work in?
- Who are our most profitable clients and why?
- Why do they work with us?
- Formulate who we want to be working with and why (some clients may be prestigious – can you afford this as a criteria right now)?

Setting time aside – weekly

Each week an hour minimum must be set aside, religiously.

Too often I hear these meetings being postponed for the 'here and now' – not good enough! If you are well organized and colleagues clearly understand their responsibilities in maintaining a great relationship and are on top of your clients' needs this shouldn't happen.

Nor is a weekly meeting about assessing who you are currently pitching (bidding) for. This needs to take place, but not within this time. What you should be discussing needs to include:

- Who are our competitors and who are they working with?
- What are our distinguishing features? Note I do not use the term USP (unique selling point); they disappear as soon as your competitors get wind of them. It's more about what makes you special.
- How the business is positioned in our marketspace; are our customers/clients and potential clients clear about what our brand stands for?
- Having clarified who you wish to be talking with, what is your 'story' and is it strong enough for someone to say 'you know what, I really think it would be useful to set time aside to meet with you'?
- How are you going to reach the list of contacts/companies that you have identified as potential clients?
- How are you talking to them? Your message *has* to be 'with' them not 'to' them – think about the difference and review your own literature!
- Are your messages consistent throughout the business?
- Review of activity adding further intelligence regarding *all* the points above – what's working, what's not? Is your message strong enough or does it need adapting? Is it current – fulfilling the issues that your potential clients are facing today and tomorrow?

Who is responsible for all of this?

New business is not only about having great interpersonal skills. The person responsible needs to be brave (to face rejections), tenacious (yet knowing when to

back away), vigilant and persistent (because sometimes this is about getting the 'timing' right).

How you keep track of your activity is vital

There is nothing worse than:

- a prospect getting five different messages from five different people within your organization;
- contacting someone who already has a relationship with another person in your company – or, even worse, is a current client;
- there is a 'history' that you are unaware of;
- you miss a deadline when a buying decision is being made;
- you don't keep a track of the history of the call to be made; including any personal data that is useful in the whole relationship-building process.

To conclude and returning to the introduction to this chapter, 'Business growth is a state of mind'.

To be successful requires all of the above and something more. It needs YOU.

Your people, stakeholders and clients need to truly believe in you. Surround yourself with positive-thinking people who are as passionate as you are about what your company stands for. If they are not, are you partially to blame for not providing them with the necessary tools or not listening to what their individual needs are? Have you and your top management the ability to delegate, or are you spreading yourself too thin to a point where nothing gets completed? And finally, for now, are you taking time out? A problem walked away from for a time can often be seen in a new light. I set up my business over 20 years ago and my concept of 'work–life balance' was revolutionary at the time. The reality is that taking care of yourself, your people and your family, makes you a much more effective, 'real' person to work with. In an age of cynicism, wouldn't you rather be working with, surrounded by, people you trust, enjoy and are confident with – because that is the key to understanding why people will work with you.

Renee Botham is chairman of Touchstone Growth. She established the company 20 years ago to create opportunities through strategic advice and practical implementation (making meetings). Her empathetic team has strong corporate backgrounds; all are articulate and engaging. Touchstone supports clients across a wide range of B2B business sectors, including Top 3 management consultants, professional services, marcomms and the IT industry.

Her special field is consultancy in supporting clients to build the foundations before carrying out their business growth initiatives. Contact: **reneeb@touchstonegrowth.com**.

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Brand rights

3.5

Name? Logo? Domain? ***Maggie Ramage****, president of the Institute of Trade Mark Attorneys, discusses how to make sure you have secured the rights in your brand*

New businesses are the lifeblood of economic regeneration at a time when growth has stagnated; unemployment is constantly rising; bank rates are hovering at a consistently low level; and recession is the buzzword of the final years of the first decade of the 21st millennium. If we are to avoid recession being the keyword of the second decade then we need to look at ways in which new businesses can thrive and how they can grow.

In this chapter I suggest that one of the building blocks for success is developing and maintaining a good trade mark strategy; avoiding some of the common pitfalls that hit new businesses all too frequently and offering guidance on how businesses can take their products and services to a wider audience with a little help from their professional friends.

I will not name names, but much of this article derives from experiences gained from speaking to start-ups and new businesses who seek advice through the auspices of a government-run series of free Business Advice Open Days in which my Institute, ITMA – the Institute of Trade Mark Attorneys – is an active partner and participant.

Business people attend these exhibitions and seminars because they need to know more about running their businesses. A lot attend because they need to know about VAT, employment issues and health and safety but they are often surprised that there are a whole range of issues that affect them, but of which they are unaware. Trade marks fall into this category.

Most people start new businesses because they believe they have a product or service that they think is going to make them money. Some may start new businesses because they believe they are contributing to the greater good of mankind. But what they all must do is to be business minded and, if they are to survive and prosper, they must follow sound business practice and this includes making sure they get things right in the way of trade marks.

The most common misconception from new business people is that they think that once they have set up a company and registered it with companies house, they can merrily go off into the marketplace and trade under that name. This is a huge mistake and can put a new company out of business before it has even started trading. This may sound dramatic but it happens all too frequently. However, it can be avoided with relative ease and is the first point I wish to address.

There are certain legal requirements as to why new businesses need to register their company names at Companies House. However, this does not necessarily prevent others from using that name in the marketplace nor does it guarantee that they are free to use that name if others already own or use the name, which may not even be the registered company name. The key register to check to see if a business can use a particular name for its goods or services is the Trade Marks Register. In fact, while many company names may appear on the Trade Marks Register the most important marks on the register belong to individual products or services deriving from that company.

So, let's start with some basic facts. The prime purpose of a trade mark is to distinguish the goods or services of one business from the goods or services of others in the marketplace. To do this, the trade mark needs to be different from any other mark used in respect of the same or similar goods or services. It can take a variety of forms including a word (for example Virgin), a slogan (Just Do It), a logo (Esso's tiger), a jingle (*Air on a G String* to advertise Hamlet cigars), a colour (the purple colour of Cadbury's chocolate packs), a shape (Dimple whisky bottles), letters (BP, MTV), a number (No 5 for perfume), or a personal name (Walkers).

To avoid any conflict, searches need to be conducted to determine what marks are already on the Trade Marks Register and whether or not your proposed mark is safe to adopt and use within the marketplace without fear of infringing existing marks.

Failure to carry out these searches could result in having to rethink your entire marketing strategy; redesigning all your promotional literature and packaging materials and starting again from scratch – not the most auspicious way to start a new venture and certainly not a cost-effective way to begin! It could even lead to your having to pay damages to the owner of the earlier trade mark you may have unwittingly infringed.

It is possible to conduct identical searches yourself by examining the UK Register and the Community Register online via the websites **www.ipo.gov.uk** and **www.oami.eu.int**. However, those online searches are limited. They do not search for phonetically similar marks, nor do they search for what may be deemed confusingly similar marks. They do not guarantee that the mark is free to use or whether it can be registered. That is a skilled undertaking and is really best undertaken by professionals.

This is where the Institute of Trade Mark Attorneys comes in. ITMA members are taught and examined on all the necessary skills. They maintain their professional knowledge through a thorough programme of continuing professional development.

Although it is possible to apply to register trade marks without using the services of a trade mark attorney, trade mark attorneys can undertake the whole process for you. This involves completing forms from the Trade Marks Registry, part of the IPO (the Intellectual Property Office, formerly known as the Patent Office), which give details of the applicant together with a representation of the mark and defining the class or classes for which the trade mark is to be registered.

There are various classes in the UK and it may be necessary to file for more than one class depending on the goods or services in question. The number of classes will determine the fees to be paid to the Registry, currently £200 for the first class and £50 for each additional class. In addition there are, of course, the fees to be paid to your

trade mark attorney. Trade mark attorney charges vary, which is why you will need to talk to individual firms for more detail.

The Registry then examines the application to ensure that it meets the requirements of the Trade Marks Act. Once the Registry is satisfied that the application can proceed, the Registry publishes the application in a weekly *Trade Marks Journal* so that interested parties can learn of the application and may, if they so wish, lodge an opposition. They have two months in which to do this.

If no oppositions are received, the Registry will enter the mark on the Trade Marks Register and will issue you with a certificate. If there are oppositions, your trade mark attorney will endeavour to resolve them and will represent you at hearings conducted by officials of the Registry.

Assuming all goes well and you receive your registration certificate, your mark will remain validly on the Register provided it is in use and the renewal fees have been paid. The mark remains on the Register indefinitely subject to these requirements. The renewal fees are due for payment every 10 years.

The major benefit of registering trade marks is that if anyone uses a mark that is similar to yours, then it is relatively easy to take action since you will have a registration certificate that shows you as the owner of the registered trade mark. Without registration, businesses have to rely on common law rights that are far more costly to enforce since they entail demonstrating 1) a reputation in the mark in question, 2) that the infringing mark has damaged that reputation and 3) quantifying that damage. Although, of course, every case would be determined on its merits, the reality is that to develop a reputation the business would likely have to have been in operation for some time, perhaps several years, or to have acquired reputation from massive advertising, which may, in itself, have attracted an infringement action.

As trade marks are territorial most new businesses will initially consider applying for a UK trade mark; the application process for which is outlined above. If a company wants to move into Europe, or even if the company sees itself in Europe in the first few years of existence, then it may be appropriate to apply for a Community Trade Mark (CTM) which gives trade mark protection in all 27 member states and which automatically extends to new members as and when they join the EU. The CTM application process is broadly similar to UK application but the relevant office (OHIM) is located in Alicante, Spain.

Again, a trade mark attorney can handle the whole process and, should the business expand to other territories, trade mark attorneys can apply for trade mark protection in overseas territories through an International Registration system called the Madrid Protocol, which is run by the World Intellectual Property Organization (WIPO) based in Switzerland. They can also secure registrations in other countries who have not signed up to the Madrid Protocol through international colleagues, some of whom are members of ITMA.

So with trade mark protection in place at home and abroad what else should new and growing businesses consider? Staying on the subject of trade marks the main consideration has to be on the subject of domain names.

Domain names create a unique address that allows a computer to distinguish one address from millions of others connected to the Internet. No two organizations can have the same domain name. Internet users have the right to expect that a domain name which consists of a trade mark in use commercially is associated with the owner

of the trade mark. There have been some court cases because, as domain names are sold on a first-come, first-served basis, it is often the case that someone who does not have the legal right to own that domain acquires it perhaps with the hopeful view that they can sell it back to the rightful owner of the trade mark. Trade Mark Attorneys can advise on such disputes.

There are a couple of other points to note. First, trade mark registration would normally be paramount over domain registrations, so if a company owns a particular trade mark, that is normally the starting base for recovery of a similar domain name. Second, it is important that domain names are renewed automatically because if a domain name is inadvertently allowed to lapse it cannot be restored to record, unlike a trade mark registration.

One of the other services trade mark attorneys can offer is a watching service. This may cover trade marks alone but can extend to a domain name watch. This can prove invaluable to see who else is out there, perhaps active with the same or similar elements. It also enables trade mark attorneys to start speedy proceedings for recovery of trade marks or domain names that have been registered in contravention of clients' rights.

Maggie Ramage was elected President of ITMA – the Institute of Trade Mark Attorneys – in April 2010. She is a UK trade mark attorney and a European trade mark attorney. She is also a member of INTA, ECTA and MARQUES. Maggie has worked for the California-based Raychem Corporation and was seconded to San Francisco in 1987. She then worked for what was Beecham Group (now part of GlaxoSmithKline), before moving to British Telecommunications. Maggie became a Partner in Surrey-based Alexander Ramage Associates in 1991.

A full UK listing of trade mark attorneys in the UK is on our website: **www.itma.org.uk** and the front page includes a box 'Find a local trade mark expert'.

Look for the UKAS mark

UKAS
UNITED KINGDOM ACCREDITATION SERVICE

Save Money... ...Reduce Risk

If your business uses **testing, calibration, certification** or **inspection services** in these sectors, *look for the UKAS mark* when choosing your suppliers

PASTA REALE

"Accredited-certification to the BRC Global standard demonstrates to our customers that we operate to a required standard. This gives us a point of difference over our rivals.

Food safety is essential. We see product recalls and food scares in the press all the time. Accredited-certification to the BRC standard builds in food safety processes to our business, and is a pre-requisite to trade with most of the major retailers. Without accredited-certification, we would not be able to service many of the customers we supply, and that would have a significant impact on the size and success of our business.

The supermarkets and retailers benefit by not having to visit our business as often to carry out activities such as routine hygiene audits enabling them to achieve resource savings. This also frees up the time of our own staff as they do not have to accommodate as many customer visits, allowing them to focus on activities such as business and product development."

Barry Denton,
Operations Director

Visit **www.ukas.com** to find out how using a supplier accredited by UKAS will deliver real benefits for your business

Delivering Confidence

Fit for market

3.6

Confidence is the key to better-quality contracts, which is why accrediting your products and using accredited services is the best route to becoming 'fit for market', says ***Jon Murthy*** *at UKAS*

Regardless of where the economy is headed, companies need to have confidence in the goods and services they procure. This is true of all companies, whether large, small, public or private. Developing better-quality contracts – with suppliers and customers – demands confidence, which is why accreditation is becoming increasingly popular as a tool. Accreditation is a method of ensuring an organization's competence. This means that companies that hold or utilize services that have achieved accredited status can be sure that they are fit for purpose.

What is UKAS accreditation?

The United Kingdom Accreditation Service (UKAS) is the national accreditation body for the UK. This means it is the only body recognized by government to assess – against internationally recognized standards – certification, inspection, testing and calibration services. Accreditation by UKAS is a guarantee that an organization is competent to carry out one or more specified tasks. As many of these organizations are conformity assessment bodies, this means that UKAS effectively 'checks the checkers'.

How does it work?

Accreditation is a robust and rigorous ongoing process that takes place over a four-year cycle. The initial assessment is to establish that the organization:

- is impartial;
- is technically competent to perform the task specified;
- has the appropriate resources and facilities;
- can perform to the required standard; and
- is capable of sustaining this level of performance.

There are then annual surveillance visits and a reassessment every four years. In some areas there is also provision for unannounced visits to ensure that the organization isn't just 'scrubbing up for the cameras'. This is why users of accredited services can have confidence in the goods and services they procure.

Who becomes accredited?

Bodies providing the following goods and services may be UKAS accredited:

- **Certification** applies to standards that relate to business operation, the most commonly used being ISO 9001 for Quality Management and the Environmental Management Standard ISO 14001. There are many other aspects of business life that can be certified, including products, personnel, information security, IT and occupational health and safety.
- **Inspection** regimes cover product design, products, materials and equipment, installations, plant, processes and services. Some of these areas will be subject to legislation that demands regular inspection, such as the Provision and Use of Work Equipment Regulations 1998.
- **Product testing and calibration** are used to demonstrate that a product meets a specification. This might be a customer requirement, a part of a product development regime, or even a legal obligation. More than 1,500 facilities in the UK have been accredited by UKAS to the laboratory standard ISO/IEC 17025.

Why accreditation?

There are many reasons why companies might choose to purchase third-party evaluation services. This might be a legal requirement, for health and safety reasons, or a voluntary choice to reduce the risk of product failure. Increasingly, organizations in both the public and private sectors are demanding accreditation as a criterion when tendering for contracts. In areas such as asbestos testing accredited status is mandatory, while in some others, such as food testing, it is an expected norm. However, beyond legal and voluntary requirements, accreditation also offers market differentiation, which means it can help in winning business. Moreover, as it is credible evidence of best practice, it offers a way to prove to potential clients that an organization takes quality assurance seriously. This means that accreditation can help to win new business and offer a route into difficult sectors.

New markets

Accreditation is also recognized worldwide under Multilateral Recognition Agreements (MRAs). This means that it has the potential to open doors to new

markets abroad as well as in the UK. MRAs not only mean that accreditation is recognized in over 120 economies, it also simplifies the audit process as products can be tested once and the results of that test are accepted in each signatory country. This means that accreditation acts like a 'passport to trade'.

Looking inwards

There are many external benefits to achieving accredited status, but what about internally? It might appear that all the effort of getting there is a large distraction from an organization's core business. In fact, the reverse is true. By increasing internal efficiency and reducing duplication, becoming accredited can mean that business owners have more time to devote to the sharp end. How does this work?

Accreditation can:

- **reduce paperwork and increase efficiency** – no longer a necessity to re-audit your business or re-test products for new markets;
- **de-risk procurement** – taking the guesswork out of choosing an evaluation body and giving confidence that services will best fulfil a company's needs;
- **win new business** as the use of accredited services is increasingly a stipulation of specifiers, most notably in the public sector;
- **facilitate access to international markets** since UKAS-accredited certificates have global recognition;
- **help with adopting best practice** because evaluating bodies are required to have appropriate knowledge of that business sector;
- **control costs** as accurate testing, calibration and other evaluation services along with the adoption of best practice can limit product failure and down time;
- **help with knowledge transfer and product development** since accredited evaluation bodies can be a good source of impartial advice;
- **offer market differentiation and leadership** by showing to others credible evidence of good practice, for instance in environmental management systems;
- **demonstrate due diligence** in the event of legal action.

As we can see, becoming accredited is an opportunity for a business to undertake a full internal audit, identifying improvements, streamlining processes and reducing unnecessary duplication – the net result saving time and money.

Sourcing accredited services

Procurement is one of the areas where 'unknowns' can have a serious impact on a business. Sourcing appropriate people and organizations can be time-consuming and difficult, but accreditation can make the process much quicker and easier. An

evaluation service that has been accredited by UKAS has demonstrated that it complies with best practice in that industry, that it is fit for purpose, impartial and can consistently provide the appropriate level of service time and again. It is also recognized as such throughout the world. Moreover, if there are safety implications at any stage in the supply chain, using an accredited supplier is a valuable tool in risk management, meaning that an organization can have confidence in the traceability and accountability of the goods and services it is procuring. By choosing a UKAS-accredited supplier, a business can have confidence that it is using the best and most appropriate service for its needs.

The United Kingdom Accreditation Service (UKAS) is the sole body recognized by government to carry out accreditation of businesses offering conformity assessment services such as certification, inspection, testing and calibration. It assesses these bodies against internationally agreed standards. Accreditation by UKAS is the key to ensuring that suppliers, purchasers and specifiers can have confidence in the quality of goods and in the provision of services throughout the supply chain.

By choosing a UKAS-accredited supplier, not only can you be assured that you are receiving the *best and most appropriate service for your needs* but you will also discover that the UKAS 'mark' on your documentation brings with it *national and international recognition and credibility* for your business. Better credibility for your business increases your chances of securing better quality contracts.

To locate a UKAS-accredited evaluation body in your area or one that provides a particular specialist service, help is at hand. Visit **www.ukas.com** for full details of all UKAS-accredited organizations. Alternatively, further information about UKAS and its accreditation role can be obtained by: tel: +44 (0)20 8917 8400; fax: +44 (0)20 8917 8500; e-mail: **info@ukas.com**.

PART FOUR
People and performance

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Rewarding good performance and lowering corporate risk

4.1

In rewarding performance, risk is too often ignored. Time to rethink, says ***Will Cookson*** *at Mazars*

Introduction

In a period of financial fragility the perception of many employees is that they are working longer and harder and yet are financially worse off. Pay freezes and reduced discretionary compensation, coupled with a 50 per cent top rate of tax and higher National Insurance contributions mean some employees are worse off than they were a year ago. Add to that the increase in other personal taxes and a decrease in tax relief on pension contributions and the picture is far from rosy.

This is, however, an ideal opportunity for employers to refocus employees on the link between performance and reward. If they perform then one would expect benefits to the organization.

For any reward structure to be successful stakeholder engagement is critical, but in many cases there is no such buy-in. How many employees truly appreciated and valued the performance conditions attached to their rewards during the 'boom times' when payments were effectively guaranteed? In any performance-based plan, which employees understand the relationship between their performance, that of the company and the quantum of the reward?

Rewarding performance

The attention of both the media and shareholders is now firmly fixed on performance-related reward. This started with bonus payments by banks, but is now filtering into all areas of business, with companies spending more and more time on their performance reward strategies.

It is now recognized that short-term performance targets that led to generous bonus payments did not recognize the long-term risks of the behaviours they were enforcing. This lesson learned by the banks, at great cost, is one that all businesses should consider. The key word is 'risk' and how that can be minimized while motivating and retaining individuals within the business.

The reward mix

The cost to a company of employee reward is one of its largest costs and it is critical that the company has the right mix of cash, equity and other forms of reward to drive performance.

Smaller companies, or those in their infancy, may look more to equity as a means of attracting and/or retaining key individuals.

Quantum of the reward

The level of the reward should be a reflection of the performance and the associated impact for the business. The size of bonus pools should be linked to the overall performance of the company. Employees' reward payments should thereafter be linked to both the individual's performance and the performance of the business. In the situation where performance of the company is poor, employees should be clear that this will reduce the value of the reward delivered, if any reward is made at all.

It is also critical to assess the level of reward payable at any one time, and how this will impact on the business, eg cash flow, and on the individual. Modelling a plan and giving employees an indication of how their bonus might look given certain conditions is one way to reinforce what you expect from them and also helps manage their expectation.

Managing risk

Historically the link between performance, reward and risk was largely ignored. Reward arrangements were typically viewed as a means to attract, retain and incentivize individuals. This in itself has elements of reducing risk because, for example, retention gives continuity and good performance, driving the business forward.

What we have seen recently, however, is that risk-taking behaviours to meet performance targets and deliver rewards severely impacted the global financial system, the ramifications of which have been widespread. As a result, companies are becoming more thoughtful in the way they structure reward to discourage excessive risk taking.

There are many ways to manage the risk elements; for example, making entry to an incentive plan conditional on risk-based performance conditions. Once a person is

in a plan, a business's risk can be further reduced by combining financial targets with Key Performance Indicators (KPIs) within the organization's appraisal system.

Here are some examples of performance conditions linked to risk:

- If a business has cash issues, you can reduce debtor days and/or increase credit terms.
- In order to avoid over-aggressive sales tactics, often the 'over-promising' of delivery and service, client retention or satisfaction surveys may be incorporated.
- If product defects could affect an organization's reputation, the focus could be on quality control and, say, the level of returns/complaints.

A further element, which again came from recommendations following the banking crisis, is that large performance payments should be capped, with the excess being payable over a further period and again subject to risk-based conditions.

Performance conditions

Attaching performance conditions to reward, whether it is a cash bonus or an equity-based reward, puts an element of reward 'at risk'. In the situation where the company and/or the individual do not perform, the reward is reduced or not paid.

Performance conditions can be absolute or comparative. It is generally considered that a measure of performance linked to comparator companies is preferable to absolute conditions. A business may perform well against its competitors during a difficult period, which would not be recognized by an absolute target.

Typical financial performance conditions include profit, turnover, earnings (often EBITDA – earnings before interest, taxes, depreciation and amortization), Total Shareholder Return (TSR) or Earning Per Share (EPS).

Performance-related reward

Employee share ownership is a well-established method of encouraging employees to develop an interest in the growth and performance of their employing group or company and thereby an increased contribution towards its future successes. The use of equity is a mutually synergistic approach for the company and employee, enabling the employee to participate in the growth in value to which their performance contributed. Depending on the type of arrangement implemented, it can be a powerful way to reward loyalty and drive future performance.

A simple deferred cash bonus arrangement is a common incentive measure. Some cash bonus schemes are designed to mimic share ownership, often called 'phantom share plans'. The use of equity is common for all employees in listed entities, but in private companies is generally restricted to executives and senior management.

Beyond the arena of all-employee shares scheme arrangements that serve almost as savings plans, eg SAYE, specialized share schemes have evolved to reinforce the link

between performance and reward. For those with these plans in place, or any form of performance-related award, there should be a periodic effort to reinforce the links to performance and empower key individuals to drive the growth of the company, which in turn will deliver personal reward.

Companies may also want to review how schemes have been targeted and their value or allocation determined in previous years. We find a number of bonus plans no longer achieve their goal, and the business is therefore leaking money. Some plans are even counter productive to a business.

Some businesses will use an Employee Benefit Trust (EBT) to run their incentive arrangements, whether cash-based, equity-based or a mixture of the two. There are often little or no tax incentives in using an EBT, although tax planning can be considered, rather the EBT ring-fences cash and/or shares from the company and employees can see there is a clear 'pot' of incentives that they can earn.

The timelines over which performance is measured and value is realized should support and be aligned to the company's key objectives. Performance periods that are too long can reduce the perceived value of the awards and cease to drive the appropriate behaviours. If too short, they may reward short-term targets at the expense of sustainable underlying performance.

Conclusion

The potential positive impact of performance-related reward arrangements on a company can be significant, even where it may only be relevant to a small population of key individuals. It is imperative that the performance measures used should support the company's strategy and be in the interests of the shareholders. Moreover, the performance measures should be capable of being assessed on a consistent basis and the link of performance to reward understood.

Ultimately, one size does not fit all. Companies differ in their activities, their size, their culture and their business drivers. Whatever the company, it is possible to structure performance-related reward to support the business, the leadership and enforce the behaviours the company encourages.

Will Cookson heads up the Equity Incentives Group of Mazars LLP in London. Will was assisted by Amanda Stapleton, a tax manager in his team. They both trained with Big 4 firms and later worked in industry before joining Mazars, Will at GE Capital and Amanda at Coca Cola.

Employment policies

4.2

Belinda Copland *at Goodman Derrick discusses the challenges that enterprises encounter in developing their employment policies as they grow from the few to the many*

One of the initial challenges for a growing business, once it is clear that its needs cannot be met by its current level of staff, will be to decide whether its policy will be to recruit new employees, or whether to take an alternative approach to direct employment that might be more suitable. The nature of your business combined with uncertain economic times may demand that flexibility is paramount. You might consider, for example, taking on agency or freelance staff to undertake the work, or in some circumstances, it might be that the work could be outsourced to a specialist service provider.

This chapter gives you an overview of the pros and cons of each of these options and also outlines the policies that a growing business ought to have in place as it grows from the local to the national and from the few to the many.

Direct employment

One hope in employing staff directly is that your employees will be more loyal to your business. Through the use of properly drafted incentive schemes, employees' income can be directly linked to the success of the business, thus motivating them. Your own employees may also be less expensive than agency or other short-term staff and you can exercise a greater degree of control over their activities.

On the other hand, the disadvantages of increasing your headcount include the time and resources spent on the recruitment process itself (eg advertising, interviews and reference checking) and the lack of flexibility in relation to staff numbers.

Agency/freelance staff

The key advantage of using agency workers is the obvious flexibility. You might engage temps to cover a particularly busy period on a temporary basis, or you might do so on an open-ended basis where your future requirements are uncertain.

On the downside, using temporary workers can be more expensive than having your own employees, since the associated agency fee increases the overall costs. Given the nature of short-term engagements, the worker him/herself is likely to be less loyal to your company, and you must still assume certain responsibilities and liabilities for them even though they are not your employee (eg the legislation that gives protection from all forms of discrimination applies to temps just as much as it does to employees).

Employers usually assume that an agency worker can never be considered to be one of their own employees. In most cases this will be correct; there will be no direct contractual relationship between your business and an agency worker and your contractual relationship is with the agency. However, the employment status of agency or freelance workers is not always a straightforward matter, particularly in the case of long-term assignments and will depend upon all the facts in any particular case. You need to be aware of the possibility that a tribunal could find that an agency worker is your employee. Current case law suggests that this is a less likely interpretation of the usual position but as the law on this point has fluctuated over the years, it is important to consider the position properly.

Employment agencies will usually draft contracts that attempt to address this situation. The contract will set out certain facts which support the position that the agency worker is not your employee. Typical contract provisions include those stating that the worker is not an employee, has day-to-day control of their work and perhaps has the ability to send in a substitute if they themselves are not available. However, if this does not reflect the reality of the relationship between you and the worker, these provisions are ineffective and you could be responsible not only for any employment-related claims, but also for any tax and NICs that have not been paid throughout the working relationship. It is therefore vital that the paperwork is properly drawn up from the outset *and* the relationship allowed to work in the way that is intended.

Similar precautions should be taken in the case of freelance workers or consultants whom you engage directly, rather than though an agency.

A final cautionary note about temporary workers relates to pay and benefits. At the moment, you have considerable freedom in relation to the terms and benefits you provide to temporary workers and it does not matter that the terms offered are less favourable than those you provide to your employees (provided that the difference is not for unlawful discriminatory reasons). An important point to note is that this freedom is diminishing. When the Agency Workers Regulations 2010 come into force (which is expected in October 2011) employers will have to provide temps with the same basic working employment conditions as to working time, holidays and pay as are provided to their employees, once the temp has completed a 12-week qualifying period. This legislation will not, however, affect directly-engaged freelancers or consultants. These Regulations will also give temps rights to other benefits such as

information on permanent vacancies and access to 'amenities or collective facilities' that you provide to your employees, such as a canteen or childcare facilities.

