The Growing Business Handbook

In association with Microsoft and DELL

Beyond XP: do more than migrate

Windows XP support ends 8 April 2014. It's time to embrace the future, not the past

Microsoft is pulling support for Windows XP and Office 2003 on 8 April 2014, with thousands of businesses around the UK putting themselves at risk if they continue to use the old software.

Many small businesses take the "if it ain't broke, don't fix it" approach, but as contributing editor Simon Jones pointed out in a recent PC Pro column, that's a risky attitude.

"If a fire took out your company's offices and destroyed your paper records – the only records you had – you wouldn't know, and certainly couldn't prove, who owed you what money, and you'd go out of business," wrote Simon. "If you had computer records, you'd be in the same boat if you lost those computers in a fire and didn't have off-site backups.

"The bad news is that a serious malware infection can wreak much the same havoc: it can hold your data to ransom by hiding your files, only giving them back if you pay the malware's writers for 'support'."

Greater chance of attack

Anyone still running Windows XP could also find themselves open to attack. From April, there will be no new security updates and no non-security hotfixes for both products, making it more likely – Microsoft believes – that hackers will target businesses running the ageing operating system.

"One risk is that attackers will have the advantage over defenders who choose to run Windows XP, because attackers will likely have more information about vulnerabilities in Windows XP than defenders," says Tim Rains, a Microsoft director who specialises in security.

"The data we have on malware-infection rates for Windows operating systems indicates that the infection rate for Windows XP is significantly higher than those for modern-day operating systems like Windows 7 and 8."

Wide choice of formats

Rather than an all-out threat, this should be seen as an opportunity to replace older machines with lightweight, flexible computers that better meet employees' current needs. Nor do they have to cost much.

Take the Dell Venue 11 Pro tablet. Three devices in one, this quad-core Windows 8.1 system gives the portability of a tablet, the power of a laptop and the experience of a desktop if you buy the optional dock. Prices start at £399 exc VAT, and that includes a Full HD 11in screen.

For even greater portability, there's the 8in Dell Venue 8 Pro. Despite its tiny frame, this again includes Windows 8.1, while an optional keyboard gives the versatility of a laptop when you need it. Prices begin at £199 exc VAT.

As you'd expect from Dell, there are many other affordable choices for a rollout, whether it's a durable Latitude 3000 Series laptop or an OptiPlex 3020 desktop. All of these are available with your choice of Windows 7 or 8.

Dell's helping hand

You don't need to face these decisions alone. If you need to migrate systems from Windows XP, talk to a business expert from Dell who can help you work out which route is best for your needs.

You can even get up to £200 cashback on PCs via Dell's Trade to Save initiative **(www.dell.co.uk/tradetosave)**. And don't forget that Dell offers a variety of leasing and financing options, turning an upfront cost into one that's managed.

We'll leave the final words to Simon. "Whatever you choose to do, do something – or accept, like the owner of a classic car, that you're going to have to be prepared for it to crash and burn at any moment, and that if it does, you're on your own."

"A malware infection can wreak the same havoc as a fire... whatever you choose to do, do something."

Simon Jones, contributing editor *PC Pro*

FIFTEENTH EDITION

The Growing Business Handbook

Inspiration and advice from successful entrepreneurs and fast-growing UK companies

Consultant editor: Adam Jolly

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FOREWORD

As the economy strengthens during the course of 2014–15, you are likely to stand out as one of the winners, less because of your type of business and more because of your ability to manage the growth process. In markets of all kinds, there will be scope to spot an opening, make a plan, create a compelling offer for customers, take yourself to market, develop a financial strategy, become more professional and lead everyone you recruit.

These are the characteristics that typically distinguish enterprises that develop the capability to move sales from one level to the next: to £1 million, £8 million, £20 million and up to the point when you have the potential to take on the market leaders. Few make it all the way through to the end of the growth cycle.

In chasing ambitious goals and stretching yourself to the limit, you will inevitably find yourself balancing the promise of top-end rewards against a whole series of challenges that could sink you. Almost always, high performance within organizations remains complex and elusive.

So in developing a strategy for fast growth, you will constantly face a series of awkward decisions that could drive you forward or knock you back. What is the right route to market? When do you know when to build from within, when to acquire and when to partner? How can you create a capital structure based on the future earnings of the business, rather than your own security? How do you attract and lead talent? How do you create a brand that captures the distinctive value that you offer your customers? How do you put in place systems and processes that keep everything on track?

Drawing on a wide range of professional expertise and commercial experience, this book is full of practical advice and concrete suggestions about how to maximize upsides and control downsides. The IoD is grateful to all those who have shared their knowledge and experience so freely.

Simon Walker
Director General
Institute of Directors

PART ONE
Planning for growth

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Our consultants understand what it is like to be entrepreneurial and enjoy working with businesses, wherever they are in their life cycles. We delight in offering fresh insights and impartial advice, especially when it leads to success!

Contact us:

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High-growth characteristics

1.1

What can 'gazelles' teach us about supergrowth? asks Allison McSparron-Edwards, Managing Director of Consultrix

David Cameron, the UK Prime Minister, recently noted that 'there had been a surge in new, young, high-growth, highly innovative firms. It wasn't long ago that Apple, Cisco and Google didn't even exist – now each one has a market value of over $100 billion. Skype, Facebook and Twitter have generated billions of dollars and reached a global scale more quickly and with less capital than any companies before. And the most innovative firms are growing twice as fast, both in terms of employment and sales, than those that fail to innovate.'