Outsourcing

You might want to consider outsourcing certain tasks, eg payroll, IT or HR functions, to specialists. The advantages are that it may be cheaper than employing staff directly, especially where there is insufficient work for a person dedicated to the task or there is no current expertise in the area. You would also have no employer's responsibility for the people undertaking the work.

The disadvantages are that where the work has previously been carried out in-house, or if you decide to transfer the work from one supplier to another, or bring it back in-house, there may be implications under the TUPE Regulations.

These Regulations *preserve the legal and contractual rights* and the employment of your employees in the event that the undertaking in which they are employed is transferred to another employer. The Regulations also give employees specific and detailed rights to be informed and consulted about any transfer and failure to comply with the prescribed rules and timescales gives employees the right to compensation.

If you are bringing services back in-house from a service provider, or if you are acquiring the assets of a business as part of your plans to grow your own business, you may be taking on more than you bargained for as the employees carrying out the work may be automatically transferred to you under the Regulations.

The TUPE Regulations are complex and could merit an entire book of their own. However, since they are not the focus of this chapter, suffice it to say that legal advice ought to be sought as to your potential liabilities when considering any contract to outsource part of your business.

Employment policies and procedures

Expanding from a handful of employees in one place to having a larger workforce in one or more locations makes it all the more important to set out clearly the standard policies and procedures regulating employee rights, obligations, expectations and behaviour. You should take the earliest opportunity to set out your company's approach to such matters and also stipulate how, in turn, you expect your employees to conduct themselves. It is advisable from both a legal and an industrial relations perspective to have something in writing to which employees and their managers can refer in appropriate circumstances.

A staff handbook becomes an important part of your internal documentation if 1) careful thought is given to its contents and 2) you then use it properly (rather than only take it off the shelf when things have gone wrong!).

Which procedures are required?

A health and safety policy is a legal requirement. The only other internal regulatory documents that lawyers would consider absolutely essential are disciplinary and grievance procedures. However, you should consider which others may be relevant to your business.

A diversity or equal opportunities policy is important to encourage a diverse workforce as you grow and to reduce the risk of costly claims for discrimination. The policy should cover all areas of the employment relationship including recruitment, employment terms, training, promotion and dismissals.

Other possible issues to cover in your handbook include:

- Anti-harassment and anti-bullying policy: a clear zero-tolerance statement is useful, along with directions as to what an affected employee should do.
- Leave: not just annual leave (where you can stipulate a variety of matters such as periods/circumstances when leave should not be taken) but also your policy as regards other types of leave such as bereavement or time off to care for dependents.
- Sickness absence: a policy can cover your reporting requirements that the absent employee should follow. You can also reserve the right to send an employee to your own appointed doctor.
- An expenses policy: what can be claimed, will you pay for first- or second-class travel, what is the timescale for submitting claims, what evidence is required.

It is also wise to include a policy governing the use of your company's IT and telephone systems. As you expand and become more remote, it is less easy to keep an eye on what your employees are doing and you may need to use other ways of checking what use employees are making of the equipment. Spending too long on personal e-mails or visiting inappropriate websites are common bugbears for today's employer. In addition, unauthorized e-mails sent by employees from their work e-mail address can bring your own company into disrepute if those e-mails were offensive in any way. It is therefore important to state that misuse of the company's e-mail, IT and telephone facilities will be considered to be 'misconduct' or even 'gross misconduct' if the circumstances warrant it. You can then handle any breach of the policy as a disciplinary matter.

In order to check that employees are complying with your IT policy you may on occasion wish to monitor your systems. Your IT policy should therefore inform staff that you reserve the right to intercept and monitor all communications made via the company's systems. You can state that monitoring is only carried out to the extent permitted or as required by law and as necessary and justifiable for business purposes. In other words, it is not a snoopers' charter but it does give you the right to make checks to enforce your rules.

Each business is going to have its own particular concerns and therefore a staff handbook is not a one-size-fits-all document. It is worth taking advice from an employment law specialist to tailor something to fit your requirements.

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Taking on an employee

4.3

Help wanted? ***Businesslink.gov.uk*** *offers advice on how to comply with regulations when taking on an employee and how to boost their skills*

As your business grows you may decide to bring in outside help, particularly if you think your business would benefit from specialist skills. Taking on an employee can also free up your time, allowing you to pursue new opportunities or markets.

However, some business owners believe employment laws are too complex and this can deter them from taking on an employee. Keeping up to date with changes to employment laws can be a greater challenge for smaller businesses, which often don't have the resources to employ dedicated HR specialists.

We've provided a summary of simple tips to help you through the process of taking on an employee. We also look at how to conduct a training needs analysis and ways to address any skills gaps to help you grow if you have existing employees.

Avoiding discrimination when recruiting

When hiring an employee you must make sure your recruitment and selection decisions are made in a fair and non-discriminatory way.

You must not discriminate on the grounds of someone's sex, sexual orientation, gender reassignment, status as a married person or a civil partner, race, colour, age, nationality, ethnic origin, national origin, religion or beliefs.

Discriminating against someone because they have a disability, are pregnant or take maternity leave, or because they're a member or non-member of a trade union is also against the law. You must also avoid discriminating against someone because of association, eg rejecting an applicant because they have a disabled dependant.

At all stages of the recruitment process, from writing the job description and advertising the vacancy, through to interviewing candidates, making the decision and making an offer, you should state clearly what tasks the person will have to do and what skills they will need. Avoid listing any requirements that are not directly related to the job, eg the candidate's marital status or race.

You could consider using the services provided by Jobcentre Plus to help fill your vacancy. Jobcentre Plus is a government agency within the Department for Work and

Pensions. It holds the UK's largest listing of vacancies. This is supported by a great deal of knowledge and local services, all of which is free of charge. For more information see **http://www.businesslink.gov.uk/jobcentreplus**.

Preventing illegal working

You must check whether your workers have the right to work in the UK. Some people are automatically entitled to work here. Others may have restrictions on how long they can stay, whether they can work or the type of work that they can do.

It is a criminal offence to knowingly employ anyone who doesn't have permission to work in the UK or to do the type of work that you're offering. The penalty for this includes imprisonment and/or an unlimited fine.

You could also receive a civil penalty if you fail to properly check that a worker has the right to work in the UK. Therefore, you should take steps to prove a new recruit's eligibility to work. For more information see: **http://www.businesslink.gov.uk/migrantworkers**.

Providing a written statement

You must give your employees a written statement of employment particulars within two months of them starting work for you.

The written statement must include a number of key pieces of information such as:

- the name of the business and the name of the employee;
- the date the employment began;
- salary and when it is to be paid, eg weekly or monthly;
- hours of work and holiday entitlement;
- entitlement to sick leave and sick pay;
- pensions and pension schemes;
- the entitlement of employer and employee to notice of termination;
- disciplinary and grievance procedures.

For more information see **http://www.businesslink.gov.uk/employmentcontract**.

Paying your employee and deducting tax

As an employer you have obligations regarding wages and tax, and while we can't list them all here, some of the key things to be aware of are highlighted below.

When you take on your first employee, you must register as an employer with HM Revenue & Customs (HMRC) and set up a PAYE (Pay As You Earn) scheme. This is used to deduct income tax and National Insurance contributions directly from your

employee's gross pay and to collect your employer's National Insurance contributions. You must ensure you deduct tax and National Insurance contributions from your employee's wages and that these are paid to HMRC.

Also, almost all workers in the UK have the right to be paid at least the national minimum wage so make sure you comply with this requirement.

You must give each employee a written itemized pay statement, usually known as a payslip or wage slip. You must issue it at, or before, the time you pay your employee. It is also unlawful to make unauthorized deductions from your workers' wages. For more information, see **http://www.businesslink.gov.uk/payingyourstaff**.

While we can't list all your legal obligations when taking on an employee in this article, this inofrmation can be found on the Business Link website: **www.businesslink.gov.uk**. For example, you also need to be aware of your obligations regarding pensions, employers' liability compulsory insurance and health and safety.

Training helps support growth

As your business grows and changes, the range and complexity of the skills your business needs may change too.

Getting the most out of new and existing employees' skills is crucial to your businesses' success. Being able to provide the right training can help to unlock an employee's potential and improve your businesses' performance.

To help you identify any skills gaps, you might consider conducting a Training Needs Analysis (TNA). This is a systematic way of investigating your Training Needs and identifying your employees' skills and knowledge gaps.

To conduct a TNA you need to:

- assess the current skills of individuals at all levels of your business;
- quantify the total skills available to your business;
- identify the skills you need to take your business forward;
- analyse the gap between your businesses' current skills resources and future skills needs;
- plan for bridging that gap with appropriate training.

It is crucial to assess skills gaps at all levels of the business. Seeking employee input can be particularly helpful as they are more likely to experience the day-to-day problems that might be avoided by improving skills though training.

When carrying out a TNA it makes good business sense to:

- consider the full range of training available, such as professional and personal training, and process-related skills;
- consider the different levels at which training can occur across different areas of the business, including your business and its immediate suppliers and customers, all departments in your business, or specific departments or individuals;
- carry out a full cost/benefit analysis for each training need.

Make sure you conduct a TNA before embarking on any training – this, as well as consultations with your staff, should form the basis of your decisions about what training is appropriate.

Making the most of your employees' skills

Once you have identified any skills gaps through a TNA, consider how you can fill these. Expanding the skills of existing employees – instead of bringing in someone new – can be a cost-effective way of addressing any skills gaps in your business. It can also have an added benefit of improving job satisfaction.

To assess the existing skills of your employees, ask yourself:

- Are you using all the skills at your disposal as efficiently as possible?
- Are you currently making the most of the potential of your staff?
- Does someone have untapped potential or an important skill they're not using in their current role?

You could then provide training that enables someone to carry out their existing tasks more efficiently or to a higher standard.

You might need to seek training for an individual so that they can take on a different role in your business, eg a position with increased responsibilities or an entirely new role that will allow your business to move into new areas of work.

A formal *development review process* helps to keep track of the skills and training of staff at all levels in your business. A development review could be as simple as an annual meeting with each employee where you establish a training and development plan for the year. It also allows you to draw up skills development plans that align the needs of your business and the personal goals of your employees.

Finally, as your business grows, the skills your business needs will probably grow too. It helps to think ahead about the skills you'll need. Recruit with a view to how your business might develop in the future, and try to recruit individuals who'll be adaptable and able to develop a wide range of skills.

Businesslink.gov.uk is the official government website for businesses of all sizes. It provides people with easy access to authoritative information, transactions and support to help them conduct their dealings with government and to find the information they need. While the information provided is correct at the time of writing, regulations and policies change so readers are advised to check the website for the most up-to-date information. For more information, see: **http://www.businesslink.gov.uk/employmentandskills**.

Training for growth

4.4

David Gibbons-Wood *and* ***Gemma Kearney*** *at Aberdeen Business School*

discuss direct – and indirect – benefits of training in driving forward a business

Traditionally, smaller businesses don't engage in training to the same extent as their larger counterparts, due in part to time and cost pressures. These barriers are further compounded in a recessionary environment, where training is often one of the first areas to be axed in an attempt to cut costs. However, there are strong arguments for participating in training, especially for smaller businesses emerging from a recession and preparing for growth.

The Business Skills for Growth project commenced in September 2008. The project was part funded by the ESF (European Social Fund) and the Aberdeen Business School, Robert Gordon University. The central aim of the project focuses on the development and provision of short courses to improve SME business skills in specific need areas. The project targets SMEs and recent business start ups with a core objective of increasing business growth and assisting productivity. While the direct benefits of training are well known, over the last 18 months we have been providing business skills training to small and medium enterprises across a range of sectors, and participants have reported a range of valuable indirect benefits. This chapter provides an insight into these often-overlooked benefits and offers advice on how managers can ensure that their organizations maximize the benefits of training.

Now is an ideal time to participate in training as you may be able to dedicate more time to it than when your business is stretched to full capacity. Indeed after a difficult economic period, engaging in training may boost employee morale and send a positive message about the future, while ensuring that your business is fully prepared for the upturn.

However, training remains an investment in both time and money and it is important to achieve the maximum return on your investment. The direct benefits of training are clear and include the acquisition of new skills, problem solving and increased knowledge of a specific topic. Many of the Business Skills for Growth participants reported these improvements, with numerous examples of participants changing their business practices to utilize their new skills. Indeed, one participant overhauled his entire website and used his new skills to improve his online sales. Another improved her firm's financial understanding by using her new skills to produce more detailed monthly management accounts to help the firm truly understand their financial position. Importantly, there are also a multitude of indirect

benefits from training and these can contribute significantly to the growth of the business.

These indirect benefits include:

- an opportunity to interact with other businesses with less pressure than formal networking events;
- a method to generate new ideas, consider new trends and gain insight;
- increased confidence and the motivation to apply new skills;
- time to reflect on business practices and garner a fresh perspective.

In fact, many of the participants in our business skills training programme have reported that these indirect benefits have proven extremely valuable. For example, participants have reported building new relationships through the training programme, which have led to new partnerships and the winning of new business. Other participants have benefited from increasing their overall business understanding, which has led to more confidence in negotiation situations and improved purchasing power. While other participants have relished the opportunity to reflect on business issues and discuss these in a non-competitive environment with those in the same situation, appreciating the clarity and support provided.

Nonetheless, some participants gain more from training than others, as everyone adopts a different approach to training. Many people are passive in the training process, merely treating the training as an isolated event, but to gain the most from training, participants must adopt a proactive approach. As such, we have compiled a useful Five Step Checklist to help managers realize the full benefit of training.

Five steps to realizing the benefits of training

1. Conduct a training audit

The first step is to understand exactly what training is required at every level in the business. Hence the training audit should consult all employees and ask them to consider:

- What problems have they encountered in their day-to-day operations?
- In which areas do they feel they would benefit from training?

By asking employees to reflect on their role in the organization, a true picture of the training required will emerge and including employees in the process will also increase their commitment to the training. This practice may also save time and money, as training is often selected on the basis of old habits and the audit will highlight exactly what is required, allowing the refocusing of resources.

2. The training search

Often, training is sought on an ad hoc basis, as a reaction to an immediate problem. However, by conducting a training search managers will have a better understanding

of the training available and new initiatives may come to light. A good starting point is to contact the Government Business Support Agencies, the Chamber of Commerce and local colleges and universities, as these organizations can provide support to growing businesses. These organizations may also be able to tailor their support to help, if the training you require is not currently offered.

Online learning is also often overlooked, but may provide a flexible option of accessing the training that you require. You could also consider forming a training alliance with other business associates, who aren't direct competitors, whereby all members work together to support each other's learning as this can confer significant benefits.

3. Consider training as an ongoing process

Encourage participants to be proactive in their attitude towards training and learning. While training workshops and seminars may be one-off events, learning should be viewed as an ongoing process. Therefore, utilize training opportunities to build new relationships and continue learning after the event by following up on the ideas generated by the training process and enacting new methods of working. Where possible, provide feedback and engage with the training providers to help build on the training process. The new situations provided by training often prompt fresh thinking and participants should aim to capitalize on these new perspectives.

4. Evaluate the training process

It is important to evaluate the training process to understand the possible benefits and identify areas for improvement. Feedback should be obtained immediately after training to ascertain participants' initial reaction. However, time should be allowed to elapse to allow participants to apply their new skills in their role. A more in-depth evaluation should then be conducted three to six months after the initial training to fully understand its impact. In-depth questions should be included; for instance, asking participants to provide examples of how they have applied what they learnt, may prove fruitful. Evaluating training on this basis will refresh the learning process and encourage participants to refocus on the content of the training.

5. Reflection

Growing a business is a combination of many factors and engaging in training prompts participants to reflect upon their business practices. This reflection allows more strategic thinking about the future direction of the business. Thus we urge participants to take time from their busy schedule to reflect upon what they have learnt, as in doing so clarity and insight are often realized.

This Five Step Checklist is a comprehensive process and although managers may be concerned that the process is too time consuming, we believe that it is time well spent to ensure that the business achieves the maximum return from the investment in training. Overall, by engaging in training and regarding it as an ongoing process businesses may realize a multitude of both direct and indirect benefits.

David Gibbons-Wood is the director of the Centre for International Labour Market Studies (CILMS). Gemma Kearney is a research assistant at CILMS. The Business Skill for Growth project is funded by the European Social Fund and delivers leadership and management courses to SMEs across northeast Scotland. CILMS is a multi-disciplinary research centre, based within Aberdeen Business School, with the remit to undertake research and consultancy in the areas of education, training, skills, employment and local, national and international labour market policy. Tel: 01224 263104; e-mail: **d.gibbons-wood@rgu.ac.uk**.

Executive search for smaller businesses

4.5

***Alex Steele** has ten ways of finding the best candidates in executive searches*

There are a number of services available in the recruitment market and by far the most common is contingency, ie agencies supplying CVs and only being paid a fee if an individual is hired – the fee is contingent on a hiring being made. Agencies will maintain a database of candidates and/or will advertise your requirement in a composite ad in either trade or national press. Depending on the strength of relationship with the agency this method is low-risk financially but could potentially be time-consuming in people-hours spent wading through inappropriate CVs if the agency is not au fait with your business, plus you may have no control or guarantee that candidates sourced will be screened or, in extreme cases interviewed. Some businesses might enter into a preferred supplier relationship in which they commit to giving that supplier all their requirements but at a reduced hiring fee. It is important in those circumstances to ensure that the best candidates are not being supplied elsewhere at a better rate.

At the other end of the spectrum there is executive search, which, contrary to the general view, is not solely the province of large businesses with equally large budgets and can be tailored to suit the needs of any business that wishes to benefit from a bespoke and dedicated recruitment service. Smaller businesses can be deterred from considering executive search services by the misconception that a retained search is an expensive alternative to the success-based contingency process. Although it is true that the overall fee for search services can be higher than those charged in the contingency market, you, the smaller business decision maker, may well take the view that the extra cost is justified in terms of ROI by the bespoke and manageable service that you will receive in return.

Having made the decision to invest in the services of a search consultancy you might wish to brief a number of firms and ask them to pitch. Firms can be selected on the basis of reputation, particularly if specialist in any given market, by word-of-mouth or by reference to any number of trade directories. There are a number of risk management and comfort criteria that should be met before signing on the dotted line. The following are the key issues:

1. Insist on meeting all the people likely to be involved in the conduct of the assignment, ie not only the consultant who would lead the assignment but anyone likely to be representing the business in the marketplace. *Would you be inspired to join your business if you met these people?*
2. Feel confident that these individuals would add value to the process by projecting a professional image through their understanding of the business, its products, its management ethos and its potential. *Do they have a feel for your business? Do they share the passion? Can they sell it?*
3. Feel comfortable that you could work with the lead consultant and that you are prepared to be guided by him/her, moreover be able to accept constructive comment on how the assignment should proceed. They may tell you that the company needs to project itself differently at interview stage or that the impression that candidates are gaining from the interview process is not as originally planned and needs to be altered. However, you must also feel comfortable that the lead consultant is similarly mature and reasonable enough to act upon any constructive comment that you may feel it necessary to make. *Be flexible and open to new ideas but you are buying their expertise, so make it work for you.*
4. Ensure that all candidates, particularly those who are unsuccessful, will be treated professionally and courteously so that they retain a positive view of your business to take back to the marketplace. *The recruitment process, particularly search, is a PR/marketing opportunity so take full advantage.*
5. Ensure that regular, at least weekly, updates on progress–timeline would be available throughout the assignment. *Be aware of your responsibility to process candidates at an appropriate rate as well as the need for candidates to be presented for consideration within the timelines agreed.*
6. Read the terms of business thoroughly and be absolutely clear on those terms that relate to when retainers and stage payments would be payable and what criteria would have to be met in order that those payments are due. Generally speaking, retainers would be payable at commencement of the assignment, eg your signing of the agreement/contract. Shortlist fees, where appropriate, would be payable upon your acceptance of the shortlist. Shortlist definitions may vary but are usually either upon your acceptance of the proposed shortlist or your completion of the shortlist interviews. Completion fees are payable upon completion of the assignment, ie written offer, acceptance of and confirmation of start date. However, in the case of long lead times, ie extended notice periods and/or covenants leading to 'garden leave' periods, there may be some flexibility. *Read the terms of business and proposal document carefully and query any issues that are not clear.*
7. Most search businesses will have reasonable clauses to protect their commercial exposure during an assignment so again you must be clear on what is expected of you and what is deemed reasonable by either party. Those clauses are usually included to cover costs should an assignment not reach completion, which, for the search firm, is not only a financial issue but

potentially one of reputation. *Therefore it is imperative to ensure that both parties agree specific and reasonable terms that cover such an eventuality.*

8. Ensure that an agreement is reached to cover the way forward in the, albeit unlikely, event that the successful candidate leaves your employ in the short-term, typically 6 or 12 months. *Each case would be judged by you and your search firm on its merits and the strength of your ongoing relationship and the mutual trust that you develop would be key in reaching a workable agreement.*
9. Understand in advance what your likely expenses exposure would be. In most circumstances a search firm would seek recompense for candidate expenses incurred during the course of the assignment and would normally cover reasonable travel/accommodation expenses within the UK. If the search criteria included overseas candidates then clearly the travel expenses would be higher. *Make sure you fully understand your exposure prior to signing any agreement.*
10. *The relationship between you and your search service provider should be a mutually beneficial business partnership with both parties concerned solely with the hiring of the best candidate available while enhancing your reputation and standing in your marketplace.*

A Steele Associates was established in June 1998 and offers 30 years' experience in the conduct of search assignments across a wide range of general and senior management disciplines in sales, marketing, risk/credit management, treasury, operations, support and technology. Our expertise has developed particularly in the identification of individuals for start-ups or reorganizations and the subsequent culture development and change processes. Contact Alex Steele on: tel: 01758 815 996 or 07525 608 761; e-mail: **alex@asteele958.demon.co.uk**; website: **www.asteelassociates.com**.

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Improving workplace performance

4.6

Dennis Jones at the Association of Business Practitioners discusses how to make sure you train your team to deliver your strategy

As the saying goes, 'What gets measured gets done'. The same principles apply for awarding organizations; if you can measure something, then you can benchmark it, and you can therefore look to improve upon it. (Assuming, of course, that you don't want to make things worse or provide a lesser service to your hard-won clients.)

Training fit for purpose

In an era of increasingly rapid social and economic change where employer organisations and the individuals who work within them are being tasked with producing better results with fewer resources, it makes good economic and business sense to ensure that training is fit for purpose. Training must deliver learning outcomes that allow learners to demonstrate the knowledge and skills necessary to either generate income or effect cost savings as efficiently as possible. These are fundamental steps for every business whether it is in growth phase or contracting due to the current economic downturn.

Let's be positive here and look at 'growing your own'. If an organization is to sustain growth then it makes sense to focus on the human resources in order to capitalize on the personnel already available. Without going into too much academic theory, we are talking about developing the 'resource-based' view in order to obtain sustainable competitive advantage.

Tangible resources are all too often matched or bettered in an increasingly short space of time. An example of this is the iPhone, which has enjoyed huge success. However, Google's Android system is getting rave reviews and winning many new friends as it offers more free 'apps' than its rival. Even Microsoft is hitting back (to great acclaim) with a new mobile version of Windows 7 after its somewhat lacklustre last few years in the mobile market.

The differences lie, therefore, not in the technology but in the inimitability of the people and the systems they deploy in the front line to gain and retain the hearts and minds of the customer. What sort of strategies does your organization use to attract customers? What skills and abilities are required to do so? How do you inculcate that winning mentality? How do you capture it in terms of training, learning and development? Most importantly, how do you benchmark it so that you know that your hard earned and hotly contested training budget is being spent efficiently and effectively? Those people who can't show results will fear the worst when the next round of cost savings (endemic in all companies in these times) comes around.

Many organizations are happy to train their core personnel, those permanent employees who are on the payroll and tasked with making real differences in the lives of your customers. But what about the army of subcontractors and associates who are often the face of your organization?

Awarding organizations often rely on staff who are not full time employees (for example, external verifiers (EVs) and trainers), yet these people are often the only real contact many customers or accredited colleges have with the organization. Such people perform vital roles in client satisfaction, and their skills need to be honed and deployed to everyone's benefit.

It therefore makes sense to train these people to create value, maintain standards of professionalism and perform essential customer-service duties. A huge task but one that is essential if one's edge in the market is to be maintained with the proliferation of 'me too', commoditized products.

Why accreditation?

Many human resource and learning and development professionals find it useful to discuss how accreditation might benefit employees' and organizational goals. The reason for getting something independently evaluated or accredited is to confirm it meets a specific standard set by an independent adjudicator in order to ensure quality for consumers. Although anything or anyone can be evaluated, here the term is used to refer specifically to training and education leading to accredited qualifications. Accredited training means that the providers of training (be they employers or private providers and the FE College business units that serve them) have been assessed against nationally and, where appropriate, internationally recognized standards to determine their competence, impartiality and capability.

An accreditation system gives people the means to identify a proven, competent evaluator, ensuring that the selection of a particular form of training is an informed choice and not a gamble. Where people's careers or an employer's business strategy is at stake, there is no substitute for getting it right. Accreditation means that both employees and employers can be confident that the courses chosen will suit their aims, that they will facilitate the achievement of personal as well as corporate goals. It also means that the customer (the learner or their employer) reduces the risk of selecting training that is not fit for purpose.

The qualifications should be selected and delivered according to the employees' needs, interests and aspirations, and, if they are, they will lead to successful progression

at work, which in turn benefits both the individual and the sponsoring employer. By studying accredited programmes employees will not just achieve a qualification; their qualification is not (ideally) the destination but a landmark along the path to further personal and professional development to the benefit of themselves, their employer and their employer's customers.

Types of programme and their benefits

Programmes vary and may include a vocationally relevant qualification that blends academic learning with vocational practice, one where the fundamental knowledge can underpin its application in a work setting, or one that is based on real-life case studies. The training could use either 'off the shelf' qualifications based on the National Occupational Standards already developed by the increasingly important Sector Skills Councils (the recognized voice of the employers and the sectors in which they operate), or newly-created and specifically tailored bespoke qualifications if none currently exist to meet specific demand.

In any event, it is very important that the learner understands the process by which their qualification is assessed, whether it involves proving knowledge in a traditional examination or by building a portfolio of evidence to demonstrate occupational competence based on theory acquired in a more formal learning environment. This varied approach enables learners to identify, and gain credit for, transferable skills. It also provides them with the opportunity to progress on to their next accredited programme or to advance their prospects at work.

Most employers, particularly large 'blue chip' companies in the private and not-for-profit sector, government departments and local authorities, prefer to hire applicants who have gained their training and education from a college or institution with the appropriate accreditation status.

Often the more cost-effective option is accreditation of the organization's own in-house training, not only to ensure that the training itself is fit for purpose, but also that the employees who undertake such courses are educated to the consistent, high standards required by the employer. It is an alternative and often simpler way of ensuring the consistency of training, the continuity of their business's development, and the capability of employees whilst at the same time meeting corporate objectives.

Jason Raife, CEO of The Association of Business Practitioners sums up the importance of accredited in-house training programmes as follows:

> It is positive proof of an employer's commitment to help their employees develop the required level of knowledge and skills to improve their business continuously in order to anticipate and meet the needs of their customers both now and in the future. By unlocking the potential of their people they will provide an inimitable service to their customers, giving the company a real edge in an increasingly competitive market place.

Monitoring performance

It is worth bearing in mind however, that accreditation is no guarantee of success. No matter how good the college or awarding body's accreditation process is, it will always remain the responsibility of the learner to make the most of the education or training he/she receives. If, however, a disproportionate number of learners within a particular institution are failing to demonstrate a high level of educational performance, the awarding organization is on hand to investigate the effectiveness of the teaching resources and methods. The awarding body can evaluate what needs to be improved and can support the institution in making the necessary changes.

The role of the awarding organization therefore becomes increasingly important to ensure that learners are receiving appropriate training, achieving the required standards and, just as importantly, that they maintain those standards throughout continuing professional development. The awarding body facilitates and supports the learning organization which, by its nature, becomes a 'growing' organization as it nurtures its employees to develop and progress, ideally creating further employment, learning and training opportunities in the process.