Definitions

The term 'gazelle' was coined by David Birch of Cognetics, Inc and popularized by Verne Harnish of the worldwide Entrepreneurs Organization whose members all run companies that gross more than $1 million a year. A gazelle is described as being the type of company capable of rapid growth and job generation as opposed to an 'elephant' which is a large ponderous company which Birch argues employs thousands of people but creates very few new jobs. David Birch's identification of gazelle companies followed from his 1979 report titled *The job generation process*, where he identified small companies as the biggest creators of new jobs in the economy. Birch estimated that gazelles accounted for only 4 per cent of all US companies, but 70 per cent of all new jobs. He also noted that the growth pace of gazelle companies far outpaced that of the Fortune 500 'elephants'.

As a rule gazelles maintain consistent growth in both employment and turnover over a prolonged period of time. They typically increase their revenues by at least 20 per cent per annum over a period of four or more years, starting from a revenue base of at least $1 million. Their pace of growth means that they effectively double their revenues over a four-year period. Research shows, however, that most gazelles have a major problem sustaining growth beyond a five-year time horizon.

In most economies only 5–10 per cent of all new entrants are likely to become gazelles. Robert E Litan, Vice-President of research and policy at the Kauffman

Foundation, noted that the political elite focus on gazelles because they are seen as potential large employers and the wealth creators of the future. He said:

> Because fast-growing young firms account for a disproportionate share of net job creation, policymakers who are worriedly poring over unemployment projections might instead seek to foster the creation of more high-growth firms.

The questions that we are constantly being asked are, 'how do they do it?' and 'can we replicate their success?' Recent studies, for example by Warwick Business School, Kauffman and Experian have tried to identify the key characteristics, or corporate DNA, of such gazelles in the hope that they can be replicated. In summary, the most successful are distinguished by the quality of their management team and their commitment to creating an advantage through innovation and intellectual property; but many other characteristics also come into play.

Sector and size

As gazelle companies are characterized by rapid growth, rather than their absolute size, they can range in size from small companies to very large enterprises. Interestingly, they are not all high-tech companies, as suggested by Cameron, but include traditional sectors such as marketing, consumer products and services. Typically the examples most quoted are from the high-tech and internet sectors and include Microsoft, Apple, Dell, Yahoo, Google and Cisco in their early days, but each has struggled to leverage their spectacular growth into long-term turnover and profitability.

Vince Cable, David Cameron's UK Business Secretary, recently quoted, as his favourite examples of gazelles, Apple and Starbucks:

> Apple started in 1976. By 2001, 25 years later, they had 9,600 employees. They really weren't a force on the planet. It was since their 25th birthday they've gone to 60,000 plus employees. That's real economic growth.

> Starbucks started in 1971. Twenty-five years later, Howard Schultz said, 'I think we've finally figured it out' and that's when they turned the gas on, and they've gone to 140,000 plus employees.

Data recently compiled by Experian, the credit checking agency, noted that in 2012 UK gazelle businesses were spread across almost every industry sector and UK region, although some sectors and parts of the country had performed better than others. About a quarter of those identified as high-growth provided business services, such as consultancy and IT support. The next biggest group was manufacturing, which accounted for about a fifth of the total, and retail, which had an 11 per cent share.

Key characteristics

Research shows that many gazelles did not start off with sophisticated strategic plans but grew almost by accident. The big strategic plans tended to come later when

they understood that they had caught a 'tiger by the tail' and needed to make the most of the opportunity presented to them. Many gazelles need funding and it is often this factor that necessitates the creation of a well-thought-out plan. Nonetheless, those that did grow often had similar characteristics. Gazelles have:

Talent

They understand that corporate DNA is rooted in the talent that they employ. They recruit the best people they can afford, aligning their remuneration packages with the company's corporate goals, providing a nurturing yet challenging culture in which they can grow and develop.

Leadership

They are run by leaders who understand and can passionately communicate a clear and inspiring vision of the company's future with Big Hairy Audacious Goals (BHAG). They have a vision of an almost impossible-seeming future and then make it happen with a 'game changer'. Through this vision they create rather than run their businesses.

Their companies are not run on the back of their personalities: it's not all about the leader. Instead, the leader is seen to be part of a team working towards a common goal. Such leaders create strong succession plans ensuring that they don't recruit clones of themselves but individuals who can contribute to the strategic plan. They also emphasize the need to recruit individuals and teams with energy and a 'can-do' attitude, each capable of resolving blockages or barriers to growth.

They surround themselves with teams of people who are 'multipliers' (flexible individuals who want to improve themselves, the company, its products and services; who look to the future and success; who are enthusiastic, full of energy and team players) rather than 'diminishers' (who cast blame, gloom and negativity wherever they go).

Such leaders ensure that the corporate board surrounds itself with experts and that throughout the business there exists a balance between those individuals who create great ideas and those that are practical problem solvers. Too much creativity can cause chaos whereas too much practicality can stifle creativity.

Entrepreneurs

They are run by leaders who not only inspire their employees but are able to take calculated risks and understand the difference between an investment and a cost. They create and monitor clear key performance indicators that drive the vision and manage change.

Brands

They create and offer breakthrough value propositions and focus on identifying and exploiting high-growth markets. Within those markets the company will work

with key customers to shape the future, will leverage big alliances and, over time, will move their products and services from a low-value to a high-value offer.

Importantly the gazelles understand their marketplace and ensure that their brand engages emotionally with the consumer. They acknowledge that they are in the business of selling experiences and of building loyalty. They need to be flexible and nimble to keep abreast of an ever-changing and complex world.