Finally, we must ask:

- What do we need to do in order to keep ahead of our competitors when technology is developing at an ever-faster pace?
- How do we maintain the quality of our customer service, technological know-how and product development to ensure that we are providing products that people want?
- How do we continue to create wealth both for ourselves and for our customers and their customers?

Often the answer lies in continually monitoring the requirements of the market and making sure that a business's most important (and expensive) asset – its staff – continue to deliver the results required, not only by the company but by the customers themselves.

The fairest, most straightforward and effective way is through the process of accreditation, which recognizes that the internal customer is meeting the needs of the external customer to the optimum level. Everyone knows where the 'goal posts' are and everyone is offered the same opportunity to continue to develop and grow. Employers know their continuing professional development is dependent on meeting their company's needs and, most importantly of all, the needs of their customers.

Dennis Jones is International Business Development Manager for the Association of Business Practitioners (ABP), an awarding organization that offers a suite of business and management qualifications, develops accredited bespoke programmes for individual organizations, or enhances and accredits existing 'in-company' awards. ABP's qualifications are designed to be flexible, affordable and highly relevant to work. For more information go to the website: **www.abp.org.uk**; or tel: 0203 405 2425.

PART FIVE
Cash flow and working capital

strong relationships, lasting rewards

In the current climate, many SMEs claim to have found it increasingly difficult to access the finance that their business needs to expand. And many banks have had to review their approach to risk which may have resulted in a reduction in lending.

But Santander Corporate Banking stands out from the crowd. In the nine months up to September 2010, the bank increased its lending by 27%.

Some of the fastest-growing, most exciting SMEs in the UK now bank with Santander. They are attracted by its progressive attitude to finance, and just as importantly, its belief that banking is a partnership.

"We're really keen to work with growing businesses in the UK, and we're putting our money where our mouth is," says Steve Pateman, who as Head of UK Corporate and Commercial Banking is responsible for Santander's overall strategy for SMEs.

"Competitive funding is important, but businesses value advice, consistency and service just as highly. That's why we aim for tailor-made solutions, not 'off-the-shelf' products."

Relationship banking: The personal approach

Every client at Santander Corporate Banking has a personal Relationship Director, based at a local banking centre, who gets to know the growing business inside out, and help select the right products.

Lindsey Rix is the Divisional Managing Director for London & the South-East. She manages a team of experienced Relationship Directors, and is clear how they work with SMEs.

"Our priority is to listen and talk to our clients," she says. "We need to understand their business, their strategy, their goals and aspirations."

This, she says, means that every solution is bespoke. "We take the time to understand our clients' needs and prospects, and we want to be with them for the long term. So when we advise on products, it's driven by their needs - not ours."

The same goes for product development at Santander. If you're a growing business, read on for an overview of the solutions designed to meet your needs.

Start here: Current accounts

The starting point for any growing business is a high-quality **current account**, around which to structure the daily flow of funds.

Most businesses need both access to a high-street branch, and a sophisticated online service. The Santander Corporate Reward Current Account lets you bank through over 10,500 Post Office® branches around the country, more locations than any other bank. Meanwhile, in addition to the support of your dedicated Relationship Director, there's also 24-hour online banking.

The Corporate Reward Current Account offers the potential to earn highly rewarding credit interest and full merchant acquiring through our payment solution provider, Elavon Merchant Services, with extra rewards if you use the integrated solutions.

Fees and charges are fully transparent, so you're never hit with any nasty surprises. We also aim to be competitively priced on any transaction you make.

And most importantly, you'll always have access to your Relationship Director to help with any problems or questions.

Banking on success: Deposit solutions

Managing **deposits** can be complex for a growing business, with the need to balance competing return, risk and liquidity requirements.

Santander Corporate Banking offers a full set of deposit products to meet any combination of these needs. Whether you want the security of fixed-rate Time Deposits, or the flexibility of instant access in the Corporate Bonus Account, we'll provide clear, straightforward advice.

In addition, you have the security of knowing your deposits are with a Standard & Poors AA-rated bank*. Marcelino Castrillo Garcia, Managing Director of Products, advises growing businesses: "Demand both solvency and strength from your bank. Quality is key and Santander UK plc has enviable credit ratings, offering peace of mind and a profitable home for your deposits."

* Source Bloomberg 06/12/2010

Santander

CORPORATE BANKING

> The message is clear – we want to begin a partnership with you, and we're very much open for business

Your Relationship Director will help you choose the best deposits for your needs at any one time, navigating you through the money markets.

Unlocking hidden value: Invoice and asset finance

Invoice finance unlocks the hidden value in your sales processes. This could be cash to pay suppliers early and earn discounts, or it could be the ability to borrow when purchase orders are raised, giving your business a helpful injection of working capital.

The best solution depends on your business. Dave Totney, Head of Invoice Finance, says: "We start by developing a clear understanding of your business and where you're heading. Then we help you drive efficiencies by using cash to purchase efficiently or pay early."

Either way, Santander's online Client Access system puts you in control of your cash, letting you draw down the appropriate funding as and when you need it.

Then there's **asset finance** - borrowing against the value of your equipment, plant and vehicles. This spreads the cost of expensive equipment over its working life.

Again, Santander designs this around your business. Mike Oxby, Head of Asset Finance, comments: "Companies are complex - you can't just pull the right asset finance solution off the shelf. Instead we work with you to find it, whether it's hire purchase, financing lease, operating lease or full fleet management."

With Santander, you can also refinance assets you've already bought, releasing capital back into the business. But whether new or old, asset finance is crucial - it lets you pay for equipment while it's earning money for your business.

Further afield: Expanding overseas

Trading internationally can be complex and daunting, sometimes even for those who've been doing it for years. But our team of experts can help you through the process of **trading overseas**.

Naturally, we offer letters of credit, documentary collections, bonds and guarantees, import/export loans and of course, foreign exchange.

And, just as importantly for a growing business, with Santander you benefit from a high-profile international brand, known all around the world.

Open for business

This is just a selection of the Santander Corporate Banking solutions available to SMEs. "The message is clear - we want to begin a partnership with you, and we're very much open for business," says Steve.

So what type of SME is Santander looking for? Attitude is the key factor, according to Steve: "I want to work with businesses who want to be successful, who want to develop their business, who have an idea that they want to turn into a reality.

"And if that describes you, we'd love to help."

To find out more, contact our specialists today:

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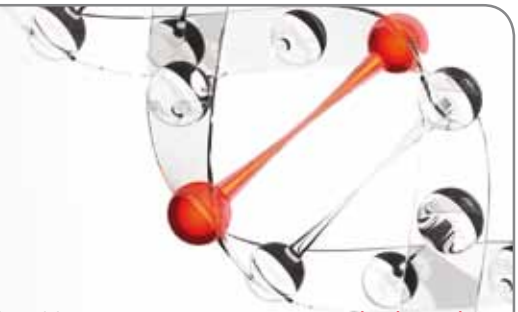

Alternatively to speak to a Relationship Director in your region visit 'Contact Us' at www.santandercb.co.uk

GBD DEC 10

Cash flow management: an essential tool for business survival

5.1

Unpredictable cash can be as disastrous as no cash at all. ***Gareth Jones*** at Mazars discusses the rules for business survival

'Cash flow management' is a phrase that has different meanings to different people. This can often lead to business owners being given misguided advice concerning cash flow management. Every business needs to make sales to be successful but it is not merely the making of sales and collecting of debt that will ensure a business's future.

Cash flow is essentially the difference between cash received in the business's bank account and cash going out of the business over a specific timeframe. However, most businesses have a particular cash cycle. For example, you should know that payments for Crown debts may be monthly (payroll taxes) and some quarterly (VAT). Terms and conditions on payment of sales invoices may require you to be paid within 30 days of an invoice being raised. Although most cycles can be estimated it is not always possible to know exactly when all receipts will land in the bank as you will be reliant on customers paying on time. This has been particularly difficult in the current economic climate as customers have tried to extend their cash flow resources by paying later.

An important cash flow management strategy is to take time to understand the cash flow cycle – what areas are predictable, which ones are not. This should be part of any company's risk management. The importance of cash is paramount. It is widely known and often understood that you can survive in the short term without profit, but certainly not without cash and simply generating sales does not ensure that the business is profitable. Therefore, the cash handled by a business must be monitored through proper cash flow management.

Many growing businesses note that cash flow is a big headache in striving for business success. Lack of available cash can weaken a business and even lead to business failure. Cash that flows unpredictably can be as disastrous as no cash at all.

Effective cash flow management addresses both short-term and long-term planning. Managing cash flow is really nothing more than managing information. Cash flow management is critical to all businesses, but is probably most critical for businesses whose trading can be seasonal and unpredictable.

Short-term cash flow management strategies rely on record-keeping systems that provide quick and accurate access to income and expenditure transactions. Important information for cash flow management can be obtained from a variety of sources including procedure manuals, bank statements, cash flow forecasts, reports on debt collection and trade payables. Routine cash management reviews must keep a close eye on debt collection, sales and deliveries, status of invoices, receipt of payments and depositing of payments. The best cash flow management strategies usually result from systems that are fully understood by the individual in charge of this process.

Cash flow management does not need to be complex to be effective. It does, however, have to be performed. There is no magical solution to managing cash flow. Although a computer and proper software program may expedite, simplify and standardize financial information, the information must be studied and monitored in a way that allows for adjustments to be made in the business's activities. Cash flow can be as simple as ensuring that you have enough sales, at a profitable price. The complexity of cash flow, however, seems to arise in the often-overlooked time lag element. Higher than expected sales at a price exceeding costs is worthless if you can't pay your supplier invoices during the time it takes for the product to be made and sold.

It is vital to the survival of any business that cash flow management is planned. This can be delegated to one of the finance team as part of their ongoing responsibilities. Once a strategy has been adopted to manage the cash flow this must be monitored on a regular and frequent basis to ensure that changes in the cash cycle are anticipated. These procedures and the results should be reviewed and managed by a different, more senior individual. Often in smaller businesses the business owner will utilize their accountant in the review process. There are some key standout actions that will help with planning your cash flow management:

1. **Collecting debts due via credit control procedures**

   Overdue customer accounts will significantly affect the cash flow of a company. One way to address this problem is to keep credit current and at a minimum. This is often a bigger task than it may seem. Keeping in touch with customers will allow you to identify if there are any issues sooner rather than later. Caution should be taken when credit is first extended to customers. Consider giving discounts (although these need to be considered in your overall profit margin analysis) for advance payments as an incentive for payments made by the due date.

2. **Look to cut excess overhead costs**

   In order to understand where payments are being made it is important to understand what the overhead cost base is in the business. Good spending discipline should keep unnecessary costs to a minimum, but good cash flow management should help to virtually eliminate excess overheads.

3 Keep a close eye on stock levels

A business needs enough stock to fill orders in a timely manner, but adequate sales are needed to minimize stock levels. Stock includes finished products held for future sales as well as raw materials held for future production. Both types of stock represent cash that has been spent but that has not yet generated a return. It is fundamental that stock levels are monitored in line with the business's sales pipeline of orders.

4 Understanding working capital

The time it takes to buy a product, sell it and collect the debt can vary significantly from business to business. The company will be invoiced for the stocks bought as soon as they are received so at that point the cash flow time lag is ticking. The time-lag issue must be quickly addressed by collecting payments and sending invoices in a timely manner. You do not have to invoice just once a month – it can be done weekly or on the day the sale is made.

5 Supplier payment reviews

It is often quite easy to delay payment of supplier invoices to help improve cash flow constraints. However, there is often a fine line between delayed payments and late payments. Crossing that line and incurring additional costs for late payments is normally not a good cash flow management technique – it can also agitate important suppliers and potentially lead to a loss of a key supplier. Do not hesitate to take advantage of credit offered by suppliers and always negotiate for better terms rather than just accepting the standard terms.

6 Monitoring customer payments history

Monitoring key customers may provide insight into their payment profile. Some customers will pay in line with credit terms and it is simple to include them in the cash cycle. However, it is monitoring those customers who often pay late that is vital. A business should consider implementing new payment procedures for customers who continually pay late. It is pretty simple these days to download credit rating reports on new customers – this type of procedure should be utilized in order to assess customers when they are taken on or when you become concerned about their payment profile. Payment terms influence potential customers, but be cautious not to offer over-generous payment terms.

7 Cash flow forecasts

A projected cash flow forecast should be developed. Forecasts will help identify when there is a lack of cash expected in the business and hence will help allow time to try to alleviate this issue. Keeping the bank informed of your projections will help them understand the business better.

8 Maintaining up-to-date management information

Continual cash flow management is only as good as the information on which it is implemented. A record-keeping system that provides information useful to making decisions regarding cash inflows and outflows is essential.

In today's current economic climate cash flow management has become an essential tool for business survival. The business owners who take the time and effort to manage this process will undoubtedly have success in the future.

Gareth Jones is a director of business advisory services for Mazars LLP. In his current role he advises predominantly small and medium-sized businesses on business planning and strategy.

Uncertain about your cashflow options?

Forget anxious meetings with your bank and move to a more predictive approach to funding your business.

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Invoice finance for growth

5.2

If banks are reluctant to lend, use invoice finance to give your cash flow a tonic, says ***David Thomson****, Chief Executive of Close Invoice Finance*

Signs are that we are slowly emerging from the deepest recession since the 1930s and businesses are tentatively turning their attention away from immediate survival towards long-term expansion. But with more difficult times expected ahead for the economy and a continuing lack of funding forthcoming from the banks, how achievable is this expansion?

The difficulty in accessing funds

The formation of a new government has, if nothing else, injected some much-needed confidence back into our business community and created a level of economic stability that we haven't seen in years. Not hard you might say, but given the rough ride SMEs in particular have had to endure over the last few years, any amount of stability is to be welcomed.

Of course we are far from out of the woods yet and the full impact of the recent VAT rise remains to be seen. Still, at long last business owners have a certain degree of direction and clarity as to the future, and a growing sense that the road to recovery, however long and painful, might just be in sight.

Indeed, figures drawn from the *Close Small Business Finance Barometer 2010*[1] would seem to support this sentiment. It reveals that over half of UK SMEs plan to increase their headcount in 2011, a huge increase on the previous year when only 11 per cent expected to do so. Even for those businesses who have no immediate intentions of hiring, many are consolidating their positions internally, taking measures such as investing in IT infrastructure and training, to ensure they are as efficient as possible when growth returns.

Although businesses clearly feel that their prospects for expansion are looking up, a weak cash flow could prevent them from taking advantage of market improvements and opportunities. Worryingly, 90 per cent of those surveyed are finding it as difficult, if not more so, to access funding than this time last year. So what's going on?

What to do when banks won't lend

Despite claims to the contrary, high street banks seem now more conservative than ever as to their lending policies and concerns are that even as we emerge, albeit tentatively, from recession, their prohibitive costs and rigid terms look set to continue.

Many commentators are of the opinion that the banks' response to the forthcoming levies, cap on bonuses, and new capital requirements being implemented by the Financial Services Authority could make them even more risk averse.

It's well-known that SMEs make up 99 per cent of our regional economy so it's not hard to see that this attitude to lending is threatening to derail the road to economic recovery.

Where companies have been busy securing new business the problem they can run into is overtrading. For the unprepared, over-accelerating in an upturn can be as dangerous as the sharp brake required in a downturn. To avoid over-trading, companies need cash flow. If a business secures lots of new orders, it then comes time to start delivering on those orders. For that, you need to invest in the raw materials and the staff, and so on, and you need cash to do it.

The bottom line is that no matter how optimistic businesses are on paper as to their expansion plans, they are merely pipe dreams without the necessary funding.

It's clear that the new government have their work cut out over the coming months when the banks remain reluctant to lend to SMEs, particularly in sectors they consider to be risky, but those same businesses need funds to prepare for growth.

Only time will tell if the Lib/Con's £200 million extension to the Enterprise Finance Guarantee (EFG) Scheme and the introduction of a £37.5 million Enterprise Capital Fund are enough to deliver an effective economic stimulus. Each have their critics, some noting that use of the EFG has become pre-restricted, with more proposals being refused than supported. This means less appetite for banks to back EFG-based deals.

So what does the future hold for SMEs amidst all this uncertainty? Thankfully there are more flexible options for forward-looking businesses, other than traditional bank lending.

Invoice finance – growing into a mainstream option

Increasing numbers of businesses are coming to realize they have a very valuable asset that they could put to work to finance their growth aspirations – their invoices.

The principle of borrowing money secured on a business's assets, particularly invoices, has been in the UK market for almost 50 years, but it's only in the last decade or so that the industry has really taken off.

Statistics from the Asset Based Finance Association show that the UK invoice finance sector has grown by £114 billion (total client sales) between 2000 and 2009 from £77 billion to £191 billion. In the last year alone, nearly 46,000 businesses in

the UK and Ireland have used invoice finance facilities to fund their business and improve their cash flow with the industry advancing in excess of some £15 billion.

It's an approach that is gaining government interest. According to *Financing a Private Sector Recovery*, published in July 2010 by the Department for Business Innovation and Skills, invoice finance 'could play a crucial role in securing access to working capital finance during the recovery for many businesses'.

While innovative businesses are quickly becoming more aware of the benefits this type of funding can bring, it's important that more businesses across the UK come to understand the power of invoice finance as a smart, sensible thing to do, guaranteeing a cash flow when you need it most.

How invoice finance works

Essentially, invoice financing allows businesses to raise cash against the value of unpaid invoices that they have issued. The invoice finance provider will pay a proportion of the invoice, often within 24 hours, and can then, as an option, take on responsibility for ensuring it is settled by your customer. When the customer has paid, they will then pay you the remainder of the invoice's face value, less any administration charge.

There are a number of significant benefits associated with invoice finance. In the first instance, it offers some certainty regarding invoice payment dates. Rather than waiting 30 or even 90 days for payment, you can get up to 95 per cent of the value of the invoice within 24 hours.

It also provides businesses with higher levels of working capital, an increased ability to make accurate financial predictions, and the opportunity to react quickly to changes in market conditions. Furthermore, the funding secured through invoice financing is directly related to the strength of the business; as a company's order book grows, so too will the amount you can obtain.

This helps to provide clients with the capital they need to expand efficiently, quickly and in a risk-managed manner without the expense and continual need for renegotiation associated with overdrafts.

Looking ahead

Cash flow is potentially the greatest danger area facing firms that wish to expand in today's business environment. It is vital that any growth is properly financed, and that expansion can occur without putting undue stress on existing core business activities. Given the reluctance of banks to lend, businesses may need to consider different financing options, including factoring or invoice finance.

With proper planning and some creative thinking, you can make the most of the opportunities for expansion. Today, strong relationships and reliable delivery are more important than ever as businesses look at the whole value proposition when choosing a financier. The invoice and asset-based lending industry has remained

consistent in its relationship-based approach throughout the last 18 months, bridging the funding gap by offering sustainable finance that many businesses are finding more appropriate to their needs today and ultimately helping them meet the recovery with strength.

Funding for growth case study – Sovereign Rotating Machines

One example of a company that uses invoice finance to assist its growth plans is Sovereign Rotating Machines – an automotive parts remanufacturer, building starter motors, alternators and ignition modules.

With travel and fleet budgets tight, purchasing a new car is a bigger decision than it used to be for both individuals and companies. Instead, car buyers are turning to remanufactured vehicles – cars where all the key components have been replaced and upgraded to create, essentially, a used car with a new engine.

In tough times remanufactured vehicles represent an ideal compromise between brand new and used cars. Because of this, Sovereign's orders were increasing but they needed to invest in parts and components up-front to meet that demand.

Reluctant to fund an expensive bank overdraft to manage cash flow, Sovereign Rotating Machines chose invoice finance. They preferred the way in which an account manager took the time to understand the business and was able to judge the quality of the book debt accurately. Apart from supporting stock purchases, the availability of funding meant Sovereign was far better able to embrace new opportunities as they arose. Their orders are increasing and the business is growing because their risk is managed and their financing secure.

Practical ways to improve your cash flow

Poor financial management is one of the major causes of the failure of small businesses. Many small firms go out of business because of inadequate working capital and poor cash flow management. Below are some pointers on how best to manage your cash flow:

- Know your customer. To do this, you can approach their bank for a reference, use a credit reference agency, or ask their other suppliers. Establish how solvent the customer is and whether they are likely to have any problems paying their invoices on time. Be aware that if you ask a prospect for a client reference it is quite likely they will have a stock of good references – it is worth investing in more impartial ratings/references.
- Be clear with terms and conditions. Formally agree payment terms in advance and confirm in writing. Devise a strategy for customers who demand longer to

pay. One example might be to require a down payment on projects so your customer funds the work, not you.

- Offer incentives for early payment. You should be able to recover the money more quickly if you offer a discount for prompt payment.
- Issue invoices immediately after supplying goods or services. Make sure disputed invoices are investigated and resolved straight away. Ensure sales invoices are fully compliant with HMRC guidelines and VAT requirements.
- Plan ahead and don't hold too much stock as this unnecessarily ties up your cash. Investigate the possibility of more frequent deliveries from suppliers so that stock levels can be kept to a minimum.
- Take more credit. The longer you take to pay suppliers, the more cash you'll retain in your business. It might not be possible to take extra credit in some cases but you could review your creditors and identify those suppliers that you delay paying a little longer. This can make a dramatic difference.
- Preparing accurate cash flow projections can alert you to problems before they materialize. Beware of potential lags in your cash flow and the fact that late payment becomes more widespread during lean times.

Notes

1 *Close Small Business Finance Barometer* August 2010 – 500 UK SME interviews conducted by Lightspeed Research Ltd.

David Thomson is chief executive officer of leading UK independent invoice finance provider, Close Invoice Finance. Since taking the helm in 2002, he has overseen a period of expansion, re-positioning the business as a product and service leader within the factoring and invoice discounting sector. Their IDeal product remains unrivalled and has won numerous awards since it was launched back in 2006; the most prestigious being the Business Moneyfacts 'Best Factoring and Invoice Discounting Provider' – an accolade Close have won for the last five years.

Close's management team offers a huge depth of industry knowledge with each of them having many years' experience working within the invoice finance industry. Without exception all started their careers in very junior positions and consequently are acutely aware of how businesses work and how invoice finance needs to interact at all levels to allow clients to grow.

Providing bespoke cash flow solutions to over 1,000 clients from most sectors and sizes, Close Invoice Finance is part of the FTSE 250 listed Close Brothers Group, one of the UK's most enterprising specialist lenders.

To find out more about how Close Invoice Finance can help your business please call: 0800 220 257; or visit the website: **www.closeinvoice.co.uk**.

Belfast – Birmingham – Brighton – Dublin – Glasgow – London – Manchester – Newbury

Preventing slow payments

5.3

Do not suffer in silence, says ***Martin Williams*** *at Graydon*

No matter what size your business is, a sale is only a sale when the invoice is paid. Cash flow is an essential ingredient for business continuity and success, so it is vital that a business does everything it can to collect cash from customers on time.

Since it is estimated that around half of all UK trade invoices are paid late, it is fair to assume that most businesses will experience issues relating to delayed payments from clients. This perennial problem has been exacerbated still further by the current credit crunch. Not only do we all have a problem with those companies that are unwilling to pay; we also have a serious and growing problem with customers who cannot pay because of their poor financial condition. Unfortunately, it's also true that smaller businesses will probably suffer most from this 'delayed payment' affliction. That's because many bigger organizations 'bully' smaller suppliers into accepting slower payments or demanding discounts for prompt payment, in the knowledge that the smaller supplier is so grateful for the business that it will turn a blind eye to tardy invoice settlements or unwarranted demands. Secondly, most growing companies cannot afford to employ a professional credit manager, who would normally have a range of tricks and skills to get the cash in on time.

It's not all gloom and doom, however. If you are a small and growing business, a number of positive steps can be taken to minimize the impact of late payments, even avoid them altogether, without going to the expense of hiring a credit management professional.

General principles

Firstly, the law is on your side! The Late Payment of Commercial Debts (Interest) Act of 1998 gives small businesses the right to charge debtors interest on overdue payments. The large majority of small businesses are worried about pushing for this right for fear of upsetting/losing the customer, but in the southwest of England, a recent survey suggested that as many as 29 per cent of businesses regularly added interest to overdue invoices.

Please recognize that cash flow is the lifeblood of your business – don't just take excuses for delayed payments with a submissive acceptance speech.

Take note: any perceived lack of interest or urgency by a supplier in getting paid will be seen as weakness by the slow payer, and that would mean your outstanding invoice going to the bottom of the finance department's in-tray. So be polite but assertive in asking for what you want.

Secondly, spread your risk. As a small business, be careful about having too many eggs in one basket with regards to commercial trade debt. There are countless tales of smaller companies going to the wall because a large customer accounting for a disproportionate amount of sales turnover did not pay up on time. Pareto's Law is a good indicator as to what customer mix should be aimed for (80 per cent of turnover should come from the top 20 per cent of your client base).

How to improve cash collection

Here are 10 more ways to improve cash collection:

1. **Sign your customer up**

   Ensure your company has got a signed contract with the customer that clearly states your payment terms. These terms should also be clearly described on your application forms and the invoices you subsequently send out. Be sure they know what the credit terms are, whether you offer discounts for prompt payments or bulk purchases, whether additional costs are payable (eg VAT or carriage costs), and whether you charge interest on overdue accounts (all businesses are legally entitled to do this). If a customer tries to unilaterally impose its payment terms on you, make sure you build that additional cost of extended credit into your prices so that your profits aren't marginalized further.

2. **Do a credit check**

   Buy a credit report from a recognized credit reference agency; especially one that collects trade payment information on how large companies pay their bills, eg Graydon, Experian, and Dun and Bradstreet. Don't rely totally on the taking up of two references given to you by the potential client. They may be cultivated. Don't be taken in either by a great-looking set of accounts to determine whether you will get paid on time; a healthy-looking balance sheet might mean that your potential customer is very proficient in getting its suppliers to finance its business. Set a credit limit for each new client, and don't allow customers to exceed limits without your permission. After all, they are set for a good reason, as you have assessed the creditworthiness of the customer and for how much your business can afford to wait (or lose, should the worst scenario occur).

3. **Is a purchase order required?**

   As part of their internal control procedures, large companies often require signed purchase orders before paying invoices. Ask the manager/department placing the order whether they need to raise an internal PO, and if so, have they done so, covering the value of the order. Ask for a copy of the PO (NB:

some large companies require invoices from suppliers to quote the PO number before they are paid).

4 **Prevent excuses**

Prevent excuses for delayed payment – after dispatching goods and sending your invoice quickly afterwards, make a pre-due call to ensure that your customer has received them and that there are no problems with quantity or quality of the goods supplied, or with the content of the invoice. Invoice disputes can be very genuine and can push back the time you get paid by weeks or even months sometimes.

5 **Send statements**

Send statements at different times in the month from your invoices. Sometimes this tactic can provoke questions, particularly when original invoices have been lost, not received, or mislaid.

6 **Check on expected pay date**

Confirm with your client when your bill is expected to be paid, remembering to ask whether they have specific cheque-run dates.

7 **Use the telephone (or even a personal visit) to chase**

If payment is delayed, chase your money by telephone rather than letter. Some experts in this field say that the telephone method can be 80 per cent more effective. Always prioritize your cash-collection activity, making sure you chase the oldest and largest debts first. Be friendly but firm when speaking with them, and don't forget to remind them that you could charge interest on all late payments. If it's a big debt, don't dismiss the idea of turning up on the doorstep and waiting for your cheque. It does work!

8 **Maximize your bargaining power**

Maximize your leverage. Try to establish how valuable the product you're selling is to your client. It may be a vital component in a manufacturing process, especially if it has been developed to the client's own specifications.

9 **Monitor your risk portfolio**

Keep abreast of news that may affect the creditworthiness of your key clients. Put their names on a low-cost monitoring service with a credit reference agency (Graydon's service is called CreditWatch). There is nothing worse than being the last to know when something has happened to one of your key customers. Don't fall into the trap of believing you know everything you need to know about your clients. A businessman I know was informed by a credit agency monitoring service that one of his clients had attracted a number of County Court Judgments over a few short weeks. As a result, he insisted on cash up-front when the client's next order arrived in his in-tray. The client declined the offer on this occasion and put the phone down in an agitated mood. Two weeks later, that disgruntled client actually went bust owing several other unsecured trade creditors money! Thanks to his foresight in buying a monitoring service, my businessman friend avoided a potentially

crippling bad debt. Losses from bad debts can really put a strain on a business's cash flow, and in the worst scenarios can even bring companies down! It's the old domino effect. You may not see all bad debts coming, but there are tools out there that can help minimize the chances of it happening, so why not use them like the credit professionals do?

10 Develop a 'friend'

Try to establish a personal rapport with one or two people in your client's accounts department. Get to know Gladys or Vera in the purchase ledger department, by engaging in some general conversation. What might seem like a time-wasting exercise asking Vera about her recent trip to the zoo could actually prove a very productive use of your time if she pulls out your invoice for payment when asked to do so a few moments later. In my experience, the personal touch never fails!

Summary

The message could not be clearer. If smaller businesses follow this advice, they will find that cash flow difficulties will ease. This course of action will be far better than doing nothing about slow payments, particularly from large organizations (apparently, half of small businesses continue to suffer slow payments in silence for fear of losing 'valuable accounts'), or do the extreme opposite, ie close the account. Two things are certain: large companies are not going to change their bullying payment habits overnight, and there will always be clients with genuine cash-flow difficulties that cannot pay up on time. Your organization may not yet be big enough to employ a professional credit manager, but taking the recommended steps above will make it look to the outside world like you do. This may well lead to you gaining not only respect from customers, but a healthier cash position for your business too!

More information

For more information on Graydon UK Limited: **www.graydon.co.uk**
Federation of Small Businesses: **http://www.fsb.org.uk**
The Better Payment Practice Group: **http://www.payontime.co.uk**

Martin Williams has spent the last 30 years in the Credit Information Industry. For the first nine years, he held a number of management positions with Dun & Bradstreet UK, but was transferred in 1984 to Dun & Bradstreet Europe, as part of a high-level team employed to help Dun & Bradstreet companies in Europe to computerize their operations. In 1987, Martin moved to Graydon, which is now one of the top five players in the UK. Since 1989 Martin has been a board director of Graydon UK and became managing director in 2001. Martin is currently the president of Eurogate, a network of European Credit Information Agencies, of which Graydon is a part. He has also been a member of the Institute of Credit Management in the UK since 1991, and is a regular presenter and speaker at credit management forums in the UK.

Graydon UK is one of the leading database information providers specializing in credit risk management. The company helps clients to reduce the uncertainty of commercial risk by providing a high-quality package of credit scoring, credit rating and credit risk management services. Graydon provides access to credit information and reports on more than 70 million companies in more than 130 countries worldwide. The Graydon group is owned by Atradius, Coface and Euler Hermes, three of Europe's leading credit insurance organizations.

For additional information visit the website: **www.graydon.co.uk**.

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Commercial fraud and business identity theft

5.4

As a small business, you can easily become a soft target for commercial fraud, says ***Martin Williams*** *at Graydon. What can you do to prevent it happening?*

It is no wonder that the research conducted by Graydon, one of the leading credit information agencies, into the levels of corporate fraud in British business sparked much debate in the press and in the credit management industry in particular. The survey, carried out among those working in credit management departments in a business-to-business environment, came up with some alarming results. The study found that one in three respondents had experienced an instance where they had received a credit application from a business wanting to obtain goods/services from them fraudulently.

The results also showed that the same percentage of business respondents believed the problem of fraud was getting worse. One thing is for sure: this is a problem that is not likely to disappear anytime soon.

So why is white-collar crime on the increase and what can be done about it?

John Dillinger, the infamous American bank robber, when asked why he robbed dozens of banks, replied, 'Because that's where the money is.' Like John Dillinger, most criminals are opportunists who also like to think they won't get caught. Corporate fraud is not exactly high on the police agenda when there are so many higher profile areas of criminality to tackle with limited resources within the force. If the police asked the average person, even if that person was the credit manager, whether he/she would prefer to use policemen to tackle knife crime or fraud, we can guess what the answer would be. Additionally, there is a commonly held belief that with the British judicial system as it stands today, convictions for fraud are notoriously difficult to obtain. So, it's not surprising that some criminals see this area of activity as attractive. They perceive that police interest is low to start with, and know that courts find difficulty in sending culprits to jail.

Similarly, if other factors exist that make the fraudster's life easier, he will use the opportunity. As an example, disclaimers on the Companies House website explaining that documents lodged there are accepted by the Registry in good faith and 'are not verified or validated in any way' may be acting as enticers to criminals to file fictitious documents for illicit gain and deception.

There are other reasons why corporate fraud happens. Losses caused by corporate fraud are often viewed by victim companies as commercial debt and not fraud. Fraudsters believe that few companies pursue them but simply write-off corporate fraud losses as bad debt. Secondly, if fraudsters obtain goods from unwitting suppliers by deception, they have to have a ready market for the goods that have come into their possession. Therefore, fraudsters tend to target certain product lines that are easy to sell for cash in pub car parks, markets and on the streets.

But perhaps the biggest reason why fraud happens is that orders for goods on credit are not properly vetted by suppliers. Smaller businesses are often viewed as 'soft' targets by fraudsters because they are too small to employ professional credit managers.

So how does the fraud happen? Firstly, fraudsters use genuine company details for dishonest purposes. This has become known as 'identity fraud'.

Signatures are forged in order to have goods delivered to an address that in no way is associated with the original bona fide company whose identity has been stolen. Also, as has already been mentioned, fraudsters are filing false documents such as fictitious balance sheets at Companies House in order to generate good credit ratings with the information agencies. On top of these filings, fraudsters are filing false director appointments and registered office changes in order to facilitate identity theft fraud.

However, perhaps most importantly, frauds can only be perpetrated when existing credit control procedures at the supplier end are insufficient, either through ignorance about what to look out for, or lack of will to introduce adequate checks to stop this from happening.

The good news for businesses is that procedures can be put in place to tackle this growing menace, and tips can be taken on board to protect your company's best interests and profitability.

First, like consumers, businesses should be very careful as to how they dispose of their 'rubbish'. Small businesses in particular should never throw away paperwork such as utility bills, credit card statements, bank statements etc without shredding them first. Identity thieves are known to rummage through garbage bins outside commercial properties.

Beware of the potential damage that can be caused by hijackers to companies and suppliers of goods and services. 'Corporate identity hijacks' normally involve fraudsters changing the details of a company's directors and registered office. To help combat company fraud, Companies House has introduced the PROOF (PROtected Online Filing) scheme. To join the PROOF scheme, you will first need to be registered for the Companies House WebFiling Service.

To prevent your business becoming a victim of fraud or corporate identity theft it is also very useful to monitor what documents have been filed at any point in time on your company. Some credit reference agencies such as D&B and Graydon offer services such as e-mail alerts and monitoring, for example CreditWatch, that will send you an e-mail when any such changes occur on your company or any business you are interested in. If you are subscribed to that service and you received an e-mail alerting you that somebody has filed, for example, Change of Particulars (Company Officers), Change of Registered Office Address or other critical documents, you may wish to check if these are genuine or known to you as true facts.

Once you have taken that initial precaution, it is worthwhile taking a few additional steps that will go a long way towards protecting your company from the risk of corporate fraud. Before giving the green light to deliver goods or services to any given client:

- Always obtain a credit report on the business. (Hopefully not from an agency that just regurgitates Companies House data. Some agencies such as Graydon.co.uk and Experian add value by analysing and scanning their huge commercial credit databases for unusual patterns of corporate behaviour and reporting such findings to clients within their credit reports and monitoring services.)
- Never set up an account until the application has been fully processed.
- Check the credit application for quality and completeness.
- Always check the trading and registered office address.
- Be wary of mobile phone numbers and non-business e-mail addresses, eg hotmail/yahoo etc.
- Know the true identity of your customer – have they got a website?
- Most companies will pay their bills by completing a purchase order from their accounts department – obtain a copy of this.
- For non-incorporated businesses, request original copies of utility bills quoting the delivery address.
- Double check all delivery addresses, keeping a close eye on what sounds like residential addresses.
- Check for valid VAT numbers. Call the VAT Office on 0845 0109000.

It is also extremely important to flag certain events and details that seem out of the ordinary. Here are some examples:

- Is there a sudden change of delivery address?
- Is there a last-minute call to collect the goods rather than have them despatched to the quoted delivery address?
- Is the delivery address given by the client shown on the credit report you obtained from your agency?
- Are the telephone numbers fixed line or non geographic, eg 0800?
- Have you received an order on the last afternoon of the month? (Fraudsters, like credit managers, understand the pressure from the Sales Department!)
- Look out for unusually large orders placed at the start of a new month, where the fraudster anticipates he has the longest time before you chase for payment.
- Have you received a large first-time order on a credit card? If so, be wary.

Businesses therefore have a choice when it comes to fighting commercial fraud. They can keep their fingers crossed and hope it never happens to them, much like the house owner who refuses to invest in a burglar alarm system when all his neighbours have done so. Or, they should fully recognize that commercial fraud is here to stay, but

appreciate that if proper controls are put in place, the opportunist criminal will move on down the commercial street and target someone else who looks easier to take on.

More information

Graydon: **www.graydon.co.uk**;
http://www.graydon.co.uk/content.asp?pageTag=fraud-prevention
http://www.graydon.co.uk/content.asp?pageTag=credit-risk-monitoring

HMRC: **www.hmrc.gov.uk**

http://www.companieshouse.gov.uk/infoAndGuide/proof.shtml
http://www.businesslink.gov.uk/bdotg/action/detail?type=RESOURCES&itemId=1075422219
http://www.businesslink.gov.uk/bdotg/action/detail?type=RESOURCES&itemId=1080006906
http://www.identitytheft.org.uk/security.asp?action=in
http://www.banksafeonline.org.uk/

Graydon UK is one of the leading database information providers specializing in credit risk management and risk-assessed marketing lists. The company helps clients reduce the uncertainty of doing business by providing a complete, differentiated and high-quality package of credit risk management services. Graydon provides access to credit information and reports on companies in more than 190 countries worldwide. The Graydon group is owned by Atradius, Coface and Euler Hermes, three of Europe's leading credit insurance organizations: **www.graydon.co.uk**.

In 2008, Graydon UK managing director Martin Williams was invited by Philip King, director general of the Institute of Credit Management (ICM), to join the ICM think tank (an expert panel of 20–25 industry leaders who meet quarterly and act as an influencing force on all issues related to the credit industry in the UK). That same year, Martin Williams was honoured by Credit Today, after being included on their Credit 100 list of people who have had the greatest impact in the credit industry during 2008 and 2009.

In January 2010, Graydon UK's new 'Level 3 Including Management Accounts Report', which incorporates standardized and validated monthly management accounts into the credit scoring process for the first time globally, was shortlisted and commended for the Most Innovative Product Award at the Business Moneyfacts Awards 2010.

PART SIX
Efficient SMEs

Build the network

6.1

*As you grow from a room to a floor to a site to a chain, **Marco van Beek** at Forget About IT™ discusses how to make sure your IT system keeps up and how you can avoid finding yourself in network hell*

As a business grows, its networking infrastructure must be able to grow with it. When you first start a business, sharing data with your colleagues is not really a problem. You might not have any yet, and even if you do, most likely you are all working from home and e-mailing each other. However, as a business grows, sharing resources can be a very powerful way of controlling costs, as well as enabling your staff to have tools that on their own they cannot justify.

When you have a handful of users, a small ADSL or cable wireless router is a practical way of setting up a network, and most manufacturers will say that they are suitable for up to 20 or 30 users, but in reality their performance will start to drop even with half a dozen people on the network. The main reason for this is that a wireless network doesn't scale unless you are prepared to spend a lot of money, and by this I mean that if you get a quote and it is less than a wired network of equivalent size, you are probably not spending enough.

Although wired networks offer at least a tenfold increase in speed over wireless, this is not the main reason they are faster. They are faster because each user can have a dedicated connection, rather than sharing bandwidth on a wireless channel. Ethernet switches have the ability to prioritize traffic, as well as queuing it in a way that optimizes the utilization of the heavier loads. However, used incorrectly, they can degrade the performance just as easily.

Most ADSL or cable routers include a small Ethernet switch, giving you four or more ports that you can use for a wired network. Wherever possible, you should use these for devices that do not have screens and will tend to be left on all the time: printers, network attached storage (NAS) devices, servers etc.

As your business grows, you will fill up those four ports very quickly, so the next infrastructure purchase should be a proper Ethernet switch. Your choices are straightforward: managed or unmanaged, rack-mounted or desktop. The difference between a managed and unmanaged switch is that with a managed switch, you can configure the behaviour of the device, and it can be used to troubleshoot problems. The more complicated the network the more likely it will be that you need a managed switch. If you do not have anyone who understands how to use a managed switch, there is no point in buying one. Stick with an unmanaged switch until such a time when your network has grown to make it a requirement. As to the physical shape of the device, the main reason to buy a rack-mounted device is because you have a rack

to put it in. If you do not, then most of the advantages of a rack-mounted switch are wasted. You should also buy a switch with around twice the capacity you currently have. Not only is this because you will need it, but because the most efficient network is one with as few hops between devices as possible, so you want to be able to re-plug all of the devices on your network into the new switch.

This, however, does lead to a network's biggest problem. From an efficiency point of view you want all of your devices connected to a single central device, but that also makes it a single point of failure. First of all this is not as bad as it seems. They have few, if any, moving parts. As an electrical device it is susceptible to mains spikes and surges, so it is good practice to connect them via a filter, or better, to an Uninterruptible Power Supply (UPS). Also, the simpler units are quick and easy to replace, so for a small business, having a spare to hand is as close as the nearest PC store.

As the business grows from a group of desks to a larger floor area, there is a temptation to just buy another small switch and stick it under the new desks. However, daisy-chaining switches is the easiest way to network hell, so if you cannot easily run the cabling back to your central point, then you need to expand it carefully.

Once you need more ports than a single switch can offer, you can get stackable switches. These devices have a 'bus' to interconnect them, turning them into one big switch. They are expensive, complicated, and you will probably never be able to add a new one to a stack when you need it as they will have gone out of production, so this gets expensive. If you need stackable switches, buy them all in one go and buy some spares at the same time. You don't want to rely on eBay to get your network back up and working.

If you cannot bring everything back to a single point (for example, your business now covers more than one floor) you should avoid having more than three switches between end devices. This used to be a golden rule of Ethernet network design, but modern switches often allow you to get away with it. That doesn't mean it is good, though. So for a good Local Area Network (LAN) design, you want a central switch, and a series of secondary switches plugged in to it. You have your core devices (servers, routers, main printers) that everybody needs to access on the central switch, and all the workstations on the secondary tier.

You can link these switches together via fibre if you need to, and this allows you to exceed the CAT5e/6 cabling 100m maximum segment distance. Where possible, you want to link your primary and secondary with a faster speed than the links to your workstations. You can do this by buying Fast Ethernet (100Mb/s) switches with a couple of Gigabit ports, that you use to link back to your primary, Gigabit (1000Mb/s) switch.

Fibre can also be used to link between buildings. If you are lucky, and have two buildings on the same trading estate, the landlord may allow you to run your own fibre through the ducts under the pavement. Alternatively, you can rent what is called a 'dark fibre' from a number of infrastructure providers. Dark simply means that it is not down to them to 'shine' the data down the fibre.

Once you have multiple sites, you need to consider how to link them into the network. The simplest way is to use a Virtual Private Network (VPN). All you need to do this is an Internet connection at each end, and a router, firewall or server capable of establishing a VPN at either end. As well as that, you need to link the

essential network services at the remote end to the core. The most important of these are the tools used to find services and computers on the network. On simple networks, computers often find each other by broadcasting on the network. However, this will not work across subnets. A subnet is a part of your network that is local. Any traffic that is not local must travel out from the router to somewhere else. A routing database on the router will determine where that is. In your network settings, your subnet mask determines how much of your network address is local.

So to get to a computer or service on a remote subnet, you need a way of finding where it is other than broadcast. For most computers, this is called DNS, or Domain Naming Services. In a properly set up network, your computer will register itself with an internal DNS server so that others can find it. This is often called Dynamic DNS. In some cases you have to hard code a device into DNS to allow it to be found. Windows computers can also use a service called WINS for this. It has been superseded by Dynamic DNS, but is a usable alternative. On most systems WINS and DNS will be linked so that one can interrogate the other when it does not have the answer you need.

VPNs are limited by the slowest speed at each end. This means that on an ADSL line, you will be limited by the upload speed at the other end, usually only 10 per cent of your download speed. This means that while we are pushing 1,000Mb/s on LANs, we are very lucky to get even 1Mb/s over a VPN using ADSL. If you have multiple sites linking in to your central hub, this gets even slower. It is possible to get dedicated LAN-to-LAN links, but expensive for a small business.

At this point you can save a lot of money by a careful choice of the technology used at the remote sites. A number of applications have been written with remote workers in mind. For example, an application written using Microsoft's Access database is unusable over most Wide Area Networks (WAN), whereas the same application using Microsoft's SQL database back-end would work.

Browser-based applications work well over WANs, as little data is actually sent over the link. However, if all your users want MS Office, than you really have two choices, provide them with a local workgroup server, which is then replicated or backed up to the Core, perhaps out of hours, or a remote desktop system such as Terminal Services (sometimes referred to as RDP). With a remote desktop solution, the user is actually using a computer (or a share of a computer) at the core, and only the screen, keyboard and mouse information is sent over the WAN. This system is often unsuitable for graphically intensive applications such as AutoCAD, Photoshop or PowerPoint.

Once you start to exceed the capacity of your ADSL line, you could move to an SDSL line. This often sounds like a step backwards, since the download speed will be slower than your ADSL line, but the upload is faster, so you will get up to twice the VPN speed. Alternatively you can find ISPs who can bond multiple ADSL lines together, although this requires expensive hardware, or you can use multiple lines separately; for example, one for the VPN and one for the local users to access the Internet. Some routers can talk to each other, exchanging routing information and redirecting traffic down different routes. Although this gets complex, it can sometimes be the only way to break a bottleneck, and has the advantage of providing redundancy.

There is no need to spend a fortune on an IT system. A proper system should be designed to grow with your business and, more importantly, grow by evolution rather than revolution.

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Marco van Beek has been working with computers since 1984, when he was working with the world's most advanced automated lighting company, Vari-Lite Inc. He first started using e-mail in 1987, but stopped when it was superseded by fax machines (yes, you did read that right). In 1998 he set up his own consultancy company, Supporting Role Ltd, which specializes in IT support for companies in the event and entertainment industry. In 2005 he took a product that had been developed internally and created an innovative, fixed price IT solution for small and micro businesses. Marco's attitude towards computers is that they are tools, and are only as good as the person using them. There is no 'one size fits all' in IT.

Strategic sourcing

6.2

*Plan to get the most out of your suppliers, says **David Noble**, CEO at CIPS*

Any business, whether a start-up or an established firm, needs reliable, innovative supplies of services or goods to keep it a going concern. Every organization needs a robust supply chain that feeds business, helps it grow and keeps customers happy.

So what do you do? The first step would naturally be to compile a list of suppliers, whether local, national or global, depending on what each can offer, what you need and at the cost you have budgeted for. You then choose the supplier based on your criteria, develop the relationship and get your goods and organize your services. Job done?

Though a completely professional approach, this is a very reactive way to build a reliable supply chain. Fine if you're in a hurry and your previous supplier has let you down and you need a contingency in place for a low-value, low-risk item, but a purely transactional approach to the development of your supply chain won't be enough for your business in the long term.

So, take another scenario. Your marketing team wants to take on board a technological development that's fast moving and the latest thing. It's a tactical move designed to add value to your business and you have to move fast to take advantage of the opportunity. But, if it's a high-risk item, do you go ahead regardless, or do you step back and take a strategic approach, and call in your procurement team specialists, even if that 'team' is actually just you?

Strategic procurement is a core activity in the management of supply chains. It can be complex, needing a high level of competence and is defined as satisfying a core business need using a proactive and planned analysis of suppliers to develop keen business solutions. Your business may need to manage its costs more tightly, so your core need may be a cheaper supplier, but a strategic approach helps you look at the entire need, which could range from anything such as faster delivery, to a more innovative product.

Develop a strategy

A regularly updated, living, breathing strategy document is a good start. Keep purchasing and supply management aligned with the core values of the business and maintain its importance and prominence in the business. Competent professionals in the field of procurement will give the most value, as their expertise in supplier relations or category management will get you the best expertise.

Analyse, analyse, analyse

To spend time monitoring and evaluating your processes will seem like an onerous task when the everyday activities of running a business will seem more pressing. But, it will make the difference between a strategy that works, and one that may lead you down the wrong path.

What do your customers, and your business need?

Be customer-focused and understand the strategic direction of your business. This and your procurement strategy should be closely aligned.

Analyse your spend

Include an historical look at where your hard-earned cash has gone on goods and services; how you have positioned your suppliers; a brief history of who your suppliers are and how long you've been using them; a cost analysis of all your transactions; the critical nature of your products and services, categorized as high risk, high spend etc.

Your future spend

What will your business need in the coming months and years? What are the trends you've identified in your market and how are your competitors responding?

A full market analysis

This analysis should include an understanding of the capacity and capability of the market (and the individual markets within); who holds the power in your supply chains (you may be surprised); supplier preferencing; the position of your organization; a cost analysis of your supply chain; a breakdown of local, national and international sourcing; the actual size of your current supply base and how big your supply base could actually become.

Mapping your supply chains

Not for the faint-hearted. A complex and long process involving time and resources, so a risk assessment across the whole organization will give you a good idea of how long you need to spend on this process. The analysis and mapping stages can realistically take up to six months, but the long-term benefits and developing a strategic procurement approach will bring dividends.

So, how and what to map?

- pinpoint your profit and gross margins in your supply chains;
- recognize how many 'tiers' of supply chains you currently operate with – can they be reduced?
- understand who has the power in your supply chains – you may be surprised;
- map your goods and services against these supply chains and see where the interdependencies lie;
- be clear on where you're spending money on suppliers, based on category of spend and business unit or department;
- look at any patterns in pricing structures, using both historical and forecast data;
- what is the history of each supplier, and how have they performed over the time you've used them?
- future market trends and where your costs are likely to be;
- the true value of your supply chain – it's not just about cost;
- what are your critical products and services?

Your options

Now you have all your data, which way now? All this consolidated data presents opportunities to take your business in the direction you want it to go. It's also a chance to be creative and come up with innovative solutions with your suppliers. Rather than buying computers for your office as goods, could an outsourced desktop service be a better solution for you?

As you have your options spread before you, now's the time to do a risk and SWOT analysis on each, just to make sure you haven't got carried away… keep your options in line with your strategic business goals. That's why keeping procurement aligned with the boardroom, and supported by the head honcho, will keep everyone focused on joint goals.

Working so closely with the board, or the boss, you'll have to have your figures close to hand. Each of your options should be supported by evidence of a Return on Investment (ROI).

Your preferred plan

Once the right option has been agreed, sourcing plans are the next step, which is where you can get really creative. Supporting the organization's mission and vision, sourcing plans should create clearly defined workstreams with milestones for each task ahead and project teams to make these plans a reality.

Keep managing the performance of your new and existing suppliers at the uppermost level of your mind, to keep everything on track. You may also have to persuade your internal colleagues to see purchasing in a different way. It's not all

about price and cost alone, bringing true value such as agility or innovation is also valuable.

New suppliers identified

So you think you need a new supplier, how do you go about it? Some options are quite obvious, such as trawling through the Internet, or looking through local directories. For more specialized suppliers, seeking out recommendations from associated trade bodies, or going to trade fairs means you get more immediate information on possible partners you can work with. Try networking with other buyers in a similar sector to yourself and discover the suppliers they're working with and could possibly recommend. Barring any competitive obstacles you may encounter of course.

Shout about your strategy

Part of the success of your strategy is to let all your key partners know about it, and that includes your internal stakeholders, including staff and peers. You may be called upon to lead the contracting process and coach or mentor your colleagues to follow the plan. Soft skills requirement alert.

Measure your success

It's pointless planning and implementing if you can't measure your success to help you build strategic plans of the future. Measure the deliverables from your new plan as compared to the outcomes of your purchasing practices before. You could do this with a post-contract audit, make notes from any regular meetings with suppliers, or a look back at any creative and innovative ideas that may have been suggested by your suppliers (they'll always be eager to help as it will develop their business too). Make a point of discussing the findings, not just with the project teams, but your procurement team if you have one, and with the board too. The results may influence the strategic direction of the whole business.

Effective, sound strategic procurement is one of the recipes for a successful business. It's not rocket science though, as the skills-set can be learned, but they need to be constantly developed, refreshed and honed and they are fast becoming one of the key skills in trained procurement professionals. The ability to source in a smart, strategic manner requires resource and key management information.

So, strategic procurement. It's not just about buying stuff.

David Noble is CEO at the Chartered Institute of Purchasing & Supply. CIPS, the world's largest professional body representing purchasing and supply management professionals, and is the worldwide centre of excellence on purchasing and supply management issues. CIPS has over 65,000 members in 150 different countries, including senior business people, high-ranking civil servants and leading academics. The activities of purchasing and supply chain professionals can have a major impact on the profitability and efficiency of all types of organization. Tel: 01780 756777; e-mail: **press@cips.org**; website: **www.cips.org**.

How to find your ideal office

6.3

***Rob Hamilton**, founder and chief executive of Instant, discusses the best office solutions for entrepreneurs and growing businesses*

Moving house is often cited as one of the most stressful experiences any of us will endure in our lifetime. The whole process, from finding the house, dealing with estate agents, mortgage advisors, and the final act of moving itself, can be a draining exercise. But how does this experience really differ from the trials and tribulations of moving office? On average we spend more waking hours at our place of work than in the comfort of our home, spending more time with our work colleagues, clients and business partners than we do with friends and family. And with research increasingly highlighting the role of physical workspace in contributing towards staff performance, morale, motivation and ultimately company performance, choosing the right workplace is absolutely fundamental to the future success of your business.

Whether you're starting a new company, setting up a new division or establishing a presence in a new location, the search for a new office can be daunting and time consuming. Finding the right premises, at the right price, can be a minefield for an experienced property professional, never mind if you are focusing on building a business. It's a big decision and in these times of economic austerity, the decision is more vital than ever. Getting it wrong could not only be costly, but could prove to be a major setback for the company in the crucial early weeks and months in getting a new business off the ground.

Essentially, there are three main options available when choosing an office.

1. A serviced office. This option is ideal for a small and growing business. Serviced offices provide companies with a ready-made space, all fitted out to a high standard, with manned reception facilities, meeting rooms and kitchen areas. You can take on just the amount of space you need with the flexibility to grow over time. There are no set-up costs and you can move in very quickly, needing to sign only one contract.
2. A conventional lease. This is the most traditional route and involves you finding an office, usually through an agent, and doing all of the set-up work yourself, including dealing with lawyers, architects and other contractors. You will also need to manage the day-to-day running of the office for the whole period of the lease as well as sorting out any exit requirements when you

eventually move on. This type of lease works best if you know exactly where you want to be and how much space you will need for a number of years – most conventional leases are typically for 10 years, although shorter leases can be found.

3. A managed office. This approach is increasingly popular and is ideal for companies looking for their own environment but with a degree of flexibility. The process starts with a brief from you to a specialist supplier. They will then find the right space, fit it out to your specification, deal with all the contracts upfront and for the whole duration of the lease. This is done in return for a fixed monthly fee for the period of the contract and will cover any exit costs and dilapidations when you move out. By outsourcing the entire process of setting up an office, you avoid the need for initial capital outlays, reduce the time spent and just work with a single, specialist supplier.

Whichever route you go down, here are five top tips for choosing office space:

1. *Location, location, location* – Location should be at the heart of the business strategy, get it right and you are laying the foundations of the company from which to build. Get it wrong, and it could be a costly and harmful mistake for your business. Your office is part of your company's brand. Where you choose to locate your business says a lot about you, but it's important to balance this with how much you are willing (or able) to spend. Clearly, the most prestigious locations will also be the most expensive, so it's important to consider – at the outset – what you want your office to say about you. And don't forget to factor-in travel costs for your colleagues and customers, to weigh against the location benefits.
2. *Consider taking professional advice* – A broker or agent has access to the whole market and will be able to recommend offices that you may not have considered. In addition, a broker can negotiate on your behalf and take much of the workload off your hands, leaving you free to run your business. It is worth spending a bit of time choosing a suitable broker – search the web for one that suits your needs.
3. *How much space does your business need?* – If you take on too much space, your overhead goes up; too little and you'll need to move again. The amount of space should be determined by the number of employees and how you wish to occupy the space – do you want open plan or closed offices or both? In serviced offices, there will be rooms set up for different numbers of people, with kitchens, meeting rooms and so on provided on a communal basis. If you take your own space, you should estimate about 100–120 sq ft per person, which will include the communal areas.
4. *Be sure to consider all the costs* – It is vital that you consider all the costs associated with office rental, not simply the headline rent. For example, in serviced offices the base rent covers all the running costs of the space, but telephones, internet and meeting rooms are charged as an extra. There may also be an exit fee when you leave. If you are taking on a traditional lease, you'll need to look at service charges, business rates and the costs of fitting out

and running the office day-to-day. All of these costs can add up to more than double the headline rent. If you take a managed option, all of these various costs are included in the monthly fee, so you can be clear from the start what your outgoings will be before you sign on the dotted line.