Their brands evolve and are not based on unique selling points, which can become outdated, or price, which might imply the cheap and potentially lowest common denominator.

When they are ready to go to market they try and make their marketing revolutionary and irreverent. Many use the web to build their brand through social marketing and do their best to ensure that their customers will sell for them.

Innovation

They inherently understand the old idiom that customers 'don't want to buy a drill – they want a quarter inch hole'. They seek out ways to solve their customers' problems and understand that only those companies which are truly innovative can stay ahead of their competitors. The very best change the 'game' with disruptive innovation. They try to leverage what they have always done well but in a new context. Those that are nimble and flexible will speedily create prototypes, seek and get feedback and move quickly to successful launches.

Processes

They understand that when they are on to a winner they will need to create an infrastructure that can cope with growth; that operations need to think about the long-term implications of what they create rather than the tactical short-term impacts. They build with the future in mind and create something that is inherently scalable. The operational teams understand that they can drive growth through operational excellence and seek to do so.

Positive and negative indicators of growth

Even if you recognize all the above characteristics in your organization, other things can conspire to prevent meteoric growth.

Research by Eric Canada showed that different indicators can suggest that a company might have positive or negative growth in the future as well as increased or decreased company value. He identified 14 positive leading indicators including: product life-cycle, status, new product introductions, emerging technologies, investment in R&D, distribution of R&D expenditures (new product, improved product or improved production), market, sales, planned expansions, export sales growth, regulatory changes, projected employment needs, projected utility service needs, jobs added and space added.

On the other hand his research showed that there were seven negative indicators that could inhibit growth, some of which were company specific, eg the effects of a union; whilst others are community specific, eg a mismatch between a company's skill requirements and the available workforce. Other negative variables include: negative regulatory conditions, competition, merger/acquisition activity in the industry, union activity, changes in base technology, jobs lost and access to specific critical workforce skills. Perhaps if some of the latter apply to your company then you might consider moving your business to a more favourable environment as many international businesses are now capable of doing.

Summary

Using the above examples and analysis I expect you have already decided whether your company is, or isn't, a gazelle. If your answer was 'no', take heart and adopt and develop some of the characteristics and strategies outlined above because they really do work. In essence a clear breakthrough game-changing proposition, pursued by a focused, energetic, driven team, led by a good communicator, seem to be the keys to success.

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 telephone: 01793 726128, e-mail: **allison@consultrix.co.uk**, or see the website: **www.consultrix.co.uk**.

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The growth coach

1.2

Stephen Peacock at GrowthAccelerator identifies how to accelerate growth

The UK SME community is home to a diverse mix of companies, all making a significant contribution to the economy. However, evidence suggests it is the fastest growing SMEs that are making the biggest impact, creating almost half of all new jobs. Because of this, it's crucial that we support and facilitate their growth, which is why GrowthAccelerator was set up in 2012.

The GrowthAccelerator network of 110 Growth Managers and 1,600 Growth Coaches is currently providing expert guidance and support to nearly 10,000 dynamic and exciting enterprises across the country, helping them to overcome barriers to their growth and achieve their full potential. With impressive skills and experience across a range of sectors, coaches are closely matched to businesses where their background and expertise will provide maximum value. Providing companies with impartial support and an external perspective, they give business owners the confidence to enter into their next phase of growth.

Where business growth comes from: insight from GrowthAccelerator

Data from the GrowthAccelerator 2013 annual report shows that, contrary to popular belief, fast growth isn't necessarily the preserve of start-ups. In fact, high growth can literally come from anywhere, as long as the management team has the ambition and skills to make it happen. Illustrating this, the majority of GrowthAccelerator clients are businesses that are at least 5 years old and a third are more than 10 years old.

GrowthAccelerator insight also confirms that high-growth companies are not limited to urban locations in England, with 40 per cent of GrowthAccelerator businesses based in rural locations. Further, it finds high-growth capability is not the preserve of London and the South East, as some would believe, but is a nation-wide trend.

The data also highlights that growth can come from within any sector, not just from those commonly associated with rapid growth such as technology and digital. This further proves that it's not what your business does, but how it is run that is critical when it comes to achieving high growth.

Barriers to growth

Although the businesses GrowthAccelerator is working with are identified as having significant growth potential, this growth does not come without its challenges. Almost half (40 per cent) of GrowthAccelerator clients say that their top barrier to growth is having the correct strategy, and 39 per cent cite getting the right people and skills as their biggest hurdle. Below are some of the challenges that growing businesses face, and some examples of how GrowthAccelerator has helped business leaders to overcome them.

Strategy and planning

Having a clearly focused vision is crucial in order for a business to take its growth to the next level; however, many SME owners struggle to find the time to dedicate to longer-term planning, being too busy working *in* their business rather than *on* it. GrowthAccelerator research shows that less than one in five (19 per cent) of SME owners and decision makers regularly set aside time to work on their business strategy, and a third (33 per cent) say that not having the time to step back from the day-to-day running of their business to focus on longer-term strategy is a barrier to growth.

GrowthAccelerator's business development coaching helps companies to build an aspirational yet achievable growth plan, with both short- and longer-term objectives, detailed targets and key performance indicators. Business leaders are also encouraged to set aside time for focusing on strategy on a regular basis, regularly reviewing their plans to ensure they remain on the right track.

CASE STUDY Stirling Dynamics

Stirling Dynamics is a Bristol-based engineering company which develops innovative products and services for the aerospace, defence, marine and energy sectors. The business was keen to set a clear path to long-term and sustainable growth, and GrowthAccelerator's business development coaching helped the team to develop a three-year strategic plan. With support from his growth coach, Managing Director Stephen Judd took a 'step back' to develop a plan that ensured the whole company would be moving in the same direction. Judd comments: 'Our coach has been fantastic and was critical to the process. The whole company is moving towards the same goals, I have a driven and redefined senior management team and we have looked at novel marketing approaches for product lines which we might not have considered previously.'

People and skills

As GrowthAccelerator insight shows, a business's growth is strongly determined by the people at the helm of the company. But having a whole team of great leaders could propel a business into rapid growth. Because of this, it's vital that SME owners build a unified and committed leadership team to drive the business forward, whilst ensuring their teams are engaged and understand their individual roles in this process.

Leadership and management training for business owners and their senior management teams doesn't just cover how to manage people effectively. It supports businesses with everything from managing change to identifying clear roles and responsibilities within senior teams. A business owner might not always be the best strategist – but they could be a natural salesperson. Leadership and management training can identify these strengths and allow senior teams to take an objective view of where they should be focusing their attention, whilst all pulling together towards a shared goal.

CASE STUDY Automotive Insulations

Automotive Insulations, a manufacturer of products for the automotive, marine and industrial sectors, turned to GrowthAccelerator for leadership and management training. The company had developed a new plan for business growth but needed to ensure its senior team was prepared to bring those plans to life. Managing Director Jim Griffin says: 'Management training helped to bring greater focus, empowerment and enthusiasm to the senior team. They are now taking what they learnt and distilling this through their own teams to deliver market, product and geographical diversification.'

To develop and empower leadership teams during a drive for business growth, GrowthAccelerator offers match funding of up to £2,000 for every senior manager involved in the strategic direction of the business, to undertake leadership and management training recommended for your business. All clients who have signed up and paid their invoice are able to apply for this funding – with the proviso that training begins within 90 days of the match funding being approved.

Marketing and innovation

Sales and marketing is the third biggest barrier to growth identified by GrowthAccelerator clients, often described as the missing part of the puzzle for

many business owners. And the word 'innovation' is often dismissed by business owners who believe it to be something that's confined to technology or manufacturing companies. However, innovation isn't just about new inventions or groundbreaking new technologies. In fact, developing upon an existing product or service or turning a fairly simple new idea into something that can generate revenue is an innovation in itself, and many businesses do this on a regular basis without realizing.

CASE STUDY Hallmark Consumer Services

Hallmark Consumer Services is an online shopping order fulfilment and direct marketing mail specialist launched 20 years ago. The management team had big aspirations to grow but felt they needed a refreshed marketing and innovation strategy to underpin their goal to double turnover in five years. GrowthAccelerator worked with Hallmark on a marketing strategy to drive growth through new innovations, new services and new markets. The business launched a new premium gift-wrapping and gift-messaging service which also attracted significant regional media coverage to drive up local support. The business is now looking towards international expansion and has formed a new partnership to pack and distribute a Swiss company's products in the UK; opening up a new revenue stream from what was considered a relatively simple, yet highly valuable and profitable idea.

Access to finance

Whilst access to finance appears to be a prevailing issue of importance to SMEs, just 23 per cent of GrowthAccelerator's clients identified this as the main barrier to growth faced by their business. However, securing funding for growth is nonetheless a challenge for many SMEs, who might previously have tried to access finance and been unsuccessful, or might not know where to start.

GrowthAccelerator's team of specialist finance growth managers and coaches are working with businesses across the country to help improve their investment readiness. In July of this year, the first cohort completed their coaching, with around £21 million raised. The expert coaching helps businesses understand the full range of sources available to them and GrowthAccelerator coaches will support businesses with sourcing and pitching for investment, helping them to expand, move into new markets, and explore new products and services.

CASE STUDY Kaizen Furniture

Kaizen Furniture designs, engineers and manufactures bespoke, high-quality furniture and interiors. The business had aspirations to boost growth to achieve an annual turnover of £5 million by 2015, but was uncertain how to achieve this without incurring losses or sacrificing the quality of the brand. Kaizen needed accessible, reliable finance and turned to a GrowthAccelerator growth coach for assistance. Founder Bill Schilling said: 'GrowthAccelerator identified Funding Circle as the most suitable option for us, and we secured a loan of £100,000 from individual investors, each lending from as little as £20. We're now launching a new marketing drive and will extend our manufacturing facilities into Essex.'

Sources

GrowthAccelerator Annual Report, 2013
GrowthAccelerator 'Working On, Not In, Your Business' report

Stephen Peacock is Director at GrowthAccelerator. To be eligible for GrowthAccelerator, your business must be registered in the UK, based in England, have fewer than 250 employees and have a turnover of less than £40 million. You must also demonstrate clear ambition to reach your next growth phase, and have the potential and determination to get there.

If your business is eligible, and you decide GrowthAccelerator is right for your business, you will work with your growth manager and growth coach to get to the heart of the barriers that are holding your business back. By seeking expert advice and coaching, ambitious owners of businesses from any background can break down the barriers to progress and drive their company towards rapid growth. Further details: **www.growthaccelerator.com**.

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5-star financial intelligence

1.3

Why cash is not always king, says Simon Hulme, a serial entrepreneur and business coach

I get tired of hearing the cliché, *Cash is King*. Often quoted by business school lecturers who've probably never run a business in their life, it offers a simple salvation to the businessman: 'If you have cash in the bank, it's all OK. That's what you must focus on. That's what business is all about – that magic stuff called cash.'