5 *Think about where you will sit* – This may sound obvious but research has shown that the layout of an office has a significant impact on the productivity of a team, with open plan offices being more conducive to good relationships between colleagues, while closed offices are preferable if elements of your work are confidential.

Unfortunately there is no one-size-fits-all set of rules that can be followed to find your perfect office. Every business and every decision is different, indeed the one thing that all businesses do have in common is that they are all unique. The most important thing is to find the office that is right for you and your business, and that the process of making that decision is given due planning and consideration. It should not be viewed as a distraction from the core business, but an excellent opportunity to find a home for your company on which to build its success.

Rob Hamilton is founder and chief executive of Instant, the company that matches businesses with the perfect flexible office space. The company uses its expert knowledge of availability around the world to broker executive suites, find leased space and operate managed offices. The company has a dedicated Managed Office business, which provides occupiers with a bespoke, full service delivery of workspace. Aimed at companies requiring between 10,000 and 50,000 sq ft on a one- to five-year lease, the service provides budget certainty through a fixed price, while outsourcing risk and project management through a single supplier. Further details: e-mail: **RH@instantoffices.com**; tel: +44 (0)20 7298 0600; website: **www.instantoffices.com**.

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PART SEVEN
Leading growth

7.1

How small business owners can become better leaders and managers

***Ruth Spellman**, chief executive at the Chartered Management Institute, explains how the demands on leaders change as enterprises move beyond start-up*

Nick Brown started his first business in the mid 1990s. An individual with immense drive and creativity he spotted a gap in the market and worked 24/7 along with his partner – his wife – to build the business. A natural entrepreneur, born salesman, keen marketer and IT and finance literate, there wasn't an aspect of the business he didn't influence or get involved with. His wife focused on the administrative, finance and operations functions. At peak times family members were drafted in on a temporary basis to assist with the operational and fulfilment processes.

The business grew quickly and Nick's appearance became more haggard by the day as he worked weekends and all the hours he could to keep up with fulfilling the demand he had created. As for holidays, these were distinctly things of the past; a distant memory of when he was a salesman for a medium-sized corporate.

As turnover passed the £2 million mark, the arrival of his first child brought things to a head. His wife was suddenly no longer able to provide the level of support he was used to and demand kept growing.

It soon became clear to Nick that he needed permanent staff if the business was not to become a victim of its own success. In very short order he hired people to look after admin, operations, the books and packaging up and posting out the orders.

However, while recruitment and selection were relatively straightforward, internally, after some months, things began to get into a mess as duplication occurred, paperwork was mislaid, staff misunderstood instructions, customers' calls were not returned and tempers began to fray under the unrelenting pressure. Things came to a head one Friday when two of the packagers resorted to fisticuffs and were ordered off the premises. Nick began to wonder what he had done to deserve this turn of events.

Nick belonged to a classic car club and though he rarely attended local events decided on this occasion to attend the next one as a good friend and former colleague was going to be present.

Over a pint of beer he poured out his troubles and answered the questions put to him in return. A number of things soon became clear to his companion, a senior executive at a large multinational.

In common with most managers Nick had never received any formal training in management and leadership. Neither did Nick belong to a professional institute from which he could source advice and guidance on management issues.

His small business appeared to be run along informal lines with no structures and processes in place. There was no induction and no training provided. If they were lucky, new staff were shown what to do on a one-off basis. Otherwise, they were pitched in at the deep-end. There were no team meetings or 'town-hall' type sessions. There was little or no formal communication.

Although Nick was good at leading from the front, he was a poor listener and lousy at delegating, believing that no one could do the job as well as he could or in the way he wanted it done.

This completed Nick's tale of woe. The good news, remarked his friend Richard, was that most of this was fixable.

The first thing his friend recommended was undertaking some management and leadership training; training that would ultimately lead to a qualification. Not only would Nick benefit from practical application of what he would learn but if he achieved something like the Chartered Manager award this would provide him with an additional source of competitive advantage when bidding for new contracts. However, this was a medium- to longer-term solution.

The second thing Richard recommended would provide a quicker fix, and that was joining a professional institute that encompassed management and leadership. For a relatively modest annual fee (under £100) Nick would have 24/7 access to how-to guides, case studies, e-learning modules, checklists, research reports, podcasts on best practices, videos and a full range of problem-solving tools covering everything from handling staff issues to team building.

He pointed out that Nick could benefit from some one-to-one coaching to address his listening and delegation issues.

Richard also pointed out that research had shown that holding a professional qualification and being a member of a professional body held numerous benefits, citing increased earnings as his lead argument.

Quoting further research conducted for the CMI he pointed out that only a small minority of workers think of their boss as 'accessible' and 'approachable'. He suggested that empowering staff to carry out their roles to agreed objectives and KPIs was one of the keys to establishing better levels of employee engagement and to seeing a significant upturn in profitability. But more, Richard said that if his words weren't persuasive enough, Nick should take account of a report from the Work Foundation, which shows that an increased investment in workplace practices related to employee engagement actually increases profits.

By this point in the conversation Nick had begun to perk up. He could see that there were several things he could undertake himself to improve his management and

leadership of his organization that didn't rely on the hiring of consultants or a large amount of investment.

As the evening drew to a close, Richard offered to visit Nick at his office to help him thrash out an action plan to help him become a better manager and leader. Nick readily agreed and they confirmed a date.

Several days later Richard arrived at Nick's offices. There was no one in the reception area and the first person Richard encountered gruffly stated that customer orders were only taken over the phone or online. Richard explained his presence and was shown the direction of Nick's office. Not a good omen he thought to himself.

Once they were ensconced in Nick's office with coffees to hand Richard began to outline an agenda that would encompass not only Nick's ability to manage and lead more effectively but sharpen up general practice across the business, particularly in the area of customer service.

Richard asked how many permanent staff now worked for Nick and whether he could identify those with the talent to supervise and manage staff and develop the business according to Nick's overall vision and objectives. Nick responded that he had never articulated a vision, mission or set of overarching goals or objectives. Step one, then, was to get this done and share and discuss them with all staff through a forum or meeting.

This would be the first lesson in beginning to build a unified team that interacted positively and cooperated with each other resulting in good working relationships. Richard suggested this was followed by a session on strategies. Nick should share and discuss with his team the actions he thought should be implemented to drive the business forward. He should also seek views from his team on where they thought the business could be improved and constructively listen and respond to their responses.

Richard pointed out that team building is an ideal way to deal with the challenges that face any business. It can provide organizations with the tools and strategies to get them back on track. Team building didn't have to take the form of expensive 'away days' or excursions, it could be something as simple as a team meeting with an element of fun, possibly holding the meeting over lunch or celebrating successes.

He continued by saying that managers like Nick needed to remember that teams are much more than just a group of people who happen to work together. Teams are groups of people all working towards the same common goals and objectives and they are more likely to be successful if they have a mix of different skills, expertise and knowledge. For example, how successful would Manchester United be if all eleven players were centre backs?

Richard then turned to the predominant management style that was exhibited by Nick within his organization. He referred to recent research carried out by CMI into managers' quality of working life, which found that the top three management styles prevalent in the UK (bureaucratic, reactive and authoritarian) have a negative impact on motivation, health and productivity and a detrimental effect on any team-building efforts. For example, these particular management styles can lead to managers dominating the work of teams, or exercising excessive control, which can stifle creativity. The research found that such styles are associated with stalled or declining businesses. Nick winced as this sounded familiar.

On the flip side, remarked Richard, organizations that have an accessible and empowering style are more likely to have a culture that enables successful team working. Nick admitted that his management style was probably fairly authoritarian and that he would need to alter his approach to how he dealt with staff and the issues they faced. Richard suggested undertaking a light-hearted management-style quiz that could be found at **www.comparethemanager.com**. Nick could use this as a springboard to read about different management styles and what could be done to offset the behaviours that accompanied a more authoritarian style of management.

Richard completed the session by outlining the common traits, behaviours and actions that characterized a number of chief executives who had taken their companies from being merely good to great and sustained this over more than 15 years. These companies had outperformed the market and their peer group of competitors by every common measure including market capitalization, turnover, profit, customer satisfaction, employee engagement and advocacy. Richard supplied the name of the management guru who had undertaken the work in this field and begun to establish a type of leadership index against which other business leaders could measure themselves and their companies.

The common traits, behaviours and actions included what *not to do* and what to *stop* doing as well as what to *do*; getting the right people 'on the bus', the wrong people 'off the bus' and most importantly the right people in the right seats; being the best at your core business. If you cannot be the best, establish what you can be the best at, otherwise mediocrity will be the norm; establish a culture of discipline. With disciplined people, disciplined thought and disciplined action hierarchy, bureaucracy and excessive controls are not needed. Additionally, understand how to carefully select and apply modern technologies.

So here endeth the lesson Richard stated. Nick's mind was working overtime as he thanked his friend; keen to begin his journey to establishing better management and leadership within his organization.

- Managers are the biggest occupational group in the country, and growing, as over 800,000 new management jobs will be created by 2017 according to figures from UKCES.
- Independent analysis of Labour Market Force Data shows that by holding a professional qualification and membership of a professional body, individuals can earn an additional £152,000 over their career.
- CMI research data from April 2010 shows that 10 per cent of workers described their bosses as accessible and just 7 per cent thought senior staff were empowering.

The Chartered Management Institute is the only chartered professional body dedicated to managers and leaders and the organizations they work in. Our

tailor-made training programmes and qualifications are designed to meet the needs of today's management professionals and to support employers in developing and delivering management and leadership excellence across their organizations. We provide up-to-the-minute research on the hottest management issues, the most relevant information and guidance through our online management centre, and consultancy services and guidance for managers at every level and across every type of organization.

As chief executive of the Chartered Management Institute, Ruth Spellman OBE leads the drive to encourage individuals, businesses and government to invest in the high-level skills we need to increase UK competitiveness and productivity. Prior to joining the Institute in June 2008, Ruth was the first female chief executive officer of the Institution of Mechanical Engineers, following seven successful years as chief executive of Investors in People. Prior to that she was a senior member of the consulting practice at Coopers and Lybrand, HR Director of the NSPCC and an advisor to NEDO (the National Economic Development Office). She brings a broad experience of the private, public and voluntary sectors to her new role.

Developing the next layer of management

7.2

***Jeanette Purcell**, founder and director of JP Associates, discusses how to find – and prepare – the right person to take the business forward*

At a networking event recently I was introduced to someone who had built a successful business over 10 years, selling and installing air conditioners. With a background as a heating engineer he started the business on his own, now employed two other engineers and had, over the years, enlisted the help of his wife, son and, most recently, his daughter. It was his daughter, he said, who had made him aware that the business had far more potential for growth than he realized. She had sought out new customers, weighed up the competition and persuaded her father to focus on customer service, something that, in the past, he had not considered important. 'Now,' he proudly told me, 'she is doing an Executive MBA. The business is sponsoring her and already we are reaping the benefits. I am confident that I will be able to pass the business over to her and that, under her management, we will really take off.'

The case for developing your talent

Here was someone who recognized the potential for his business to grow but understood that he was probably not the person to help the company develop. Luckily for him, his daughter quite obviously demonstrated the skills and talent required and he did the right thing by encouraging her further development. For other small businesses (often family owned) it is not so easy to identify the next layer of management. Many face the challenge of finding the people in their team who are going to move the company beyond its small beginnings to the next growth phase. And that's not the only problem – having identified the need to develop its people, how does a small business, preoccupied with short-term survival in a period of recession, justify the time and the money required to invest in training? It's an important question. However, the owner-manager of the air conditioning business reflects an increasing awareness that investment in the long term is crucial even, or

perhaps especially, when times are hard. And investment in MBA training continues to be the most popular option for potential business leaders.

MBAs are versatile

Ten years ago the MBA might have been considered a qualification that was designed primarily for city high-fliers, was offered at a few prestigious business schools at a high price and only on a full-time basis. The situation has changed dramatically in recent years. The MBA market is strong and vibrant, despite the recession, and courses are available in thousands of good business schools in a range of formats. The beauty of an MBA is its versatility. It is essentially a general management degree, giving you good all-round business skills and preparing you for business leadership in any industry from manufacturing to consultancy. All MBAs offer the opportunity for students to specialize in their chosen field or area of interest, either through a range of electives that accompany the 'core' modules, or through a specialist MBA that focuses on a particular industry (there is even a very popular 'Wine MBA' delivered by the BEM Bordeaux School of Management!).

Leadership can be learnt

There are some who argue that only experience can make a good manager, claiming that you can't teach leadership. Certainly, experience is important and business schools with accredited MBA programmes will insist on at least three years' relevant experience before enrolment onto the course. The intention is to build on and enhance what you already know and can do and to provide opportunities for you to share and exchange experiences with others on the course. If you come onto an MBA programme without experience you will struggle to keep up. But experience alone is not enough – it is inevitably specific to your own background, area of business and restricted to the particular challenges and projects you have managed. The real value of an MBA is its ability to enhance and develop 'real life' experience while at the same time adding new knowledge (the business theory if you like) and new, practical business skills. All of this in a stimulating, learning environment with a high level of academic and practitioner support. This combination of experience, knowledge and skills is extremely powerful and is, arguably, the richest and most effective form of learning.

Research the options

Anyone considering enrolling on an MBA course should spend time considering what they want to get out of it, what type of course would suit them and how much time and money they are prepared to spend. If you are clear about these things and you research the options thoroughly, you have a better chance of choosing the right programme for you and therefore of getting the most out of the experience. There are

so many choices available that good planning and research before enrolment are essential. Not all MBA programmes are the same and business schools differ in their approach, their specializations and the fees they charge. Don't make the mistake of simply going for the most highly ranked business school or even of choosing the cheapest course you can find. Choose according to your needs. It's a good idea to consider only MBA programmes that are accredited by the Association of MBAs (AMBA) – accreditation provides an assurance of quality and, with over 45 accredited programmes in the UK, still offers a diverse range of courses.

Part-time study

What will I get out of studying an MBA? The answer depends on a number of factors including the type of programme you choose: full-time, part-time, distance learning or any number of flexible study formats that are widely available. The part-time and distance learning courses are particularly attractive to those who need to continue working and want to spread the cost and time involved over a longer period. These courses involve a lot of hard work and commitment – it's not easy to start studying after working a full day and some of the tuition will often take place at the weekends. The advantage of a part-time course though is that it allows students to apply their new knowledge and skills in their workplace as they go along. In this way, both the student *and* their employer get a more immediate payback from their investment in the course.

MBA content

MBA programmes include a range of subject areas and all will cover the basic business functions such as finance, marketing, operations and human resources. However, in response to changes in business practice and the global business environment, many business schools offer programmes that are far more international in content and delivery. It is not unusual, for example, for an MBA programme these days to involve international exchanges or to require the study of a second language. In addition, rather than focusing solely on the 'hard' stuff of business, MBA courses are increasingly focusing on the development of so-called 'soft' skills such as communication, team building, networking etc. This change of emphasis reflects the growing demand from employers for senior managers who can manage teams, work constructively with others and communicate effectively. It is interesting that what many MBA graduates remember as a key benefit of their training, is the opportunity they had to learn from and work alongside a highly talented, experienced and diverse group of fellow MBA students. A typical MBA course can include over 20 different nationalities from a range of cultures and backgrounds, which makes for a challenging and dynamic learning environment. The networks formed among MBA students during study are highly valuable and continue to add value long after graduation day.

Financial support

MBA courses are not cheap and sadly the number of employers offering sponsorship to their staff for study has declined recently. Although many small businesses recognize the long-term benefits of funding staff development, others are reluctant to provide any finance. However, if money is an issue, it is worth considering some of the other ways in which employers can provide support for MBA study and protect their investment in the qualification. Time off for study or money for books are less costly alternatives and demonstrate a willingness to help. Employers can also specify that the MBA business project (a compulsory part of the course) is based on a particular issue or topic relevant to the company. In addition, employers paying tuition fees can also insist on a written contract that requires their employee to remain with the company for, say, two years after graduating. These sorts of arrangement are not unusual given the sums involved.

When money is tight, customers are scarce and competition is fierce it's all too easy to forget about the long term, neglect your people and avoid the question of succession planning. Enlightened businesses keep an eye on the long term and have discovered that the MBA opens up the possibilities for developing talent and for securing their company's future.

Choosing a business school

- clearly specify your objectives, budget and preferred way of learning;
- seek out the business schools and programmes that meet your objectives;
- use all resources for information: websites, accreditation bodies, rankings, MBA fairs;
- visit your shortlisted business schools, you can even sit in on a lecture;
- ask business schools about funding options.

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The leadership process

7.3

Without leadership, growth will falter. ***David Pardey****, head of research and policy at the Institute of Leadership and Management, discusses the skills and characteristics that enterprises will have to find within themselves*

The demands of growing a company, especially in the current economic climate, mean that the day-to-day emphasis is inevitably on securing deals, driving revenue and maintaining competitive edge. Growth, however, will be short-lived if a business doesn't have the necessary leadership processes in place to ensure it is sustainable or a proper succession planning strategy to provide a pipeline of talent for the longer term.

Many small businesses are particularly susceptible to this neglect, with the busy owner/manager or entrepreneur at the top often firefighting their way through the day rather than setting time aside to focus on the medium- and long-term. Compounding the problem is that they are often the kind of people who find it hard to delegate because they have grown used to being in total control. Emerging from recovery after a recession can be a particularly hazardous time from this point of view. It is in an entrepreneur's nature to seize all new market opportunities that are out there. In doing so, however, they can often over-stretch the company and themselves or make rash decisions that adversely impact elsewhere on the business.

Small business owners must learn how to be effective leaders if they are to elevate the operation of their companies on to a more professional basis. Moreover, they must also learn how to recognize and develop the leadership potential in those individuals around them. This isn't just because one day they will have to hand the reins of the company over, but because businesses need good leadership at all levels.

A survey carried out by the Institute of Leadership and Management may provide small-business owners with insight if not a yardstick for assessing their own abilities as leaders as well as identifying leadership potential in others. The report, *Creating Future Leaders*, which surveyed senior HR professionals, found that future leaders must possess a distinct set of personal characteristics, principally embedded in the relationship and inter-personal domain. More than one third (36 per cent) said leaders must be able to motivate and inspire others, while a third (34 per cent) believed they must have high levels of emotional intelligence and the ability to deal with people. Other important characteristics were natural leadership (24 per cent),

followed by trustworthiness, being a natural communicator, possessing vision and being driven and ambitious (all on 22 per cent).

Combined with these characteristics, more than half (56 per cent) believe leaders should also have technical and professional skills in particular areas of practice, such as law, accounting or engineering, and a deep understanding of broader business issues and commercial acumen (54 per cent). Perhaps surprisingly, problem-solving and being entrepreneurial, intellectual or insightful ranked relatively lowly with only 4 per cent and 6 per cent, respectively, citing them.

Much is expected of leaders today and the debate over whether leaders are born or made continues. Many entrepreneurs are naturally inspirational people because they have typically built their businesses from scratch through their own inventiveness and sheer hard work, so in theory they should have a head start over leaders at bigger organizations. They must, however, demonstrate this side to their people, as well as their ability to be a real team player. There can be a tendency for small-business owners to go off in their own direction and not be concerned about who is following them. They must be self-aware and understand the impact their behaviour is having on the workforce or a particular team. So although leaders can be born, most are made and by focusing on certain areas all small-business owners can start to embed leadership processes into the organization that will help to build solid foundations for growth and a sustained model for the future.

Learning to trust others and earning the trust of employees is central to effective leadership. With trust in place, employers are more likely to feel comfortable delegating and empowering people and sharing tasks and responsibilities. It also means they have more scope to assess the performance of their people and identify where the talent lies. From the employee's viewpoint, if they believe there is mutual trust they are more likely to follow the leader, possess a desire to perform, as well as be prepared to go the extra mile for the business. Without doubt trust plays a major part in releasing an employee's discretionary effort and, at a time when workforces are reduced, this is key.

The ILM's Trust Index identifies six factors that are key to rating trust: ability, understanding, fairness, openness, integrity and consistency. All are traits also associated with good leadership. Developing an open and honest style of leadership is essential to building trust and it is vital for employers to deliver on any promises they make. When trust breaks down, it is usually because one side fails to do what they said they would. So the more consistent and authentic a leader is in their behaviour, the more effective they'll be at building trust.

Recent years has put the importance of a high level of emotional intelligence on the map as far as effective leadership is concerned and ILM's report on future leaders showed that a third of those surveyed see it as essential. Those leaders with a high emotional intelligence quotient are more able to empathize and see another person's point of view. This means they are also far more likely to be able to find out what motivates people, communicate with them and therefore get the best out of them. The pressure of the day-to-day toil can mean that small business owners don't spend sufficient time understanding their people and what matters to them. Scheduling-in regular face-to-face meetings will help but it is also important to tune into them as people on a day-to-day basis.

Although many entrepreneurs are gifted when it comes to spotting an opportunity in the market, they are not as strategic or visionary as they should be. They need to be able to take a step back and see the business in a broader context and anticipate the challenges it might face further down the line. Being able to predict and adapt to change and changing market conditions is essential in an uncertain economic climate. It is also important to involve your people in the vision so they understand the part they will play in it today and in the future. Ensuring the business has their buy-in and understanding of the vision is a key strand in your succession planning strategy. It makes employees feel they have a future in the company and that they are instrumental to its growth.

Investing in their own personal development is not generally seen as a priority by the small-business owner, whether it be because they don't feel they have the time or because they have learnt their skills on the job. Owner/managers can be the least qualified people within their company even though they place importance on qualifications when recruiting people. No matter how successful in business, however, there has to be an openness to learn. A willingness to take on board new ideas and new ways of thinking is key to innovation, the lifeblood of any organization. Investing in learning and development is also important for developing the future leaders and employers must accept responsibility for this. Training no longer has to be something that takes the individual out of the business for several days. The emergence of more bite-sized and on-demand online learning modules mean it is more accessible and relevant than it has ever been.

HR professionals surveyed in ILM's *Creating Future Leaders* report identified a need in the modern business world for a more bespoke style of training potential leaders. The report says the training needs of senior managers often reflect the current state of the organization. So if the company is involved in major transformation, the emphasis will be on change management training. People management skills were still held up as a prime target for training and development efforts and should never be underestimated when it comes to embedding leadership processes within the company. There was a general recognition of the value of practical, on-the-job training which ensured that the development was embedded directly in the business. Clearly this approach will be favoured by small businesses, who need to maximize the benefit of any money spent on training.

Whether heading up a major blue chip company or at the helm of a small business, no one can pretend that the leadership challenges aren't significant. More than ever, leaders need to maximize the opportunities today as well as keep the long-term vision in view and the latter is likely to be a changing picture in the current operating environment. They can only do this if they give themselves the time, opportunity and space to do so and ensure that behind them is a succession of talent that can support and grow the business alongside them.

The Institute of Leadership & Management (ILM) is Europe's leading management organization. We believe that good leadership and management holds the key to organizational effectiveness and social and economic prosperity.

Our fast-growing community of over 30,000 practising leaders and managers gives us a real insight into the issues affecting the management community day-to-day, both in the UK and globally.

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The Institute of Leadership and Management (ILM) website is at: **www.i-l-m.com**.

Ethics and the growing company

7.4

As you grow, you are going to face a series of ethical dilemmas. Your company's survival ultimately depends on how you handle them, according to a report from Victor Smart at CIMA:

> *Ethics are pivotal in determining the success or failure of an organisation. They affect a company's reputation and help to define a business model that will thrive often in adversity.*
>
> **CHARTERED INSTITUTE OF MANAGEMENT ACCOUNTANTS, INCORPORATING ETHICS INTO STRATEGY, 2010**

Are ethics relevant to business growth?

In 1970, the economist Milton Friedman famously argued that in a free society, 'there is one and only one social responsibility of business… to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.'

But many would now agree that even were this true then, things have changed. Since these words were written, the 'rules of the game' in free societies have altered to such an extent that, today, companies that do not embrace a much broader practice of corporate ethics and social responsibility, through sustainable growth and profitability, are unlikely to survive.

Why are ethics relevant?

So why should growing companies concern themselves with ethics, or corporate social responsibility, as it has become more recently known? What's in it for them? This chapter will consider:

- the impact of ethics on business success and failure;
- how corporate ethics impacts on companies and those who interact with them;
- why ethics has never been more important to corporate survival than today; and
- why ethics and profitability are becoming inextricably linked.

Of the 28 companies that fell out of the world-leading Standard & Poors index in the past 10 years, comparatively few casualties were claimed by shifts in technologies and markets. More were victims of massive fraud (as with Enron and WorldCom) or had leaders who'd failed to create a sustainable business model. This was evident most graphically in the financial services industry, with the likes of Lehman Brothers, Bear Stearns and Wachovia choosing huge short-term gains at the cost of their long-term survival. Similarly, the UK electronics company Marconi was brought down by its unsustainable plan for its business. In other words, somewhere in the companies' business models, there was almost certainly a failure to behave in an ethical or sustainable way.

What are business ethics?

One problem for businesses is that, although some ethical issues are straightforward, many are highly debatable. Are nuclear power stations bad and wind turbines good, for example? Should an armaments business quit markets where bribery is rife or simply behave better than its rivals? And terms such as 'predatory lending', 'excessive risk taking' and 'greed' are all notoriously hard to define.

How should a growing company behave?

Business ethics may be defined simply as the code of behaviour by which a company chooses to conduct its business. How does an incorporated company, which is a separate legal entity, choose how its representatives will behave? If the company is growing, the chances are that it will regularly need to make ethical business choices; for example, how will it choose its suppliers? Will it simply be on the basis of cost and convenience, or will the purchasing company consider the potential supplier's reputation and behaviour, and the potential impact of choosing this supplier on its own longer term sustainability?

Legal duties

Whether your growing business is a company or a partnership, the company's appointed directors or partners will have legal duties to the business, to its customers and to its stakeholders.

For example, company directors have a legal duty to exercise a degree of skill and care, including:

- demonstrating the skill expected of a person with the director's knowledge and experience;
- acting as a reasonable person would do in looking after their own business.

Directors must also act in good faith in the interests of the company as a whole. Directors must, for example:

- treat all shareholders equally;
- avoid conflicts of interest;
- declare any conflicts of interest.

Ethics goes beyond the law

But beyond the law a growing company will need to consider how its behaviour will be perceived, not only by its employees, but also by its customers and all those who might reasonably be likely to be affected by the company's behaviour; ie those who may have a stake in how the company conducts its business.

Of course businesses can be tempted to make short-term gains by turning a blind eye to ethics. Despite codes of practice, regulatory oversight and ever-increasing public pressure, many firms routinely ignore ethical considerations. As has been suggested, some even claim that a business simply needs to abide by the law without concerning itself with broader ethical issues. Yet such disregard can undermine the wider economy and, in time, cause irreparable damage. Lessons must be learned from the corporate collapses of the past: myopic strategies can create massively profitable entities, yet impressive initial results may turn out to be unsustainable.

Ethics and reputation

If your growing business designs clothing to sell on the high street, will you consider the possible damage to your company if one of your suppliers makes your articles of clothing using illegal child labour, or in dangerous working conditions? In today's Internet world, companies cannot effectively protect their reputations as an ethical business simply by saying that they did not know such things were taking place. Global reputations can be irrevocably damaged in minutes at the click of a mouse.

A multinational supplier of consumer goods, for example, can replace a burnt-out factory more easily than it can restore a tarnished brand. In the 1970s Ford calculated that the cost of recalling all its Pinto cars, which were prone to fuel tank fires, would probably exceed that of handling all the accident victims' claims for damages, so it initially decided not to recall the model.

For the most part, corporate culture rejects such an approach today. Dealing swiftly and openly with problems can serve to establish a firm's credibility as trustworthy brands. Toyota management has recently discovered that it is judged just as much on its handling of the recall of millions of vehicles with suspected defects as on the specific engineering problems.

So what practical questions should our company be asking?

Do we have the best possible governance structure in place?

- Do we comply with best practice?
- Do we have effective collaboration between the board and the management team, with the latter guaranteeing the most relevant management information on which to base decisions?

How does risk affect our business?

- Do we understand our model for delivering projects and all the risks we are taking?
- What are the circumstances under which we would fail?
- Are we happy with the risk mitigation?
- Do we spend enough time discussing strategic issues?
- Do we have a workable process for overseeing strategy?
- Do we get the right information?
- Do we focus on long-term sustainability?
- Do we have a healthy, ethical and thoughtful culture that encourages constructive challenge?

How can I make sure my business behaves ethically?

Ethics should be embedded in business models, organizational strategy and decision-making processes.

Senior managers and business leaders should demonstrate an ethical approach by example. This will show that middle and junior managers will be rewarded for taking an ethical stance.

Middle managers need to be given explicit and implicit authority to speak up where they believe that the welfare of the organization and its employees is being threatened. They must be converts and evangelists for the corporate mission – including the ethical dimension. The leader who understands the value of ethical principles and practices will effect real change only if their zeal can be converted into a strong culture that pervades the whole organization.

Non-executive directors should act as custodians of sustainability, with the particular duty of ensuring that their executive colleagues are building a sustainable business.

Managers must be aware of the issues, looking at ways in which an organization can benefit from an ethical approach rather than one that relies narrowly on cost cutting or compliance.

Business leaders should use the skills of the finance team to evaluate and quantify reputational and other ethical risks.

Finance professionals must play an active role as ethical champions by challenging the assumptions upon which business decisions are made. But they must do so while upholding their valued reputation for impartiality and independence.

Management accountants can help ensure that businesses are measuring performance on an appropriate timescale that will deliver sustained and sustainable success.

Finance professionals need to take social, environmental and ethical factors into account when allocating capital, so that sustainable innovation is encouraged.

All CIMA members and students are bound to uphold the global IFAC (International Federation of Accountants) ethical code, which applies to all accounting bodies and is based on principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

Investors are increasingly using environmental, social and governance criteria to inform their investment decisions.

So what's in it for the growing company?

Strong ethical policies that go beyond upholding the law can add great value to a brand, whereas a failure to do the right thing can cause social, economic and environmental damage, undermining a company's long-term reputation and prospects in the process.

Once they have adopted an ethical approach, companies will often find there are bottom-line benefits from demonstrating high ethical standards.

High-quality management information on social, environmental and ethical performance assists business strategy and is vital for monitoring the environmental and social impacts of a company and for compiling connected reports showing how effective its governance arrangements are.

Shareholders, directors and employees will benefit from increased brand value.

This chapter is based on a report by Victor Smart, Head of Profile and Communications at CIMA and Danielle Cohen.

CIMA, the Chartered Institute of Management Accountants, is the world's leading and largest professional body of management accountants, with 172,000 members and students operating at the heart of business in 168 countries. Chartered Management Accountants have broad ranging business and management skills to complement their financial training. They are able to offer strategic and practical advice; make and support key decisions; and manage risk. CIMA develops high quality professionals through a combination of skills, knowledge and the most relevant financial qualification for business – driving business success.

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PART EIGHT
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Competing and collaborating with China and India

8.1

Do not despair, look at your strategic options in engaging with emerging markets, advise ***Frances Trought*** *and* ***Irene Brew-Riverson*** *at London South Bank University*

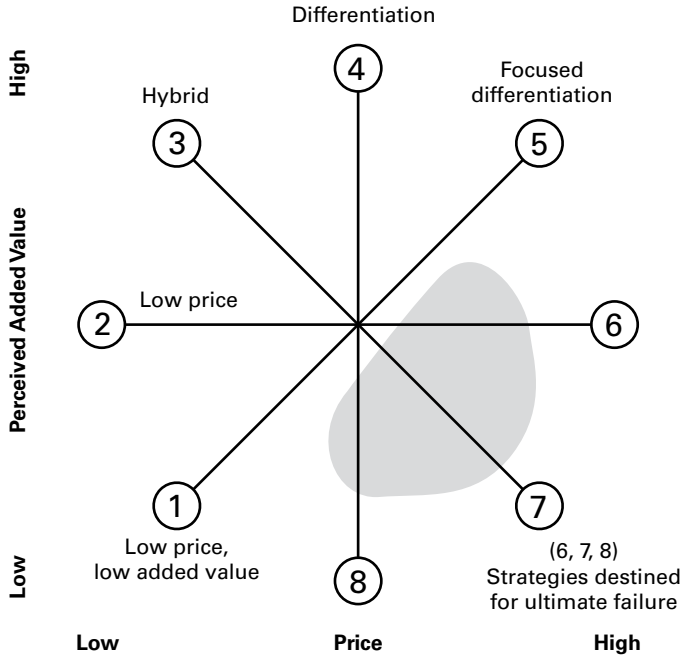
The very mention of these two countries – China and India – appears to send chills down the collective spine of small and medium-sized business enterprises (SMEs) but there could be ways of harnessing a business's strengths to not only compete but collaborate with these countries. As Sheth (2008) so succinctly puts it, while the two countries will, by 2025, contribute 39 per cent of the world's output (GDP) they will need more of every product and service imaginable. Also, it cannot be assumed that products sold by China and India will meet all the needs of target markets. Businesses need therefore to consider how they can positively benefit from this change in the world economy; often, looking for ways to collaborate with companies in these countries and the adaptation necessary (Yu, 2008) may be the best way forward.

To compete or to collaborate – that is the question

For SMEs, the threat posed by cheap imports from India and China is all too real, especially in these times of austerity. Taking a good look at some of the fundamentals is a good place to start. A generic strategy is an organization's basis for competing in a marketplace or its way of achieving competitive advantage. Clive Bowman's 'Strategy Clock' (1995, cited in Johnson *et al*, 2006), a development of the concept originally espoused by Michael Porter (1980), presents a business with eight competitive strategy options as depicted in Figure 8.1.1 on the next page.

With regards to SMEs, options one and two, which are very much based on seeking to be the lowest cost producer in the marketplace, may not be feasible unless the products sold are sourced from low-cost economies also. What may be best for

FIGURE 8.1.1 The Strategy Clock: competitive strategy options (adapted from the work of Cliff Bowman cited in Johnson, Scholes and Whittington, 2006)



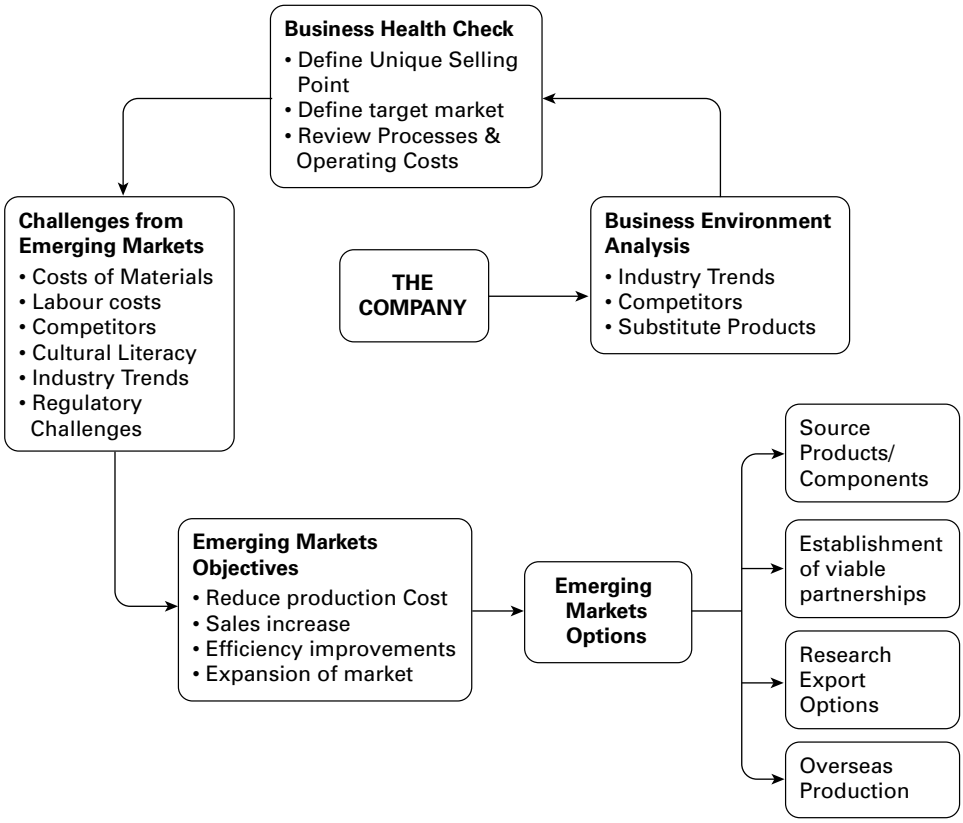
small businesses would be the adoption of option five, the focused differentiation strategy that offers clearly distinguishable added value that customers are willing to pay extra for. Without in-depth research into what customers want, it is unlikely that this generic strategy will be truly adopted. Acquiring knowledge of markets and fostering successful new product development remains crucial. It will be vital to continually ensure that the organization constantly works on the positioning of their products relative to competing products so that the customers' perception of value-for-money is suitably disposed towards the SME.

The hybrid strategy (option 3) is a more effective option when competing with emerging markets. This option clearly indicates the points of differentiation from competing products but it offers a price that is lower than that charged by similar organizations, often because of lower operating costs. The success of large companies such as Tesco and IKEA are based on this premise. A small business that is able to keep its operating costs low is best placed to follow this more competitive strategy.

The Emerging Markets Diagnostic Tool

The Emerging Markets Diagnostic Tool (Figure 8.1.2) was developed by Trought and Brew-Riverson (2010) to provide a means for SMEs to assess how to engage with the increasing challenges presented by emerging markets. The model invites SMEs to review both their current business environment and their business processes. Central to the ability to compete is an understanding of the key components of the business and the environment within which it operates. By conducting this overview the SME will be in a better position to understand which are the most relevant of challenges and set clear objectives. The tool then presents several options for the SME to consider in order to achieve their objectives.

FIGURE 8.1.2 Emerging Markets Diagnostic Tool



Asia inside – an example of collaboration utilizing the Emerging Markets Diagnostic Tool

An example of the model being applied to a business would be in the case of Femi Omowo, the owner of Scorva Watches.

Business environment

After conducting an analysis of his business environment Femi recognized that competition for luxury brands was fierce and was mainly between well-established brands such as Rolex and Tag Heuer. Sociocultural trends pointed to exclusivity being even more sought after.

Business health check

As this was a start-up, post other small ventures, Femi's business health check highlighted the need for capital to start this new venture. It also pointed to the fact that in deciding to go into watches, he could effectively position his product as a luxury brand with custom designs (USP) that expressed individuality for the young 'discerning' male. In considering the proposed manufacturing processes, he realized that this would be extremely costly.

Challenges from emerging markets

The main challenge faced by Femi was the fact that operators using Far Eastern suppliers had the advantage of low-cost materials and labour costs as well as an increase in the size of the market they could serve.

Emerging markets objective

- Identify Far Eastern partner to reduce labour and material costs within three months.
- Aim for high sales growth within the first year of trading (turnover £10,000), with 100 per cent increase by year three.

Emerging market option

As a result Femi not only identified a viable partnership in the Far East, where he could source his product at competitive rates, but also entered an exclusive contract with the supplier securing his USP. Within three years Femi's turnover has increased by 600 per cent; despite the current market trends he has remained competitive.

Seeking an Eastern partner

Schumpeter (2010) and those with a knowledge of doing business in China reiterate the crucial importance of a near reverence for the country's traditions and an unflinching devotion to an organization's core principles and values. Abandonment of either is likely to result in difficulties that may prove near insurmountable, as experienced by Google and RioTinto recently.

Although a partnership may sound an exotic solution, it should be approached with caution as naivety is not seen as a defence. You must always have something to put on the table and the patience of an elephant to ensure you do not leave a frustrated divorcee. Joint ventures have decreased in popularity; in 2001 for example, 34 per cent of new business entries were achieved via joint ventures – in 2005, this had fallen to 24 per cent (*China Business Review*, 2006 cited in Peng *et al,* 2008).

Phil Gonzalez and Supin Tapaneyasas (international business academics) reiterate the need to focus on the value proposition being made to customers and advocate the need for SMEs to foster 'cultural literacy' – an appreciation of cultural differences and quirks – if they are to succeed; the use of websites as key channels to markets, personal contact when possible and the need to take advantage of exclusivity options that present themselves (as with the case of Scorva Watches documented above). Interpersonal networks, although not as vital as in the 1990s are likely to still play a part in the success of SMEs (Peng *et al*, 2008) in both China and India.

Chindia – or still China and India?

The two countries, while often referred to in the same sentence, still differ in a variety of ways. As Todd Guild (cited in Barton, 2009) highlighted for example, China has a growing pool of affluent customers who have an affinity for foreign brands but the products developed for Western customers may not suit their taste and will need to be altered in line with preferences unique to particular target markets. The one-child policy also makes China an ageing population.

India on the other hand, enjoys the power of youth as one of the three core competences highlighted by Seshasayee (2007): the power of youth promotes risk-taking and the daring to turn the status quo on its head; the power of knowledge facilitates creativity; and thirdly, the power of enterprise that promotes the growth of a nation.

Doing business in either country will permit so much more by way of risk and possible reward – nothing ventured, nothing gained.

Conclusion – China and India, friend or foe?

The Emerging Markets Diagnostic Tool presents SMEs with the opportunity to assess their business and clearly define the challenges they face in the current market place. All too often, companies fear the unknown, but the model allows businesses to review their options in the light of the rise of the emerging markets. China and India present great opportunities for SMEs if they take the time to assess and modify their business models accordingly.

Summary of key points

- Apply the Emerging Markets Diagnostic Tool to your business in order to develop an appropriate response to the rising emerging markets.
- Do not assume Western models of ownership and control are applicable.
- Pay close attention to traditions and norms.
- A joint venture, although attractive, must be undertaken with caution.
- Resist the temptation to compromise your values – it will only enhance the suspicion with which you will be regarded.

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Advice from industry

Sabe Tibbitts – International Trade Adviser, South Asia Specialist, UK Trade and Investment
Huge markets but local competition is strong and the key to gaining the big opportunity is to look for small gains multiplied by enormous numbers. Success is in 'more for less for more' (simplifying and improving the offer to reduce cost for supply to more customers).

Annabel Fogden – Head of World Trade, London Chamber of Commerce
Make contact with organizations in the UK that can help you – Chambers of Commerce offer much practical advice and assistance. Also organizations such as UK India Business Council, China-Britain Business Council, UKTI.

Ittira Davis – Managing Director, Corporate and Institutional Banking, Europe, Arab Bank (UK)
Globalization need not be a 'win–lose' situation. It can be made into a 'win–win' situation for SME companies in Britain if they can integrate lower production costs from the emerging markets with British product design, marketing, delivery and after sales services.

Ekua Mensah – Vice President (Technology Manager), Bank of America
Clamp down on operating costs ensuring a focus on pricing and servicing.

Kwame Sarpong – Head of Retail Banking, Ghana International Bank (UK)
Companies need to consider complementing rather than competing – they may be best placed to provide innovative and highly complex inputs into products in some industries. UK companies have the advantage of access to finance, excellent technological standards, information infrastructure and better patent protection (among others).

Frances Trought, senior lecturer and consultant in enterprise at London South Bank University, has 15 years' experience, working directly with SMEs to manage, design, develop and implement marketing and strategy solutions to complex business environments. Frances provides both training and consultancy to SMEs. If you would like a business health check or to apply the Emerging Markets Diagnostic Tool to your business, contact Frances Trought at: e-mail: **troughfa@lsbu.ac.uk**; tel: 020 7815 7854. Irene Brew-Riverson, lecturer and consultant in strategy at London South Bank University, has 16 years' experience in lecturing in strategy and marketing. She currently lectures at the London South Bank University. Her primary interest is in strategic analysis and strategic choices that facilitate competitive advantage for SMEs. Irene offers training to small businesses wishing to harness the opportunities presented by emerging markets, contact Irene Brew-Riverson at: e-mail: **brewrivi@lsbu.ac.uk**.

Stepping into a new market can be challenging. Nonetheless, the Netherlands is a business location that really adds up. The close proximity to a large European market whilst remaining conveniently close to the UK, make doing business in the Netherlands straightforward and easy. Our like-minded international business culture and our multilingual workforce make your next step into Continental Europe as easy as doing the most basic sum.

The Netherlands Foreign Investment Agency facilitates foreign companies' direct investments in the Netherlands. Our services are confidential, free of charge and without obligation.

Holland.

Pioneers in international business

International expansion made easy

8.2

***Liesbeth Staps**, Executive Director of the Netherlands Foreign Investment Agency in London, gives an insight into how to make the move into a new market work*

Now that the world is slowly recovering from the large economic crisis that affected us all, business may slowly start to think about the future. With domestic markets only hesitantly picking up, you might want to put your eggs in more than one basket to support your need for growth. Having survived the economic turmoil, and with a solid basis but perhaps a bit shaken, now might be the time to strengthen this baseline with a wider geographic coverage. So when the economy really picks up, you are ready for the future.

Expanding your business across the UK border represents many challenges, as it is new ground and companies have to take a lot into account before setting out. Dealing with different cultures and legal frameworks can be challenging. Knowing your way in the maze will ease decisions and implementation.

Opportunities in Europe

Europe is the world's largest consumer and industrial market. Continental Europe offers a large market and limited risk, within relatively easy reach. Due to distance and culture, expanding your business across the channel is easier than, for example, in the US or Asia. And with the single market in the European Union there are no more duties and legal issues related to trading. Once in the eurozone, the single currency facilitates international trade between euro-countries and limits costs and risks due to currency conversion. Although the euro might offer some uncertainties, the north-western European economies are doing well and customers are looking forward to better futures. So, British companies need a stepping-stone into Europe.

Making up the equation for location

A company has to make a calculated decision on how and where to make that next step into Europe. Make a clear business plan with feasible objectives, matched by a realistic but long-term strategy. In times of austerity, be prepared to take one step at a time and have a backup plan if the scenario as envisioned does not work out that way. One has to compare all the criteria, and solid market research prepares for the foreign venture – wherever in Europe that is.

Envisaging a long-term presence makes the calculation more difficult. However, there are a few elements that you should gather the pluses and minuses of to determine the best location for your business in the long run. Obviously, these depend heavily on the nature of your business and the type of operation you aim to set up. Here are the five key considerations for choosing a location, and why; as easily lined up as counting the fingers on one hand:

1. Proximity to market.
2. Accessibility.
3. Quality of staff and labour market.
4. Business environment.
5. Tax climate.

1. Proximity to market – naturally, the location of your new venture is driven by current customers and experience; take advantage of the already established relationships and their network. They are the low-hanging fruit for company growth. Besides them needing local services and support, they can help you with jumpstarting your presence abroad. But do look ahead as well; although the currently most successful market looks the best location at first, this location might not be enough to support your growing business in a few years to come. As the geographic scope of your business expands, factors critical to your success can change considerably. One should take this into account now, so as to avoid the cost and disruption of having to move later. Do create a good flying start on the continent, but an even better stepping-stone for further European expansion.

2. Accessibility – the geographical location and infrastructure largely determines the cost and delivery times for your products. Accessibility is also important when visiting your foreign establishment from the UK or hosting clients from across Europe. Furthermore, it is indispensable for your people to serve your customers and develop your European footprint. So evaluate the following for considered locations:

- Airport connections to major European cities and your own UK office provides time-efficient and convenient sales travel.
- Transport on the ground. High-speed passenger rail services provide convenient links between European cities, including the UK's main cities and easy access to road networks provides flexibility in reaching your customers.
- An excellent IT infrastructure with access to high-speed internet is essential to guarantee effective communication within your international organization and with your customers.

3. Quality of staff and labour market – the availability and quality of your staff are crucial for succeeding in your European growth strategy. In developing the market across Europe, with many languages and cultures, local knowledge combined with international experience and preferably multilingual skills is pivotal. The latter enables serving customers throughout the continent from one base. With respect to the labour market, one should consider the labour regulations as well. Although the European Union has harmonized many regulatory frameworks, labour regulations are different in each country. The possibility of flexible contracts, like in the Netherlands, permits you to manage workloads more easily and respond faster to peak situations. Also, temporary contracts or open dismissal laws enable you to minimize risk in case of poor results.

4. Business environment – a location with an international outlook will both facilitate you as a foreign company there and also benefit your drive to get access to markets and customers beyond. For example, in the Netherlands, with its centuries-old trading history, a solid international outlook and openness to foreign investment is firmly ingrained in the Dutch culture. An international business location also hosts an extensive network of experienced world-class business partners who know how to deal with global business challenges for your company. A pro-business environment eases the successful operation of your international business. By choosing a location with relative political and economic stability, a sound banking system and consistent regulations, your company is less likely to be disrupted by factors beyond your control.

5. Tax climate – in the end, all that counts is the bottom line. Besides direct operating costs such as office rent and labour costs, the tax climate in a chosen location provides the basis for your results below the line, both for your current trade and future expansion. The corporate tax rate is only the tip of the iceberg. Look at the competitiveness of fiscal regimes for internationally operating companies, tax deductions, VAT and labour taxes; differences are well worth exploring. Furthermore, different regulations and accounting rules can make your fiscal operation quite difficult. Countries have implemented measures to ease this for foreign companies. For example, you are allowed to have a different financial year, for instance its British parent's 5 April tax year, and annual reports may also be filed in British pounds instead of the local currency. Concluding a fiscal climate offering cost effectiveness equals a healthy business case.

A helping hand

Setting up in a new country can be tough, costly and time-consuming and your company's success is at stake. It pays to have high-quality service and support. There are many advisors out there, and often even at low costs.

Inward investment agencies, such as the Netherlands Foreign Investment Agency, provide you with information, advice and practical assistance. From the early stages of considering a foreign establishment, through the decision on a country and a specific location, they can provide you with the data for your business plan, introduce you to their network and find available property. They often employ skilled business

professionals who have assisted many companies before yours and leverage that experience to your benefit facilitating your international expansion strategy. They know how to do business and to address the right people to facilitate your smooth landing.

And for all the necessary internal arrangements, do not forget your own lawyer and accountant; they know the consequences for your company of an international operation and might have already established relationships with their counterparts abroad to facilitate the set-up. Likewise your bank can advise you on international banking and the financial resources.

Just across the Channel is one of the most important trade and investment partners of the UK: the Netherlands. With its long history of international trade, the Dutch business environment and workforce have adapted perfectly to host foreign businesses. The country offers an ideal base for British and foreign companies who want to grow internationally across continental Europe. Despite being a relatively small country, the Netherlands is an important player for the world's economy. The Netherlands provides a gateway to Europe, helping foreign companies succeed throughout the continent. The location in the midst of the important north-western European market, superb accessibility through main ports and hinterland connections by road and rail, a highly skilled multilingual and flexible workforce, an international pro-business environment, and a competitive tax climate sums up the equation for the Netherlands.

For further details, contact: Liesbeth Staps, Executive Director UK & Ireland, Netherlands Foreign Investment Agency, 38 Hyde Park Gate, London SW7 5DP; e-mail: **liesbeth@nfia.co.uk**; tel: +44 20 7225 1074; website: **www.nfia.co.uk**.

The export challenge

8.3

As a growth enterprise, you will want to start winning work away from home, but you have to be ready for the complications of making and fulfilling international sales, says ***Jim Sherlock***

A British Prime Minister, Harold MacMillan, once said 'exporting is fun', which proves he had never actually done any. There are many words beginning with 'F' that might describe exporting but 'fun' would not be the most obvious. 'Frustrating' would certainly be in there somewhere, so would 'frightening'. But talk to experienced exporters and you will also hear words like 'fascinating' and 'fulfilling'. Yes, it's 'complicated', 'confusing', 'unpredictable' even 'infuriating', but also 'absorbing', 'exciting', and most importantly, 'rewarding'.

The fact is that exporting provides a huge diversity of functions and environments, which balances the good with the bad and makes it an incredibly worthwhile experience for all those involved.

Also, in the last two years the pound value has consistently fallen against the dollar and euro, which means UK exporters are increasingly cost competitive in world markets. However, the unfortunate fact is that many companies entering into export trade are not properly prepared and will only ever experience the bad side.

If we are to get to the rewarding parts, both in a personal as well as a commercial sense, then we have to accept that there is an enormous range of pitfalls for the unwary and our job is to prepare ourselves and our companies so that we enter overseas markets in full knowledge of what to expect – and ready to handle it.

First, we have to accept that overseas markets will inevitably be different from our home market, and it is not just that they speak a foreign language. Good research can reveal a myriad of political, legal, economic, technological, social and cultural differences. These have to be considered when we are deciding what we are going to sell and how we will sell it.

Then, when we are successful in getting the enquiries, we are faced with the complex and detailed procedures concerned with converting them into firm orders, getting the goods or services delivered and, most importantly, getting paid.

So what sort of questions would an exporter have to answer before entering an overseas market?

- Do I have the commitment of the whole company to a long-term development of overseas markets?

- Do I have the administrative and financial resources to conduct an efficient operation?
- Do the current staff have the expertise to market our goods and services successfully overseas and collect payment?
- Can I find appropriate support from my bank, government services and freight forwarders?
- Which markets offer me the greatest potential at the minimum risk?
- What modifications will be needed to make my product/service saleable there?
- What price is the buyer prepared to pay and on what basis, (ex-works or delivered)?
- Do I need an agent or a distributor and if so, how do I find one?
- How do I promote my products effectively?
- Are there any Customs barriers that I need to consider?
- How do I cover the risks of theft and damage to my goods in transit?
- How do I make sure that I get my money?

The answers are not always so obvious and will be different from one market to another. However, good research and the use of the many sources of information and advice available both in the UK and overseas will provide many answers.

Specifically, you should first contact your Local Business Link – **www.businesslink.gov.uk/internationaltrade** – and talk to an International Trade Advisor (ITA) who can offer help in almost every aspect of your export planning and direct you to other sources of help and information. Foremost in providing that help is the employer of the ITAs, UK Trade & Investment, who are the export trade development section of BIS (previously BERR, which was previously DTI). They have an excellent website – **www.ukti.gov.uk/export.html** – full of vital information and links to your local ITAs and other useful sites.

It may be that as new exporters you are eligible to participate in the 'Your Passport to Export Success' programme which offers hands-on help, essential staff training and subsidized overseas visits.

Register for free on the UKTI website and gain access to a wide range of information and support. In particular go to 'Our Services'–'Preparing to Trade' and try the 'Are you ready to export?' online questionnaire covering all of the questions above and many more. The short time it takes you to complete the questionnaire will be time well spent when you print out the subsequent report that is generated from your responses. It will also allow you to make a direct contact with your local Business Link and an ITA who can follow up the preliminary report.

It is often the case that such a report will highlight the need for specialized training for new exporters in export marketing and the technical processes involved in distribution and payment. A number of organizations offer relevant short courses, notably the Institute of Export who offer a comprehensive Short Course Training Programme (details on **www.export.org.uk**).

Other websites that offer essential support are:

Market Access Database: **www.madb.europa.eu/mkaccdb2/indexPubli.htm**
Providing detailed and product specific information on the import requirements and barriers for all non EU countries.

HM Revenue & Customs: **www.hmrc.gov.uk/**
The Customs site provides a huge range of information regarding export and import procedures, mostly written in plain English.

And all for free.

There is a lot of information and help out there. Just make sure that you are not sharing the fate of the exporter who lost money because:

- Their bone china dinner services specially designed for the Italian market failed to sell at all because they lacked a pickle bowl.
- The Libyan flags in the left paws of the promotional teddy bears were seen as an insult to the flag and were destroyed. (In most Muslim countries the left hand is for toilet purposes only!)
- The sole distributor they appointed was actually already contracted to sell a direct competitor's products – which they continued to do with great success.
- The 'before and after' photographs that had worked so well for the sale of depilatory creams in English-speaking countries did not work so well when translated into Arabic, which reads from right to left. They forgot to reverse the pictures!

And how about the loss of £155,000 worth of goods because a comma instead of a full stop on an invoice presented against a letter of credit meant the bank rejected the documents. The buyer, quite legitimately, refused to pay and, because the exporter did nothing, the original buyer then picked them up at the auction in the port of destination some 10 weeks later at a quarter of the original price.

All could have been avoided with some basic research and good advice.

Finally, and with particular reference to the current UK domestic credit crunch, the value of pound sterling and, perhaps more importantly, an ongoing global recession, current economic research consistently shows companies who export to any country, in any financial climate, perform better than those who don't.

They say that companies that export:

- **Improve** their productivity.
- **Achieve** levels of growth not possible domestically.
- **Increase** the resilience of their revenues and profits.
- **Achieve** economies of scale not possible domestically.
- **Increase** the commercial lifespan of their products and services.
- **Increase** the returns on their investment in R&D.
- **Improve** their financial performance.