Since I sold my own business five years ago, I've mentored around 50 companies and their owners. I have got to know some of these businesses and the entrepreneurs behind them very well. I've understood their motivations and seen first-hand many of their challenges. In fact, I've seen a great deal of talent and enthusiasm, which I find enormously encouraging for the future of the UK economy. I'd also add that the younger generations of entrepreneurs are far more caring about the environment and their impact on society than most of my generation ever were at their age.

But back to cash and the cliché, *Cash is King*. This has been quoted back at me by some of those I've mentored. The problem is, the simplicity of the statement overlooks the *source* of the cash. Cash from the wrong source can be dangerously illusional. One small company I helped had run up over £120,000 of debt with a single supplier, who had been totally negligent in chasing payment. Consequently the business had carried on trading 'satisfactorily', ie with cash in the bank, far longer than it would have done without this sham financial facility. When reality dawned, ie that the business was in fact losing money, it was getting very late in the day to save it.

I also found an entrepreneur taking his monthly sales figure from the change in the bank balance each month. This was not a micro-business, but had around 30 staff. I almost choked on my coffee at this revelation. Needless to say, they had built up serious arrears with HMRC and other creditors, all with potentially disastrous results.

So what is happening here? In both these cases, and in numerous others I have seen, far too little attention is paid to profitability. Perhaps the saying should be *Profit is King; Cash is Queen*. If these businesses had been more profitable, they would have been ultimately generating their own cash. Just as the best vegetables are those you've grown yourself, so it is that the best source of cash is derived from your own profits. Your own cash generation is also ultimately the long-term driver of your business's value. Is this not obvious? No, it seems not.

Needless to say the focus on cash ahead of profitability ultimately leads to a crisis when all available sources of cash have been expended. Suppliers, PAYE and VAT are

all in arrears. The entrepreneur then turns to the banks and, on finding this door closed, complains bitterly at their lack of interest in small businesses like their own. They conveniently overlook the fact that the banks are not venture capitalists, but rather seeking to lend money relatively risk-free for a usually modest return. The entrepreneur may also turn to business angel investors like myself, but they have little comprehension of an angel's requirements, the most basic of which is good *financial intelligence* and a strong management team, regardless of the market sector or idea.

So what is the solution? Quite simply it is to turn attention to *driving* profitability. I have observed that many entrepreneurs get distracted by goals other than profit, and I also made this same mistake in my own first business. Growth is the usual distraction – my first business was in retailing and within the first 18 months I made it my primary objective to open new outlets as rapidly as possible. I assumed profitability would somehow take care of itself, with near-disastrous consequences at the time. *But the drivers of growth and profitability are two distinct things, and it is important for a management team to appreciate this fact.*

In a more recent situation, one business owner I helped was obsessed with the research and development within his business. He had some unique and world-beating products in his portfolio, and was continually looking for ways to improve them technically. He set no financial cap on the amount he spent on their development, and as a result had previously gone bust. In the business's second incarnation he was in the process of repeating the same mistake, and was struggling to meet his payroll at the end of the month. It was extremely difficult to persuade him that technical superiority wasn't the primary function of the business – it was in fact, to make a profit. As a passionate and skilled engineer, his agenda was different.

Perhaps a simple way to explain this is to ask what the primary function of a human being is. All sorts of things may spring to mind, including a long list of activities we should be undertaking to make this world a better place. But in fact the primary purpose of a human being has to be to breathe. Without breathing, nothing else is possible, including the consumption of food and drink, which probably ought to rank second!

Profit is like the human breath. Without making a profit, ultimately the business cannot survive. Without profit, it cannot live to give great customer service, pay staff fairly, and carry out that vital research and development. Of course, you can say there are businesses that have become vast, particularly in the dot.com sector, without ever having made a profit, but these are still not exceptions to the rule. Their investors are ultimately waiting for enormous profits in the future, and if their faith in this long-term outcome collapses, inevitably so will the company. This was clearly demonstrated to us all at the end of the 90s when the dot.com bubble burst.

All the SMEs I have mentored have been producing some form of management accounts, but all too often their financial intelligence can best be described as low. The information is usually inadequate, frequently poorly presented, and often ignored or not seen as the doorway to success. In the following table I have allocated a star rating to a company's financial intelligence, where one star indicates the most basic state, to five stars being the ultimate. This is not intended to be a perfect description of where businesses sit on a scale of financial intelligence – it is merely meant to paint a picture based on my own experiences, and to serve as a discussion point on where progress can be made.

TABLE 1.3.1 Financial intelligence: star ratings

Star rating	Typical level of financial intelligence in the business
*	**Annual accounts produced each year by external accountant** The profit or loss is usually an annual surprise, ie no clear expectation of the result. 'It is what it is!'
**	**Basic monthly management accounts** These are frequently in a convoluted format, unhelpful for managing the business. There can also be basic errors, eg including non-profit & loss items in the statement, such as a monthly loan repayment. **Short term cashflow planning** This is usually only looking a few weeks ahead, and is frequently associated with 'crisis management' of the cash, ie 'Can I pay the wages/suppliers this month?'
***	**Monthly management accounts with comparison to last year and budget** This is when some real meaning to the accounts becomes possible. We can start to say performance is 'good' or 'bad' relative to the planned budget, and also relative to last year.
****	**Monthly management accounts as above, plus a rolling forecast of annual outcome and cashflow forecast 12 months ahead** The business is now capable of planning ahead and seeing the potential outcome of decisions in advance. Forward visibility of cash position now allows fund-raising, if required, to take place in a timely fashion. **Basic Key Performance Indicators (KPIs)** These will typically cover gross profit and net profit percentages, plus a few others.