In other words, professional exporting is just about the best way to survive the recession.

Jim Sherlock FlEx (Hon), Cert. Ed: Following management experience in the UK export manufacturing sector, 20 years as senior lecturer in international trade at Central Manchester College and 10 years as director, educational projects of the UK Institute of Export; Jim is now a full-time writer, trainer and consultant in international trade.

Co-author of *International Trade* (Kogan Page, 3rd edition due January 2011) and author of *Principles of International Physical Distribution* (Blackwells) he is also currently the senior tutor for the online qualification, Certified International Trade Advisor (see **www.citaworld.co.uk**). Contact: **jim.sherlock@citaworld.com.**

PART NINE
Structures for growth

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Partnerships and collaborations

9.1

Partnerships and collaborations are becoming an increasingly popular way to grow. ***Rebecca Gardner*** *at Goodman Derrick discusses how to make sure that they work best for your business*

Whether you've got an idea for a new business venture or you're a well-established sole practitioner looking to expand your business, a partnership or collaboration could be the perfect solution.

What structure you decide to adopt will depend largely on the nature of the business involved and who the relevant parties are but it also pays to think about other factors, such as:

- the level of involvement of each party in the management of the new business;
- the level of potential liability for the debts of the new business;
- the tax consequences of your choice of business structure; and
- the administrative and financial burden of running the business.

Below we look at a number of hypothetical scenarios and consider the most suitable partnership or collaborative structure to suit each one. Clearly, in practice the most appropriate structure will depend on the specific facts and circumstances surrounding the new venture, but we have endeavoured to cover the most common options.

Scenario 1

Mr A is a vet who has been operating as a sole practitioner for a number of years. Another vet, Ms B has recently moved to the area. A and B have decided to set up a practice together with Ms B investing new capital to fund a move to improved premises and the purchase of new equipment.

Preferred option: Partnership or Limited Liability Partnership

Partnerships are founded on the basis of the talents and expertise of individuals. The partners are responsible for generating income and managing the business and as a result are entitled to take home a proportion of the profit.

Here, we have two veterinary professionals. Both could continue to operate as sole practitioners, but each recognizes the benefits of working together. For A, setting up a partnership with B will allow him to move to new premises and purchase new equipment, while reducing his share of the overhead costs of running the surgery and allowing him to expand his current client base. For B, while also benefiting from the halved administrative and overhead costs, as a new resident in the area, she will benefit from A's established practice.

Traditionally, under partnership arrangements, each partner was potentially liable for all and any debts of the partnership. Liability was unlimited. The Limited Liability Partnerships Act 2000 introduced the possibility of forming a partnership where liability is limited to the level of investment of each member. This has proven to be a popular alternative as members still receive the tax benefit of being self-employed, but the risk of unlimited liability has been removed. While LLPs are subject to more cumbersome registration and accounting requirements, the benefits of limited liability status outweigh this burden.

Things to consider: unlimited partnerships

- The partnership does not exist as a separate legal entity. All property owned by the partnership must be owned by one or more of the partners on trust for the partnership.
- Each partner must make annual self-assessment tax returns to HMRC. The partnership must also prepare returns and keep a record of all business income and expenses.
- Partners provide the initial capital for the business from personal assets or borrowing. They are each entitled to a share of the annual profits of the partnership.
- Partners are jointly liable for losses of the partnership. In the event of insolvency, a creditor can pursue any of the partners for the full debt owed.

It is essential to have a formal Partnership Agreement as this will govern how the partnership will be run, what the role and responsibilities of each partner will be and, most importantly, what will happen if the partners fall out or wish to terminate the relationship.

Things to consider: LLPs

- An LLP is a distinct legal entity – it can hold property and assets in its own right. LLPs must be registered at Companies House.
- The liability of each member of an LLP is limited to the amount of money that they have invested. However, where an LLP is seeking to secure external finance and it does not have sufficient assets to provide adequate security, members are often asked to give personal guarantees which extend their personal liability.

- Any profit of an LLP is split among the members proportionately unless the LLP Agreement states otherwise.
- Each member is treated as self-employed and must make annual self-assessment tax returns to HMRC. The LLP must also prepare and file annual accounts (in a similar format to those for limited companies) at Companies House.

Again, it is essential to have an LLP Agreement drawn up at the outset to govern how the LLP will be run and how any profits will be divided. It is also important to set out in detail what will happen if a member decides to leave the LLP.

Scenario 2

Concrete Castles Limited is a property developer that has recently come across an area of land that they believe would be perfect for residential development. Dollar Investments Limited is a small investment company that is always looking for new opportunities.

Preferred option: Special Purpose Private Limited Company

Private limited companies are most commonly used for joint ventures where one or more of the parties involved already have an established business. It is often the case that each party is bringing a different area of expertise to the new venture.

In Scenario 2 we have two established companies: CC has the knowledge and experience to put the development scheme into practice while DI provides the funding. By setting up a special purpose limited company, both parties can play their separate roles while still receiving a share of the rewards. The administrative burden of running a company, which can act as a deterrent for individuals, should not have the same effect here as both parties are familiar with the requirements.

By using a private limited company, CC and DI are also able to protect their existing businesses. Should the new venture fail, neither shareholder will be liable for the debts of the failed business.

Things to consider: Special purpose private limited company

- A limited company is a separate legal entity. The company's finances exist entirely separately from those of the shareholders.
- Companies must be registered at Companies House. They must also have at least one director that is a real person (ie not a corporate entity).
- The director or directors are responsible for the day-to-day management of the business, not the shareholders.
- Working capital is provided by shareholder investments, loans taken out by the company (usually secured against its assets) and retained profits.

- Accounts must be prepared each year in accordance with the Companies Act 2006. The level of detail and whether there is a requirement for them to be audited will depend on the size and turnover of the company.
- Profits are usually distributed to shareholders in the form of dividends but the company can retain some of the profits as working capital.
- A company is liable to pay corporation tax on its profits and shareholders are liable to pay income tax on dividends.

Special purpose companies will require bespoke Articles of Association and a detailed Shareholders' Agreement. These documents will deal with issues such as the issue and transfer of shares, the rights and obligations of each shareholder and what will happen if one party decides that it no longer wishes to participate in the joint venture. Also, where a company is owned 50:50, deadlock provisions are advisable to avoid stalemate situations should the parties not be able to agree on a particular issue.

Scenario 3

Emma runs a small dry cleaning service. Recently her business has been struggling because a number of rival businesses have been set up in the local area. Fresh & Clean Limited is a national chain of dry cleaners that have been looking to expand their presence in the region.

Preferred option: Franchise Arrangement

Fresh & Clean have an established business with a good reputation and a well-known brand. By franchising their business model, F&C increases its reputation and profitability by opening more branches, without assuming any of the risk of setting up a new business.

As franchisee, Emma will be licensed to use F&C's intellectual property and their format and will benefit from F&C's goodwill and reputation. She will also have a stronger bargaining position with suppliers.

Things to consider: Franchise arrangement

- An excellent way to take advantage of an already successful business model.
- A franchisee can operate their franchise as a sole trader, a partnership or a limited company depending on the size and nature of the business involved.
- A franchisee must pay a percentage of its profits to the franchisor each year before any benefit goes to shareholders or partners.

It will always be necessary to have a Franchise Agreement. It will dictate exactly what rights are being licensed to the franchisee and will ensure that the integrity and reputation of the brand are protected. It will also set out what percentage of profits will be paid by the franchisee to the franchisor. Again, exit and termination provisions

will be important and should be understood fully by both parties before a formal agreement is signed.

Partnerships and collaborations are becoming an increasingly popular way for businesses to grow and expand. During times of economic uncertainty it can be advantageous to join forces with a similar-minded business to ride out the difficult times and in times of recovery, new business ventures can flourish.

Whatever your situation, it is advisable to seek both legal and financial advice early in the process. Goodman Derrick LLP has the expertise to provide you with advice and guidance on all available business structures and in turn could help you to make the most out of your business. Please note, this chapter is for general information and interest only and should not be relied upon as giving specific legal advice.

Rebecca Gardner is an assistant solicitor in corporate department at Goodman Derrick LLP in London. Goodman Derrick is a dynamic law firm with a broadly based commercial practice, representing both UK and international clients. The firm has developed an acknowledged expertise in the areas of media law, corporate and commercial law, litigation, property, employment and private client. Rebecca can be contacted by telephone: 0207 404 0606; or by e-mail: **rgardner@gdlaw.co.uk**. For further information about the firm, please visit their website: **www.gdlaw.co.uk**.

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Acquisitions that work

9.2

Strategic acquisitions can be an unbeatable route to growth, says ***Dr Mike Sweeting*** *at Acquisitions International, but there are five main ways in which they can go wrong*

Every time acquisition is discussed around a boardroom table a few simple issues jump out and bite straight away. These issues all have something to do with a lack of clarity as to what an acquisition can really deliver. Here are the issues, followed by some remedies! I have encountered them from both buying and selling perspectives.

Issue 1

Today there are around 40,000 businesses for sale in the UK. In 12 months' time most will remain unbought. Meanwhile, during the same time period, 60 per cent of acquirers will not have found a business to buy! This points to the incredible lack of overlap between what people want to buy and what people have to sell. Unless you wish to buy a printer or a sub-contract engineer, you are unlikely to find for sale already a business that will deliver you any real growth at all.

Solution 1

Look at the firms that fit best, not the ones that are being touted to you. Of course, most will not be 'for sale'. That need be no hindrance. In our own work we habitually approach shareholders of companies just getting on with life being modestly successful. When the dust has settled, 82 per cent will have spoken to us. Those who sell have been paid on average 10 per cent less than the going rate on a trade sale. The received wisdom that approaching companies results in higher prices is a fallacy – if the approach has been done the right way.

Issue 2

Even synergistic purchases do not necessarily produce growth. A new client told me recently that their company was the offspring of a corporate reshuffle. Their £20 million turnover firm bought a £60 million turnover firm and managed to turn the whole into a £40 million turnover firm! Not the kind of growth we are all looking for. Sixty-three per cent of the companies interviewed by Harvard Business School in a major survey indicated that their deals did not deliver to the level they had planned. Nobody decided: 'Let's go out and buy a firm that looks good but is useless really!' At the time of purchase the team thought otherwise. The advisor may have had private reservations but, hey, they needed the deal in order to get paid.

Solution 2

Establish a true choice of both purchases and possible homes for your money. Look at other routes to growth and run a budget on them. If acquisition is more cost-effective than opening another office, then do it. If acquisition gives you a better return on investment than doubling manufacturing capacity, then do it. If acquisition is a more cost-effective and reliable route to new product or service development, then do it. The failed acquirer has typically looked at eight or less companies during the notional 12 months. They have usually only looked at companies 'for sale'. They have not thoroughly investigated their alternatives.

Use advisors that do not entirely depend on a deal being done for their remuneration. Use ones that have a vested interest in your repeat business.

Issue 3

Because most purchases are either of what is offered or out of administration, strategic issues are often not discussed by the board prior to purchase. Everything is seen through a tactical 'set of spectacles' – 'Wow, that's cheap'; 'I like their client list'; 'Jim would be a great asset on the technical side'. All of this may be accurate, but is just rationalizing what you want to do. Strategy is something you decide on before you commence, not during the process. D-Day was not planned half way through the Battle of Normandy. Both were planned a year beforehand.

Solution 3

Plan *before* you start! Look at both the up and down side of acquisition in principle. Has it worked for others in your sector, for your competitors, for your peers? Then look at acquisition in comparison to your other options for growth as mentioned above. Finally look at what you want a specific acquisition to deliver in specific for your business. Resolve not to progress talks with firms that are less than an 80 per cent match with what you identify as crucial.

Issue 4

The money!

There are always far more deals that could get done than do get done. The human factor is always important (see below), but I think it is fair to say that money is the single quickest way to bring out that factor.

Research in late 2006 showed private equity winning 74 per cent of bids in competitive situations against trade buyers. Not only did this reflect a willingness to pay around 10 per cent more, but also derived from the fact that the PE firm had typically raised its fund, while the trade buyer so often expected to borrow on the target and couldn't get everything done in time. The issue is even clearer when we look at MBOs and MBIs. These are normally teams of individuals who are putting themselves on the line – resulting in deals that tend to transact at about 10 per cent lower prices than trade sales.

I find it fascinating that those who were unlikely to gain from amalgamating functions and other related savings were prepared to pay more. This is because they think entirely strategically. It is potential they are seeking to unlock, as a route to value. The trade buyer, who has most to gain immediately, is usually slow to make decisions and poor on the money management side. The MBO/MBIs are treated by sellers as poor relations.

The recession knocked these verities about a bit, but things are now not far off the previous status quo – just with fewer outfits buying!

Solution 4

Always secure your line of finance before making a firm offer. It's fine to make an indicative offer prior to funds being secured, but there is still the risk of your offer being accepted! There is nothing more detrimental to your credibility than not being able to progress a deal because funds are held up.

Most trade buyers want to borrow on the target. Most lenders want to lend on the buyer! If your bank will not consider lending to you on your own assets, cash flow or profit, I would argue that you are in too marginal a situation to afford the right buy. Of course, there is always an exception to the rule. Why are you it?

If you are a MBI team, build credibility. Lenders lend on the proposal, the people and the purchase. Are all three equally credible, or does one let you down? The same principles apply for any form of leveraged deal.

Issue 5

The people!

I am afraid that we are now on ground where no statistic helps and no pattern can be relied upon. What can be said, is that if yours is a people business, there is no more risk in buying a people business than using normal recruitment practices. In fact, observationally, there is often less risk since you are buying a proven functioning

team, not a ragbag of individuals. Cost wise, acquisition can usually also be well-justified in comparison to recruitment fees etc.

If you do not see yourself as being in a people business, then you are wrong! Even the most techie IT firm has a human face, which we neglect at our peril. For instance, if you are buying a division or subsidiary off a large group ask yourself why it has not been offered to its own management. Maybe it is already under offer from the very same people you expect to work well for you after the shareholders have exited. Maybe they have been turned down in your favour. How workable is the business after purchase in such circumstances?

Solution 5

Put as much time into checking out the people as you do into valuing the assets, analysing the cash flow or computing the tax. Remember, your target is also supplied by people, discussed by people and supplies people.

So there you go. I feel like an agony aunt now! By now you can spot that I regard strategic acquisitions as an excellent route to growth – with much evidence – and perceive tactical buys to be all very well, but unlikely to deliver what you really want. There are cheaper, less-risky ways to organic growth than bolt-on acquisitions. There is only one other route to substantial 'step-change' growth beside a strategic acquisition – marketing something new that everybody wants at a reasonable price!

Summary

- Good acquisitions perform as investments.
- Good acquisitions give a 'step change'.
- Good acquisitions further strategic goals.
- Good acquisitions add value to your shares.
- Good acquisitions help you to diversify.
- Good acquisitions give you 'critical mass'.

Dr Mike Sweeting is the managing director of Acquisitions International. He is also part of the senior management of its parent – the BCMS corporate group of companies. Mike has particular responsibility for relations with the professions.

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He likes rock climbing, poetry, military history and shooting – some of the things he finds as stimulating as getting a deal done!

Licensing

9.3

In finding the best route to market, licensing can be a powerful tool. ***Tony Randel****, a consultant at Animus and an advisor to the Intellectual Property Office, explains how it works*

When you mention 'licensing' to most people in the UK they immediately think of pub opening hours or a vehicle tax disc. Not so in most other industrialized countries; they think of the commercial implications of the word. As the UK economy becomes based more and more on our creative and inventive skills, as opposed to our traditional strengths, it is vital that all UK businesses look for new, imaginative and innovative business tools that they can all use to grow, find new or faster routes to market and gain competitive advantage. Licensing is just such a tool.

Lots of businesses are conservative in their business model and apprehensive of doing anything outside their 'comfort zone'. 'We have always done it this way and we know it works' is a common cry; but might it not work better if they tried something innovative? Licensing, in itself, is not new but it can be a novel and alternative approach for many businesses to escape from their traditional comfort zone to gain competitive advantage. This is particularly so in a world where times to market are getting shorter and windows of opportunity for new product introduction are getting smaller.

So what do we mean by licensing? It is best described, in this context, as 'permission to do something that, without the licence, would be an infringement of intellectual property'. The expression 'intellectual property' should be construed broadly to encompass soft IP (know-how, trade secrets, unregistered designs, unregistered trade marks etc) as well as the harder actual IP Rights. Having defined what we mean by licensing let us consider for a moment some of the possible business benefits of licensing.

Revenue Generation: An owner of IP may commercialize that IP itself within its own industry sector. It may then obtain additional income from that same IP by licensing it to someone else to commercialize it in a different field.

Increasing Market Penetration: An owner of IP may license another business to manufacture and/or sell in territories that the owner cannot or does not want to cover.

Reducing Costs: A business may 'buy-in' IP that has been wholly or partially developed by another to reduce its research and development costs.

Saving Time: A business may get its products or services to market more quickly by acquiring a licence to use existing IP, rather than re-inventing the wheel, even if that IP has to be modified or further developed to more exactly suit the requirements of the business.

Accessing Expertise: By taking a licence, a business may tap into expertise that it does not have in-house. This is particularly relevant if a business needs very specialized knowledge that might only reside in an HEI or Research Institute or requires the IP for so short a time that employing someone with the knowledge is not a sensible option.

Obtaining Competitive Advantage: By acquiring a licence to use certain IP, a business may obtain an advantage over its competitors who have not been able to acquire that IP.

Collaboration: Businesses may want to work together to develop new products and services to their mutual benefit.

Redundant IP Assets: Many businesses have IP assets that they have developed over the years but are no longer of use to them. These assets can often be turned into a very useful income stream by licensing.

The possible benefits above may seem attractive, and indeed are attractive to many businesses. However, there are circumstances when licensing is not the most appropriate tool for a business. Every business must carefully examine, possibly with help from an experienced licensing professional, their own circumstances and then develop a licensing strategy.

If we assume that a business wants to at least examine the possibility of licensing in or out how do they find a suitable licensing partner? Remember here that a licence is a long-term agreement between partners that must be to their mutual benefit. It can be likened to a marriage – it is usually relatively inexpensive to get into but can be extremely expensive and stressful to get out of! By far the best way of finding a partner are by personal knowledge, by word of mouth or through a trusted intermediary. There are a number of more formal mechanisms and many 'technology brokers'. Some of these are extremely good, highly reputable and very successful in their matchmaking activities. Others, unfortunately, are less good and some have a fairly dubious reputation. Any business new to licensing should take advice from a trusted, or at least recommended, advisor who is governed by a Code of Professional Conduct, or similar. UK IPO has recently produced a guide entitled 'Choosing your IP Advisor' to assist businesses new to this activity.

Once a business has decided that they want to embrace licensing as part of their business strategy and they have identified possible partners they must give some consideration to the contents of any licence agreement. The terms of the licence are those under which the two businesses will cooperate and must be fair to both parties. There is no such thing as a 'standard' licence agreement or a template. Every case is different and must be treated on an individual basis. However, there are a number of common elements in most agreements; these are:

- What IP is being licensed? This needs spelling out in detail, including the hard and the soft IP; it may include certain drawings, bills of quantities, operating procedures – often as an Annex to the agreement if complex.
- Who may use the IP? A company, a partnership, an HEI, any of their subsidiaries or joint-ventures etc? Ensure that you detail this sufficiently and ensure that the other party is authorized to enter into such an agreement.

- The type of licence? Is the licence sole, exclusive or non-exclusive? What limitations are there concerning industry sector, geography, etc? Can the licence be sub-let, if so on what terms? Include the duration, with options on renewal and renewal options.
- Improvements. Who owns any developments or improvements?
- Infringement. Who is responsible for and who will pay for fighting apparent infringements or accusations of infringement?
- Quality and conformance. Who is responsible for ensuring that the items under licence meet the required quality standards and conform to any other national or international requirements.
- Charges and payments. Initial payments, royalties, penalties for non-performance, advances on royalties etc.
- Termination. Detail the various grounds upon which the licence can be terminated by either party.
- Various legal. Warranties by both parties, the law governing the agreement, is the agreement applicable to successors in title etc.

The list above can only give a very broad indication of what might be included and is certainly not exhaustive. A full and detailed list of matters to consider can be found in a number of publications; particularly the UK IPO booklet on licensing, and its very comprehensive checklist, which is specifically aimed at the SME without previous licensing experience.

Charges and payments are mentioned above and must feature high on the list of matters for consideration by both licensor and licensee. So how does one value intellectual property, or more specifically in this context 'agreeing a price for IP'? This subject is regarded by many as a 'black art'; as indeed it is. However, there are various mechanisms used by licensing professionals that at least turn it into a 'grey art'. The three most commonly used mechanisms are 'The Cost Method', 'The Market Value Method' and 'The Economic Benefit Method'. All three approach the issue from a different angle but each is constrained by the amount of information available or by possibly unreliable forecasts. A good and experienced licensing professional will attempt to use each method in any particular case in the hope that there is some commonality in the outcomes. Such calculations are then tempered by 'industry norms' and the very basic '25 per cent/5 per cent' rule. If both parties address this issue separately they will often come to very similar conclusions that will go some way to dispelling the often-unrealistic expectations of one or other party.

We have travelled down the route to entering into a licensing agreement by stages. First 'are there benefits for my business', then 'finding a partner', next 'what am I letting myself in for – the contents of the agreement' and finally 'what's it worth'. There is no set of rules under which licences are negotiated. The methodology below is intended purely as a guide. It has worked successfully many times, particularly between SMEs, but is not written in tablets of stone.

- **First meeting.** Principals only involved, more 'get to know you', 'can we do business together' than anything else. Probably held on neutral ground. If either party is not 100 per cent happy, walk away from any involvement.

- **First exchange of documents.** Disclosure of confidential information; possibly very first draft 'Heads of Agreement', usually prepared by licensor. Hopefully some heads agreed electronically. Second, more detailed draft tabled electronically.
- **Second meeting.** Again, only principals involved; often at the premises of the licensee; firming up the personal relationship; discussion over second draft, hopefully most heads agreed but there will almost certainly be certain matters that cannot be agreed or have to be referred to more senior decision makers. Further electronic exchanges, but if still no agreement:
- **Third meeting.** With experienced advisor(s) present to facilitate the negotiations over 'sticking points'. Heads of Agreement signed.
- **Finally.** Heads of Agreement turned into full licence agreement by lawyers for one or other party, usually the one that produced the initial heads; other party completes due diligence and agreement is signed.

Many UK businesses are frightened of licensing. They have heard anecdotal evidence of people being 'ripped-off' and they are unsure of how to go about it. They are therefore apprehensive of even exploring the issue. UK plc will only thrive into the 21st century if industry really accepts that it is operating in a global economy. To take advantage of that, rather than be left behind, businesses should think much more seriously than they have done in the past about licensing being a part of their strategy. If the business is diligent and uses the right advisors even the 'licensing virgin' should be able to make their way safely through the minefield to a happy, long-lasting and profitable marriage.

Contributed by Tony Randel on behalf of the UK Intellectual Property Office. Tony works for Animus, a small consultancy business in south west England, see: **www.animusconsulting.co.uk**. In previous existences, in manufacturing industry, he has been on both sides of successful licence agreements. He has been advising knowledge-based SMEs in the south west on intellectual property, product development and licensing for the last 20 years. He is a Fellow of the Institute of International Licensing Practitioners and represents that Institute on the UKIPO working party, formed as a result of the Gowers report, concerned with the licensing, and other methods of exploitation, of intellectual property by SMEs. He has co-authored some of the IPO guides on the subject.

The series of guides so far produced by this working party, including the licensing guide and checklist, can be found on the IPO website at: **www.ipo.gov.uk/whyuse/business/business-support.htm** as part of the IP Health Check series.

Preparing a business for sale

9.4

Peter Gray *at Cavendish discusses techniques for improving your worth to potential buyers*

Maximizing the valuation achieved on a company sale takes time and careful preparation. Work can take place over a few months or even years before a sale to enhance the attractiveness and value of a business to potential purchasers. This is achieved by measures such as:

- identifying potential purchasers early and positioning the company to attract them;
- raising the public profile of the company;
- maximizing recurring profits by reducing or stopping non-recurring costs;
- improving margins through cost-saving measures;
- eliminating excess working capital from the balance sheet.

A review of the business to determine appropriate pre-sale preparation should cover the following areas.

Financial matters

Pricing review

Even where a company enjoys a degree of pricing power, it may choose not to fully exploit that power. Generally, the pricing policy of a company is designed to maximize long-term rather than short-term profits. This may involve keeping prices sufficiently low to deter potential market entrants. However, in the context of sale, consideration should be given to enhancing margins by increasing prices in the lead-up to the sale to improve the bottom line.

Review of costs

A review should be undertaken to identify and eliminate all proprietorial costs that would not be incurred by an incoming purchaser. Proprietorial costs may include

relatives on the payroll, excessive travel and entertainment costs, and remuneration that exceeds accepted market norms. Although a purchaser might be persuaded that these costs should be added back to determine the company's underlying profit, the argument is always stronger if the business can be run for a period with these costs removed.

Every other element of the company's cost base should be also scrutinized. If your business will attract a multiple of say eight times earnings, every £1 of cost savings achieves an eight-fold return in the form of a higher purchase price.

It is not just the quantum of costs that should be reviewed but also their impact. For example, seek to ensure that expenditure on advertising, business development and R&D is designed to produce shorter-term results to help achieve a higher valuation, rather than long-term results that may not.

Review of assets

When a business has assets that may not be required or fully valued by a purchaser (such as surplus property or investments) removal before a sale commences is recommended.

In addition, in the lead-up to a sale, working capital should be reduced to the minimum level required to run the business. Policies concerning stock-holding levels, debtors and creditors should therefore be reviewed at an early stage to ensure that there is no 'fat' in working capital. If the company is sold with excess inventory levels or, owing to poor credit collection, excess levels of debtors, the vendor is, in effect, gifting the excess working capital to the purchaser. Any surplus working capital should be eliminated well in advance of a sale and the resultant cash proceeds either stripped out of the company or, preferably, added to the purchase price.

Any hidden or undervalued assets of the business should also be identified. If the value of property assets is understated in the company's balance sheet relative to their market value, they should be re-valued independently prior to sale.

If the company owns the property or properties from which the business is conducted, a higher overall valuation can be achieved by either selling the property to an institutional property investor prior to the sale and leasing it back or acquiring the property from the company at the time of the sale and leasing it back to the new owner.

Tax review

All PAYE, VAT and corporate tax matters should be up-to-date and tax computations agreed with the Inland Revenue. Any tax losses available to be carried forward, or corporation tax benefits from an Enterprise Management Incentive Scheme, should be identified so that value can be obtained for them from a purchaser.

Pension schemes

Final salary schemes can be very problematic in the context of a sale owing to the associated valuation issues. Subject to any regulatory constraints and the rules

governing the schemes, a final salary scheme should be closed to new members immediately and, if possible, commuted into a defined contribution or personal pension scheme.

Accounting policies

With a sale in mind, a review should be undertaken of the following accounting policies to maximize stated earnings and balance sheet values:

- Recognition of profit, particularly for contract-related businesses.
- Depreciation policies, both for tangible and intangible assets – the policies may be overly aggressive with a resultant depression of profits and asset values.
- Provisions – making excessive provisions against stock or debtors is one of the most commonly used techniques to reduce tax. In the lead-up to a sale, excess provisions should be released to boost profits and asset values, preferably over more than one accounting period.
- Valuations of properties and intangible assets.
- Research and development – this may play a large part in the purchaser's interest in the business. Small companies are frequently bought for their innovative skills and product development capabilities. Where all research and development has been written off in the past through the profit and loss account rather than capitalized, this should be identified and highlighted.

As with excessive proprietorial drawings and one-off items, it is possible to adjust stated profits in the information memorandum to show the impact of using more conventional accounting policies. However, purchasers are always suspicious of 'add backs' and in the context of a sale it is preferable to show the highest profit figure possible in the company's audited accounts. Even if this involves paying some additional corporation tax, it should be more than compensated by the increase in the purchase price that can be achieved.

It is important to avoid the temptation to adopt overly aggressive policies that may lead a purchaser to adjust the company's profits downwards in due diligence.

Accounting systems

It is essential to have high-quality monthly management accounts and have in place good management information systems that track Key Performance Indicators (KPIs) and produce timely reports on key variables. During a sale, it is vital to have up-to-date, high-quality information on the current trading performance of your company and the purchaser will be looking to the vendor to warrant a recent set of management accounts.