TABLE 1.3.1 *continued*

Star rating	Typical level of financial intelligence in the business
*****	**Management accounts and forecasts as above** **Extensive KPIs covering entire business** These will analyse the gross profit margins across the product ranges as well as covering the cost structure of the business. In addition there will be some financial ratios covering the balance sheet. **Trend analysis** Analysis of trends of the KPIs in the business. Trailing 12 Months (T12M) graphs are an excellent way of doing this. For example, if the T12M graph of sales suddenly dips one month, you can instantly see that your business has just shrunk in size. Often such a realization is lost in the 'noise' of data and only seen retrospectively many months later. **Foreword visibility of market** KPIs are frequently 'looking in the rear view mirror', ie analysing what has happened in the past. By adding some forward-looking measures, such as the size of the future order book and some other market trend data, the business is now capable of seeing opportunities and threats to its market well ahead of time. A simple example would be a roof tile manufacturer watching the trend in planning applications and actual house starts – they would see an upturn or downturn well ahead of their present sales trend, and could then plan accordingly.

Most SMEs I have encountered fall into the 2-star box. Their management accounts have no benchmark to measure against. Is a profit in the month of £10,000 *good* or *bad?* It is a question that cannot be answered unless there is something relative to measure it against. A budgeted £5,000 loss would make the £10,000 profit *good*, whilst a budgeted profit of £25,000 would make it *bad*. Also, how do the figures compare to last year? Is there growth in sales and net profit, and if so by what percentage?

The place to start is to create a simple financial model of the business using a spreadsheet tool like Excel. Ideally, this should be for 36 months ahead, which will give some good medium-term visibility. Once this modelling is completed, the first 12 months becomes the budget and the numbers are 'frozen'. I would suggest printing this out and, if several pages, binding it into a formal document with a date on the front. This helps to freeze it as a benchmark and avoids the natural tendency to

constantly revise it in Excel. One mentee said, 'We're always on budget'. When quizzed further, they explained that they kept revising it throughout the year, and hence were always 'on track'. This is, of course, confusing the *budget* document with the *rolling forecast*. Once the budget is 'frozen', the spreadsheet is revised each month with the now actual performance, and the forecast for the remaining months of the year are updated in the light of more recent events. This then provides a useful year-end forecast, as well as an accurate long-term cashflow. But the budget still remains unchanged for that financial year.

Once you have a budget, you have a benchmark to measure against. This, and last year's data, become an integral part of the monthly management accounts. All performance is then looked at against budget, last year for *both* the month *and* year-to-date. This is now powerful information.

Remember the company I referred to that ran up a debt of £120,000 with a single supplier? They were a contracting business and had three distinct service elements to their business. However, the '2star' management accounts that were being produced made no differentiation between the small separate 'divisions' within the company. Consequently it was impossible to see where the profits and extensive losses were coming from. By creating three separate profit & loss statements, with every cost allocated to one of the three divisions or a head office central cost centre, we were able to see clearly what was happening: one division was in fact making money; one breaking even; and one losing a small fortune. This was somewhat of a surprise to the entrepreneur, who then made rapid changes to each division, and brought all three into profitability. This came about through cutting costs, changing procedures and raising prices. The effect was dramatic – within 12 months the business was making over £30,000 a month and the debt 'mountain' no longer represented a problem. Instead of looking outside for cash *they had grown their own*.

This entrepreneur was far from stupid, as witnessed by his ultimate success. However, his knowledge – like that of so many other entrepreneurs – was too focused on, or too limited to, his own product or service. Entrepreneurs can be world-class experts in their sectors, but extremely blind when it comes to financial intelligence. They quite simply have not been taught about it, but have picked up bits of knowledge along the way. Sadly some of this information can be wrong or even unhelpful. Once given more financial know-how, they can often dramatically improve their business's performance.

In Table 1.3.1 on page 17 I have illustrated what a 5-star rating should potentially look like with respect to financial intelligence. Once the building blocks of the budget and rolling forecast are put in place, it is relatively easy to climb the remaining rungs of the ladder to this position. These incremental changes can, if applied effectively, produce spectacular results for the business, and provide that strong elusive cashflow that every business owner craves.

Long live the King *and* Queen!

Simon Hulme is a serial entrepreneur, having built up and sold two significant businesses in the past 25 years. At the age of 24 he started his first business, Frame Express, a chain of fast picture-framing shops and built this to 16 outlets. In 1989 he sold it to a public company.

Simon then started Card Connection in 1992, a greeting card publisher distributing through over 100 franchisees in the UK and Ireland. The business was widely regarded as one of the best-run franchises in the UK, and was in the Top 10 publishers in the greeting card industry. The business was sold to American Greetings Inc in 2008 and is today a key division of their UK business.

Simon is currently a management consultant and active business angel investor. He is a non-executive director of several companies. He is also a teaching Fellow at UCL, lecturing on entrepreneurial finance, Visiting Entrepreneur at Kingston University and a business mentor.

Safeguarding the rewards

1.4

Once entrepreneurs cover their personal risks, they have a better chance of reaching their personal goals, says Mandy Caunt, a financial planner at Kingston

Setting up your own business from scratch is at once terrifying, exciting and even exhilarating. Amongst the main motivators for taking this route, however, is also having the all-essential 'control' of one's own destiny by no longer being beholden to or reliant upon an employer; being able to create a better work/life balance; and finally having freedom and future security based on personal efforts. To be, therefore, 'self-sufficient' and 'self-reliant'.

But...

- What happens if things don't work out as you planned?
- What happens if your health fails or worse still, you die before your reach your goals?
- What about your family's security whilst you are 'taking the risk'?
- And when the business starts to take off, how can you get profits out of the business tax efficiently and at the same time leave them available to use in the growth of the business?
- How about building a back-stop to your longer-term income and personal financial security too, regardless of what happens to the business in the future?
- How will you fill these gaps and what impact might they have on the profits and future of the business and indeed, therefore, the financial security and personal finances of you who set it up?
- Finally, what are the options for using profits in the business as they grow to achieve your longer-term goals and ambitions?

This book will give valuable guidance on how to set up a business and most people will automatically think about consulting an accountant to decide upon the best way of starting out so that they understand how tax and national insurance will work. That advice will almost inevitably include considerations such as buildings and public liability insurances and personal indemnity insurance.

Those policies protect the business against such risks as fire, flood, interruption of business, third-party liability and so on, and so they are very important covers for the business and its continuity as they allow the business to keep running when those catastrophes, however unlikely, occur. Sadly though, they don't insure the *money machines*.

No doubt you are wondering what a 'money machine' is and may wish you had one sitting in your kitchen at home?

The truth is though, you do. You are it – the entrepreneur, the person who sets up the business, who works night and day to get it off the ground and takes all the stress, risk and worry that inevitably go with it to achieve the above objectives.

Whilst you set about putting the right protections in place for the business, what about your family and you – the protection of your lifestyle now and into the future?

Perhaps the most important asset a new business has is its people and initially that is the entrepreneur who sets it up regardless of its structure. As time goes on this may extend to employees but initially it is the founder.

And when you have got the venture off the ground and are making profits – there is the consideration of planning how best to use them so that your longer-term as well as your short-term lifestyle is planned for:

- Is it not logical therefore that when you look to set up your business you also look to protect/insure yourself – if not for you, then for your family?
- Is it more important to insure the wastepaper basket via your contents insurance than to insure you, who creates the money in the first place for yourself and your family?
- Finally, would it not be great to know that the back door has been locked so that you can focus on building wealth with some security in place in case it goes wrong?

The simple fact is that any person planning to take the leap to set up their own business should also look to find a good financial adviser, preferably *before* setting out on the exciting business adventure.

This will allow for a proper understanding of the less palatable and desirable personal business risks of running your own business and thus help ensure that any business founder(s) really do go into it with 'eyes wide open', and also with a thorough understanding of business and personal wealth creation potential.

This puts the business owner in an informed and better position to make the right financial planning decisions as time goes on and with a much better chance of achieving their ultimate objectives – whatever they are.

Specifically, therefore, in addition to business risks it is important to consider:

1. **Family and personal protection** – in leaving your employed situation, did you leave behind some 'taken for granted' and important protections that need to be replaced for the benefit of your family as soon as possible? These may have included:
   - Death in service benefits – typically twice your salary and if you were a member of a final salary scheme, sometimes including widows' and dependents' income benefits.

- Sickness benefits – there is no protection if you are sick when you set out on your own and as most now know, the state is reluctant to pay out anything of any significance. What it does pay will not cover most people's mortgages and household bills – so even your home may be at risk in setting up your business.
- Pension benefits – these are almost invariably undervalued. Even if you are/were not in a valuable final salary/defined benefit arrangement, there is every chance you have enjoyed an employer's contribution to a personal pension arrangement of some kind which will no longer be there.

In making the leap to the ideal of 'self-sufficiency' therefore, the first questions that should be on the financial planning agenda are:

- What is the minimum protection you and your family actually need?
- What are the consequences of not having it for you and them?
- How can you put that protection in place cost effectively, having regard to how you are setting up your business?
- How much will it actually cost?
- When is it reasonable for me to set it up?

2 **Future wealth creation and retirement planning** – you need to know *at the outset* how you might be able use profits in the business as they start to come through to achieve your objectives. (It is too easy to *live for today* and forget that tomorrow does actually come to most people faster than they think too.)

Most business advisers will advise that good business planning needs long-term personal as well as business goals, and to achieve those you need to know at outset ideally what the possible options are, how they might benefit you and how they may be achieved – accepting of course that any plan has to be reviewed and above all be flexible.

So for example you need to know at outset how profits:

- might be used to effectively improve your personal wealth and future financial security *regardless* of what may happen in the uncertain future, whilst at the same time understanding how profits ...
- can in some circumstances be protected from creditors should the business fail; and yet whilst sheltered in this way, ensure profits ...
- can (subject to certain rules and limits) still remain accessible to the business in times of cashflow need via short-term lending.

Setting up your own business is of course a risk – life is a risk – and if you don't take any risks you never move forward. But if risks are going to be taken, surely a wise man or woman knows what they are before they set off so that he she can decide from an informed position which risks they are willing to take for themselves and their family and plan for them as time goes on?