It is equally important to produce high-quality budgets. At a minimum, a purchaser will be looking for profit projections for both the current and the following financial year. In the case of financial buyers, a three-year financial plan with detailed supporting assumptions will be required. If the company has not had a history of

producing detailed budgets (and hopefully beating them), any projections produced specifically for a sale may lack credibility.

Operational matters

Management review

The quality of the management team will generally be of paramount importance to a purchaser, especially where the vendor is proposing to leave the business at the time of, or shortly after, a sale. It is important to be able to demonstrate to the purchaser that there is competent second-tier management available to assume executive control of the business following a sale. This will involve the vendor devolving management control in the lead-up to a sale. Where second-line management is taking executive decisions, their decisions should be documented. For evidentiary purposes, it may help to recognize their input formally by:

- minuting management meetings;
- issuing formal job descriptions;
- promoting senior management to the Board.

It might also be advisable for the vendor to take an extended holiday before the sale to show the purchaser that the business can operate effectively in their absence. It may be a warning sign for a purchaser if the vendor has rarely taken holidays as this may indicate that they make all the important decisions within the business and have no confidence in the management team. For the same reasons, it is a danger sign if the vendor is the only director.

Quality marks: non-execs and professional advisors

The appointment of an experienced non-executive director or chairman can assist a company in various ways. Apart from assisting in the strategic development of the company through his business acumen and contact base, it is likely that the non-exec will have been involved in several sale processes and can help guide the vendor through a potentially complex and stressful experience.

Moreover, if a highly regarded industry figure accepts the offer of a non-executive directorship, this gives the company significant credibility as a person of such standing will not accept an offer unless the non-exec believes the company is of high quality and has strong growth prospects.

It also helps if the company has high-quality auditors and professional advisors on board. Purchasers will regard this as a mark of quality. In the case of auditors, purchasers will accord significantly more credibility to accounts that have been audited by a well-known firm of auditors.

Legal review

In the lead-up to a sale, the vendor should consider conducting a legal audit in conjunction with the company's legal advisors, which should, at a minimum, ensure the following:

- Trading contracts are examined to ensure that no change of control restrictions or provisions apply.
- Provisions in key contracts that allow the other party to terminate the contract on a sale are potential 'poison pills' for a purchaser as the contracts in question may have considerable value. To the extent possible these provisions should be resisted.
- Intellectual Property rights are properly registered. For high-tech companies, deficiencies in patent or other IP registrations can have a major negative valuation impact and sometimes deter purchasers altogether, especially where a third party has challenged the validity of an important element of the company's IP. Where overseas expansion forms a key part of the company's growth story, it adds to credibility significantly if the IP rights in the territories targeted for expansion have been registered.
- Shareholder agreements and the company's articles of association are examined to review provisions relating to a sale.
- Where possible, any outstanding litigation is cleared up. If it cannot be resolved, and is not covered by the company's existing insurance, litigation insurance might be considered to remove it as an issue on a sale.
- To the extent possible, the ownership structure of the company is simplified. This may involve buying-in minority or joint venture interests. Complex ownership structures can diminish the attractiveness of a business.
- All leases, title deeds, share certificates and key contracts are located and reviewed.
- Any issues relating to the ownership of the company's assets including IP rights are resolved.

Positioning

Well before a sale exercise is undertaken, potential purchasers or categories of purchaser most likely to be interested in acquiring the business should be identified and the business positioned as an attractive acquisition target for those purchasers.

Corporate strategy

Before making any strategic decisions, you need to assess whether it would enhance or detract from value from a purchaser's perspective. This ranges from the obvious, such as not renewing a 20-year lease on the company's premises just prior to a sale, to more subtle positioning-type issues, such as whether diversifying the business into related activities will make the company more or less saleable.

Environmental audit

Potential environmental liabilities will be a major area of concern for any purchaser.

Depending on the nature of the business, it may be appropriate to commission a specialist environmental consultancy to conduct a desktop environmental audit or (in the case of premises with potentially significant environmental issues) a full environmental audit including ground-testing prior to the sale to enable any potential problems to be identified and remedied at an early stage.

Data room

Gathering information for a data room at an early stage can significantly truncate the subsequent sale exercise and is an essential component of the information disclosure process.

Vendor due diligence

Vendor due diligence involves instructing a reputable firm of accountants to prepare a due diligence report on the business in advance of a sale being undertaken. The report is then given to potential purchasers who have expressed serious interest in the company for use in finalizing their offers.

The purpose of vendor due diligence is to flush out financial, tax, operational and other issues relating to the business at the outset of the sale and in conjunction with the data room, to ensure that final bids are based on all 'price sensitive' information. If this objective is achieved, the chances of the deal collapsing or the purchase price being reduced once heads of agreement have been signed and a preferred bidder chosen, are significantly reduced.

In choosing an accountant, it is advisable to appoint a top-tier accounting firm and avoid the temptation to use the company's auditor. If this rule is ignored, a purchaser is more likely to use another firm of accountants to conduct final due diligence rather than adopt and update the vendor due diligence report after being confirmed as preferred bidder. Adoption of the report by the purchaser is a key objective of the vendor due diligence process, as introduction of another firm of accountants will have timing implications, leaving the business vulnerable to the new accountants taking a different view on certain financial issues or the validity of the financial projections.

Prepare for site visits

The impression that purchasers take away from site visits can have a significant impact on their appetite to acquire it. If they experience a desultory greeting at the reception desk, witness peeling paintwork and a premises in a general state of disrepair and form a negative view of employee morale from a walk around the office, their initial interest may quickly fade.

Purchasers will use site visits to determine whether the business represents a good cultural fit with their own as this is generally a prerequisite for a successful acquisition.

Conclusion

The more prepared a business is prior to the commencement of the sale process, the greater the ultimate valuation achieved will be. However, it is important not to prepare the business for sale in an over-zealous fashion or attempt to boost profits in artificial ways that will be exposed during due diligence.

Cavendish Corporate Finance LLP is a London-based corporate finance boutique and a leading independent specialist advisor to vendors of businesses. Founded in 1988, Cavendish has advised on some 400 company sales with an aggregate value in excess of £3 billion. Cavendish's clients include private companies, financial institutions and fully listed public companies with typical transactions falling broadly within the £10 million to £150 million 'mid-market' value range. Cavendish is unique in that it has only ever acted for vendors of businesses and as a result has built up an unrivalled specialist expertise in managing the company sale process. Cavendish is a member of M&A International Inc, the world's leading alliance of specialist mergers and acquisitions advisors and investment banking firms. Cavendish's expertise and success in selling businesses is acknowledged in our being named Corporate Finance Boutique of the Year at no less than four leading industry awards ceremonies in 2007 and 2008.

Peter Gray graduated with degrees in Law and Commerce from Melbourne University in 1984. He joined the corporate finance department of Minter Ellison, a leading Australian law firm, where he qualified as a lawyer. In 1989 Peter joined the corporate finance group of Clifford Chance in London. He worked on a wide variety of transactions, including management buy-outs, stock market flotations and acquisitions and disposals. After completing an MBA in Finance, Peter joined Cavendish in 1994 and was appointed a director in 1997. Peter is a frequent lecturer and author on the subject of mergers and acquisitions. He has published a book entitled *Maximising Value on the Sale of a Business*.

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PART TEN
Growth capital

Funding your business through the recession

10.1

As we enter the third year of the global financial crisis, businesses continue to encounter a myriad of obstacles, and while there is no doubt that the current recession has marked the end of easy money, there are still sources available and actions to take to ensure survival, say ***Paul Beber*** *and* ***Brian Johnson*** *at The Fisher Organisation*

Although the government and the banks have committed themselves to ease the funding difficulties caused by the financial crisis in the banking industry, in practice this is often no more than 'lip-service'. Businesses today are still fighting for a share of the limited funds available and, to add to the challenge, the cost of these funds has risen significantly.

Forced to think beyond traditional routes of funding while interest rates and deposit demands are higher, some creative and alternative finance options should be considered, particularly as less credit is available and lenders become more selective about who they lend to. But just what are the options for established businesses that are finding it difficult to obtain bank loans and overdrafts?

Considering other types of finance

With banks still reluctant to lend to individuals and businesses, or demanding additional security that entrepreneurs either do not have or are reluctant to give, there are other options worth consideration and, fortunately, there are resources available to help businesses accomplish their goals and continue to grow, beyond the 'friends and family financing'. These include:

- Asset-based lending. Invoice finance is the foundation of asset-based lending (ABL), whereby money is advanced against a company's assets. In the case of factoring, the most popular form of asset-based finance, the financier can

collect debts on behalf of a business. Apart from invoices, other suitable assets can include stock, machinery and, of course, property.

- Peer-to-peer lending has recently emerged in the UK as a successful alternative, whereby private investors often lend directly via the Internet, offering various types of loans from business to personal, without the requirement for a financial intermediary.
- Government grants have notoriously difficult application processes and can be complex to navigate, but there are genuine opportunities available for those who persevere.
- Enterprise Investment Schemes (EISs) are designed to help smaller, higher risk trading companies to raise finance by offering a range of tax reliefs to investors who purchase new shares in those companies. Despite the recession, there is still a considerable amount of investment money available looking for suitable opportunities.
- Businesses of any size can use joint ventures to strengthen long-term relationships or to collaborate on short-term projects, while sharing the risk and costs with a like-minded partner.
- Business angels can often provide substantial investment in return for equity in the business, offering a direct involvement with that investment for business owners.
- Venture capital typically comes from institutional investors and high net worth individuals, and is pooled together by dedicated investment firms. A type of private equity, it is largely provided to early stage, high potential growth companies.
- Venture Capital Trusts (VCTs) aim to bridge the equity gap between banks, government grants and business angels on one side, and institutional venture capital on the other.
- Investment from private equity houses frequently involves either an investment of capital into an operating company, or the acquisition of an operating company, typically in a young or emerging market. There is a wide array of types and styles of private equity including leveraged buyouts, growth capital, distressed investments and mezzanine capital.
- The lack of available bank finance has led some companies to consider getting a public quotation. Companies typically seek a public quotation because it offers profile, some liquidity for its shares, an audience receptive to growth and an environment where management can devote as much energy as possible to doing what their shareholders want them to do – to run the business. Available markets include PLUS, AIM and even potentially the London Stock Exchange.

The going is tough – what do you do?

Although by this stage in the recession those that have survived may think they can start to breathe a sigh of relief, this is actually the time when even more care is required. It is a sad historic fact that more businesses go to the wall when the economic cycle starts to improve than when it is on the way down or bumping along the bottom. Lack of working capital – eroded through the recession – is primarily the problem and a sudden pick up in business can create insuperable strains.

Delay is seldom a good idea in any business, and never when a company is in difficulty. Studies have repeatedly shown that many failed businesses could have survived if only remedial action had been taken in time. When the going gets tough, it may be time to call in the specialists. Working with ailing businesses, corporate advisory specialists aim to rescue a company either by helping to raise required finance or, if necessary, helping to reconstruct the business. They work with the directors, shareholders, lenders and other stakeholders to find the optimum solution for all involved, with an emphasis on recovery.

If some form of insolvency is unavoidable, this may not need to be the end of the line. Insolvency is generally a last resort, and whether it be a complex corporate reconstruction and recovery situation, receivership, administration, company voluntary arrangement, liquidation, or personal bankruptcy, early intervention is key to successful outcomes for all involved.

What next for growing businesses?

The current economic climate has led to many businesses focusing on consolidation and cost efficiency to survive. One positive outcome of this is that most businesses at this stage in the cycle have developed the drive to push their businesses forward. But this does not mean that you can take a rest – far from it. The challenges are not going to go away quickly and the need for businesses to continuously reevaluate their position and goals, and revisit their business plans remains as important as ever.

When preparing your plan, make sure that you carefully evaluate all needs and assess your financing needs properly. If you need additional funding start seeking it earlier rather than later.

Improving your chances of securing the finance you need

Securing funding is proving more difficult than ever before but there are ways to improve your chances of securing finance and managing cash flow while positioning your business for the future.

Top tips for attracting and securing funding:

- Know your business. Consider what your business's product or service is, how relevant it is in the current economic climate, and how sustainable it is in challenging times. Ensure you have a strong business case in support of the strategy and longevity of your business before seeking funds. Keep your business plan up-to-date.
- Closely manage your relationships with key clients. Know your competitors.
- Understand your finances. Instigate robust forecasting and financial management. Know your debt levels, understand what type of debt you have, when those funds are going to roll over, and when and if loans will be renewable.
- Know how much funding you need. Take a long-term view, identify your end goal, and calculate how much funding you need, allowing for contingencies.
- Prepare your business for due diligence. Usually carried out when an investment or acquisition is going to be made, the process of checking the facts of a business before seeking funds can save a lot of time and energy when negotiating an investment.
- Seek advice. Your relationship with your financiers and other professional advisors should be nurtured at all times, but even more so when times get tough. Ensuring they know and understand your business as well as you do can help them determine what sort of funding is required – as well as when it is required – and seek out the best options for your business. Your advisors can prepare strategic reviews, examine the validity of forecasts and business plans, and carry out pre-lending reviews for banks and pre-investment reviews.

Paul Beber is a director of Fisher Corporate plc, part of The Fisher Organisation. He has written many articles on acquisitions and disposals and has extensive experience in this area, as well as in corporate strategy, flotations, the raising of venture capital and the injection of capital through private equity.

Brian Johnson is a partner and licensed insolvency practitioner at Fisher Partners, the business recovery, reconstruction and insolvency practice of The Fisher Organisation. He advises companies and individuals with a view to avoiding formal insolvency, and deals with both corporate and personal formal insolvency appointments. He has substantial experience in commercial and residential property and construction-related matters, as well as the charity sector.

For more information, visit: **www.hwfisher.co.uk**.

Structured finance

10.2

Structuring the most efficient, cost-effective financing package can make all the difference between success and failure of a company, says ***Kevin Smith***

It is all too easy for the owners or management of smaller businesses to think that funding for their growing operations comes only in the form of equity or debt and that debt can only be in the form of a term loan or an overdraft.

This perception is often caused by the unimaginative approach of many banks and, sadly, many of the banks' small business advisors don't seem to know terribly much more than the businesses that they are meant to be advising.

The reality is, of course, rather different with a whole range of different products available from banks and other more specialized providers of funding. What is the perfect solution for one company may not work at all for a very similar company and structuring the most efficient, cost-effective financing package can make all the difference between success and failure of the company. This is particularly true for growing businesses and, at the very least, the wrong financing package can hamper growth.

In recent years obtaining debt funding from banks has become even more of a challenge although the availability of equity finance has in many ways remained the same.

Equity

There are many different types of equity. As well as 'normal' equity there can be different classes of shares with different voting rights, preference shares, which rank ahead of 'normal' equity in the payment of dividends, and many other variations on the theme.

It is also worth remembering that ownership of shares in a company and control of the company can easily be varied by using a shareholders' agreement so that ownership of the majority of shares does not necessarily translate into control. This structure is often used when equity is injected by a venture capital firm that only seeks to own a minority stake but needs to be able to exercise control in order to limit the risks on its investment.

Senior debt

All banks offer senior debt and many branches, in practice, *only* offer senior debt. This is debt that is backed by some form of security (often a first fixed and floating charge on the assets of the company) and ranks before almost every other creditor. The standard term loans and working capital or overdraft facilities invariably fall into this category. Over the last few years banks have virtually stopped all lending that is not very well secured on tangible assets, making it even more difficult for SMEs to raise funding.

Subordinated debt

Subordinated debt, as the name implies, ranks behind senior debt. This type of debt is often only available to larger companies and, as strange as it may seem, is often part of a package of debt that includes senior debt. Larger syndicated loans may offer both types of debt with the subordinated debt tranche paying a higher interest rate to reflect the higher risks being taken by the funder. Despite the fact that subordinated debt ranks behind senior debt it often has some form of security attached to it and so still ranks ahead of unsecured creditors.

Mezzanine finance

Mezzanine finance is a form of subordinated debt but is actually midway between debt and equity (hence the name mezzanine). It would typically be structured as debt but would have options, warrants, equity kickers or some similar structure to provide some of the potential upside normally enjoyed only by holders of equity. These may be linked to various performance criteria or events, such as flotation or takeover of the company. As with subordinated debt, the risks for the funder are higher so the cost of this type of finance is higher. Nevertheless, providers of mezzanine finance are prepared to accept levels of risk not acceptable with standard bank facilities.

Asset finance

Leasing is the most common form of asset finance. The major difference with asset finance is that it looks primarily to the value of the asset as security rather than to the strength of the balance sheet. This can be particularly useful for smaller companies with only limited balance sheets or for companies that operate in asset-intensive sectors. Leases can be either on balance sheet (finance leases) or off balance sheet (operating leases) and, depending on the equipment being leased, 100 per cent of the cost can be financed.

Factoring or invoice discounting is another form of asset finance as the lender looks towards the quality of the trade debtors and outstanding invoices as security rather than the balance sheet. Again, this can be useful for smaller companies, especially during periods of rapid growth as the facility advances a percentage of outstanding invoices (typically up to 80 per cent of eligible invoices) and as such is more flexible. The funding is also available more quickly than a bank overdraft facility, which looks back in time rather than forward and is far more reliant on the balance sheet. Because it is trade-related with pre-determined repayments of advances, higher gearing is possible than with a working capital overdraft facility.

However, in line with all lending post 'credit crunch', lenders have become more cautious and relative costs have increased.

Trade finance

The term 'trade finance' is normally applied to companies that are exporting, as financing trade within the same country can easily be achieved using general bank facilities.There are many different forms of trade finance (letters of credit, bills of exchange, forfaiting, tolling, pre-export, countertrade, project finance… to name just a few) and many of these can either be with or without recourse to the company seeking the facility.

Trade finance can be just as useful to small and large companies alike as not only is it a way of passing many of the risks on to a bank, but again it can often be done without particular reference to the size or strength of the company's own balance sheet.

Many foreign banks specialize in this type of finance and are more than happy to provide facilities alongside a company's other bank relationships.

Structured finance

Structured finance as a term is normally applied to large, complicated transactions where a whole range of different financing techniques are employed in order to put together a package that provides a workable solution that would not be possible using more conventional lending methods. However, the principal is just as valid for smaller companies.

By using a little more imagination and identifying the strengths of the growing business's financial structure it is possible to mitigate risks more effectively and by playing to these strengths it is possible to structure a financing package that is larger, more flexible and more cost-effective than traditional lending. Remember that as a company grows its funding requirements will increase and change over time, and a good relationship with flexible, enlightened funders will help to ensure that suitable funding keeps pace with the growing company. Finding such a funder (or indeed a combination of funders) is not necessarily easy but it will always be worth the effort.

As we have all experienced, in recent years high street banks in particular have been rather lacking in imagination, even for very solid companies, and this has impacted severely on many businesses. We can only hope that matters will improve shortly.

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Transforming the finance function

10.3

As you grow, how can your finance function add real value to your business? A report from Ana Barco at CIMA looks at the ways in which its role can change

Research and commentary over the past decade described a vision of finance as a function, rather than a physical presence, where transaction processing would be outsourced, specialist advisory teams would deal with areas such as tax and treasury leaving control functions delegated to the business and finance personnel adding value integrated into the operations of the business. But how far has this been achieved in practice? What lessons can be learned? And how can these help the growing company?

This chapter explores the following questions:

- How has the structuring of the finance function developed?
- Has the finance department disappeared?
- Should the finance function be a business partner?
- What is the future for the finance function within the growing company now?
- What does all this mean for the development of your finance function?

The story so far

> Traditionally, the finance function used to operate in an insular manner but in the last decade there has been a step-change in its role. Finance is now 'creating value' in its own right by shaping strategy and tactics. This is made possible by finance business partners who work alongside the business gaining tremendous insights into the business and using their finance skills to bring sharp commercial focus to operations.
>
> Sriram Kameshwar, Head of Knowledge Services, Prudential – India

For the growing company, the last 10 years have seen real change in the finance function, particularly in cost reduction and reduced headcount and often on the back of IT and improved systems and driven by globalization and highly competitive landscapes. But importantly, more companies are increasingly embedding the finance function operationally in the business, creating a holistic, collaborative

environment in which the finance function moves towards actively supporting the organization's strategy, decision-making and operations: *business partnering*. Finance function changes can be seen as either motivated by the need for cost efficiency or the need for value creation and are generally geared either to the internal or the external environment. But which model should you adopt, or should it be a combination of both?

Revolution or evolution?

Organizational size, sector and location all affect the range and extent of finance function changes, but so too do the *drivers* of organizational change, such as:

- increased competition;
- advances in IT;
- increased risk and uncertainty;
- the impact of external reporting requirements and regulation;
- new markets;
- changes in top-level management;
- increased service demands.

But growing companies should perhaps consider an evolution rather than a revolution with regard to both the finance function – and their finance professionals – taking on business partnering roles and being integrated within the business. These roles are more closely aligned with finance function changes designed to improve value creation (focused on internal processes and products and services) than with cost efficiency (cost reduction and Business Process Re-engineering (BPR)).

The full service model

Business partnering activities generally complement rather than eliminate the traditional roles of the finance function itself. So in many businesses we usually see a full service model, in which the finance function is responsible for accounting processes and financial information as well as business advice and support. It is mainly in larger organizations that the shedding of traditional responsibilities is encountered more widely, facilitated by outsourcing and the use of shared service centres (finance function BPR). Abandoning traditional roles is not a necessary condition for adopting business partnering practices; however, BPR may release time and personnel for business partnering roles, but it is not necessarily a driver of change or the only way of implementing change. For example, improved systems with distributed inputting may free-up the time of finance professionals for other activities without resorting to outsourcing and the use of shared service centres.

Techniques for improvement

To achieve improving business support through business partnering activities, you do not need to disperse finance professionals throughout the business, nor do those professionals need to spend a large part of their time outside the finance department. Instead, the cross-functional collaboration that is essential in supporting the business can also be achieved through virtual communication and cross-functional projects and initiatives, which allow finance personnel to interact across departmental and geographic boundaries. Attachment of finance professionals to the finance function, regardless of where they physically sit, is now the predominant model and this does not inhibit collaboration. Even where finance professionals are part of the finance function, around half see their duties as supporting or most directly related to other parts of the organization.

Objectivity and tradition?

Limiting the degree of finance professionals' involvement and integration with the business may set a limit on the extent of business partnering activity, but there may be benefits, which appear to carry significant weight. Notably, having finance professionals accountable to the finance function helps to maintain their independence and objectivity – a quality often valued as much by non-finance personnel as those within the function. Limits on integration may also derive from some resistance to becoming more business-facing by individual finance professionals who are more comfortable within more traditional finance roles.

> Integrity, independence and objectivity are not negotiable for the finance professional and are the cornerstone of all finance roles. However, the business partnering role puts these values under stress, which is why such roles require maturity, strength of character and skill in dealing with business partners.
>
> Dominic P Moorhead, President, European Operations of Caris Life Sciences and ex CFO Hoffman LaRoche

So, consultant or business partner?

Although strategic/advisory activities and the business skills that support them largely define the business partner role, many more finance professionals see themselves as providing business advice acting as an internal consultant, rather than undertaking business partnering as such. The distinction between advisor and partner may lie in whether the finance professional takes a stake in or is jointly responsible for the operational and strategic decisions with which they are involved. Doing so represents a somewhat radical move away from the traditional role of the finance professional for all but those at the most senior level.

> I believe there is a benefit in progressing to true partnering. It is something I do see increasingly happening, however it is not part of the standard DNA of the finance department. This is currently outside the comfort zone of finance. We will see a much wider finance role, but the basis will always be the independent person with the proper financial background being a specialist on the finances, governance and compliance.
>
> Erik ter Horst, Vice President Finance, CFO EMEA and Latin America – BT Plc

It is perhaps a step too far for some finance professionals given that they may have been drawn originally to a role that was at most advisory, and also given the nature of historic professional education and training, and the potential effects of taking such a stake on their independence.

The importance of roles and skills

What is certain is that transformation has not led to the dearth of traditional finance roles; the finance function continues to provide a full service model with a wide range of roles. However, the changing interplay of skills and competencies is also certain. Finance professionals now require a mix of technical finance skills as well as commercial or business skills across all roles – albeit in different degrees. A 'front office' finance professional whose duties are business-facing in support of other operating units is likely to spend more time on activities associated with a strategic/advisory role and require a higher interpersonal and business skill set. The time spent on strategic/advisory activities increase when the front office individual's duties mainly relate to other parts of the organization, and it also increases in line with their seniority, reflecting the importance of the strategic/advisory role within the organization.

Ledgers to leaders: what are the real skills needed?

Finance professionals at all levels rate their business competency as being more important to their organizations than their technical competency, though the balance between the two competencies depends on the individual's role, duties and seniority, and on the size of their organizations. But, according to a recent consultation by CIMA, non-finance senior management continue to rate finance professionals' technical skills more highly than their business skills in terms of the value they add to the organization. Although organizations rate business competency very highly, technically competent people may hit the ground running, add value from day one, and can then be trained to gain more business and commercial skills.

But finance professionals require a mix of skills and competencies and while technical skills are a critical requirement at the recruitment stage for organizations, there is definite evidence of a shift in requirements for business and commercial

acumen across all finance roles. This interplay of competencies is not restricted to organization-facing roles such as advisory or strategic roles, but is also in evidence across all role types, including in general accounting and the specialist technical ones such as treasury, tax and audit.

A leadership gene?

For the growing company, business skills become increasingly important as executives move from the duties with the lowest business orientation (general finance/accounting) to those with the greatest (where individuals see their work as directly relating to other functions/units). Similarly, business skills (as well as technical skills) are more important for the more senior finance roles, and are more comparable to the skill set required for senior non-finance personnel.

Training is critical. But often it seems finance staff are simply unaware of their employer's training offerings. It is very notable, however, that organizations with a higher degree of business partnering deliver more training and development support. Companies that want to follow this transformation and shift into business partnering roles in their value-creation journey need to evaluate the training and development policies and offerings carefully.

But when it comes to the recruitment of future leaders we see that finance professionals in strategic and advisory roles, alongside management accounting ones, demonstrate the mix of competencies that is associated with those identified for leadership development. Moreover it is these individuals who will be more attractive to organizations' leadership programmes and who are likely to be the finance leaders of the growing company of tomorrow.

So, finally, what's best for you?

If your growing company's finance function operates a full service model you are likely to retain a pronounced need for finance professionals who do not necessarily fulfil a direct business partnering role. Those who have not developed the requisite business skills, or whose strengths are primarily technical, are still vital to undertake activities within and outside the strategic advisory roles; in financial, management accounting, regulation and systems roles.

Even in performing these activities however, better business and communication skills would enable your finance professionals to improve their contribution to the organization. Professional qualifications are widely valued for the technical skills they deliver and, together with the personal characteristics of the finance professional, are the most critical requirements for organizations when recruiting for the finance function.

> A sound knowledge of finance, including technical skills provides an excellent platform for a career in business, but it is clear that to make an impact in any role you need a broader palette of skills, not least in communication. Thankfully the

> days when finance staff were just seen as number crunchers are largely behind us but the quid pro quo for being taken seriously as business influencers is that you have to demonstrate that you can make a difference and to do that you need a number of different business skills.
>
> Steve Cresswell, EMEA CFO and COO, Jones Lang LaSalle

The evidence is that the roles undertaken by the finance function and its personnel have evolved away from the traditional information-provision model and towards a more business-oriented model. However, the change has not been revolutionary in that, for example, traditional structures such as the finance department persist and the vast majority of finance professionals still see themselves as part of the finance function.

Rates of change have varied across the range of organizations and there are constraints on how far many will travel down this path of further integration with the business. Notably, continuing the demand for the traditional services of the finance function indicates the need for a portfolio of skills and talents within the finance function, with an important continuing role for those finance professionals who do not seek to operate as partners integrated in the business. Those who develop as business partners or with greater collaboration with the business will help the finance function to better integrate its activities with and meet the needs of the organization shifting towards the creation of value. But the organization's business partnering vision will require management sensitivity to preserve the independence and objectivity of the finance function so vital to ensuring accurate and credible business planning and reporting.

This chapter is based on research by the CIMA Centre of Excellence at the University of Bath School of Management.

CIMA, the Chartered Institute of Management Accountants, is the world's leading and largest professional body of management accountants, with 172,000 members and students operating at the heart of business in 168 countries. Chartered Management Accountants have broad-ranging business and management skills to complement their financial training. They offer strategic and practical advice; make and support key decisions; and manage risk. CIMA develops high-quality professionals through a combination of skills, knowledge and the most relevant financial qualification for business – driving business success.

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