Mandy Caunt is a Chartered Financial Planner and Director of Kingston PTM Limited based in Northampton and Ferndown (Dorset). She also personally holds the International standard ISO22222 certification that recognizes consistency and quality of financial advice to clients. Kingston PTM Limited specializes in providing fully integrated financial and tax planning and accountancy services to individuals and SMEs. This includes advising and arranging pensions, investments, life and sickness protection and, within taxation, offering a tax advisory, compliance and accountancy service. Telephone: 01604 636345, e-mail: **mandy.caunt@kifagroup.co.uk**, website: **www.kingston-solutions.co.uk**.

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PART TWO
Innovation

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Innovation in the crowd

2.1

Entrepreneurially and financially, innovation is becoming more collaborative, reports Brian McCaul at Networthnet

> *This is really the biggest paradigm shift in innovation since the Industrial Revolution.*
>
> **PROFESSOR ERIC VON HIPPEL, SPECIALIST IN INNOVATION MANAGEMENT, MIT**

> *Peer production is about more than sitting down and having a nice conversation... it's about harnessing a new mode of production to take innovation and wealth creation to new levels.*
>
> **ERIC SCHMIDT, EXECUTIVE CHAIRMAN, GOOGLE**

Crowd wisdom, *crowdsourcing* and *crowdfunding* are emerging as powerful new ways of mobilizing external resource to drive innovation. Arguably, we are witnessing only the beginning of the impact of these trends on our ability to develop new ideas, products and ventures. Still, it's far from clear how this relates to the standard innovation processes of most established companies, corporates and the wider entrepreneurial and investment community. Those working to turn new technology into new business have yet to embrace the crowd as core to their work. I would argue that if used in an integrated manner, the crowd offers the prospect of lifting the lid on the most intractable bottlenecks in the knowledge transfer (KT) and innovation pathway. How? By cracking three major constraints:

1. **Filter Failure**. Crowd wisdom remains at the periphery of business decision making – yet it holds the potential to crack some of the most resource-intensive and difficult problems in the venture capital (VC), early-stage investment and technology transfer (TT) business: picking winners.

   Entrepreneurs, VCs and angel investors alike, struggle to find effective and affordable means to sort the 'wheat from the chaff'. Most either erect

artificial barriers to idea flow (such as referral) or throw more expensive people and resource at it. Corporate R&D outfits and university TT offices alike simply handle the same problem by 'erecting' often bureaucratic stage-gate processes that are biased to saying 'no' for fear of the false positive over the false negative.

The benefits of crowd wisdom range from Goldcorp using the crowd to beat its professional geologists in identifying the most likely spots for gold exploration – resulting in a 30-fold increase in gold yield – or to allow Made.com to determine which designs reach the production line, eliminating product failure. Likewise, investment decisions would generally benefit from a good dose of crowd intelligence and diversity.

2 **Non-Scalable Business Development**. As *Open Innovation* reminded us, 'most of the smart people don't work for you'. You can't afford to employ all the necessary skill sets to effectively handle even the best innovations that come across your desk, never mind all that are potentially viable. Activating, selecting and nurturing a range of IP opportunities to fruition is time- and resource-intensive. New venture or product creation calls on a broad range of highly-skilled players with both technical and business acumen, required to understand, appraise and realize opportunities. It's not possible for most – if not all – businesses, VC funds or universities, for example, to employ sufficient people to drive forward the quantum of opportunities that a university can generate. It's neither practical nor affordable. Engaging external collaborators is the only way scalability can be achieved.

(Crowdsourcing, perhaps, has made greater inroads into the transformation of some business processes on the back of the well-worn route to outsourcing but without the downside of lock-in. It's also the obvious route to expanding access to skills and achieving more with less in commercializing early technology.)

> Right now, entrepreneurs like these bakers and these gadget-makers are already using crowdfunding platforms to raise hundreds of thousands of dollars in pure donations. Imagine the possibilities if these small-dollar donors became investors with a stake in the venture.
>
> White House Office of Science and Technologies on the American Jobs Act

3 **The Valley of Death**. Venture capital, with a few exceptions, continues to drift away from the early stage of technology development. Many of the public interventions designed to address this 'market failure' have evaporated as the public purse has been constrained, Regional Development Agencies (RDAs) have disappeared, and bank debt is rarely an option. Crowdfunding remains, in the main, the preserve of creative industries, services and consumer goods. However, crowdfunding is likely to explode as an industry, with thousands of emerging platforms, and with the Jobs Act slowly crawling its way through the end stage of the US legislative process.

The other bright spot in the UK early-stage investment landscape is Seed Enterprise Investment Scheme (SEIS) and Enterprise Investment Scheme (EIS) tax breaks, and the stimulation of angel investment; link these with the crowd

too, and then there is perhaps a new game in the investment town. Angels are increasingly working together to share experience and spread risk – 35 per cent said they invested more as part of syndicates than they did in 2011–12. So the distinction between angel syndicates and the crowd increasingly melt in many respects.

For the more mature venture, crowd or peer-to-peer lending platforms such as Funding Circle present viable debt instruments in place of the banks.

Integrated well, the three crowd-driven approaches – wisdom, sourcing and funding – map onto each of these bottlenecks and have the potential to unlock each of the constraints. So if this is the potential solution to core constraints in new business creation, and these are the general trends, what's stopping the progress towards their wider adoption?

One might assume that as these models develop and become accepted, regulated and legalized, they will eat into the natural way of things. As with any new approach, it's only when the approaches are coordinated into a coherent business model and molded to the specific needs of a profession or a business sector, with reasonably well-defined routines, that they become widely adopted. Only when the use of the crowd meets the needs and challenges for early-stage commercialization, investment, business creation and technology transfer, will the real benefits be demonstrated. In short, we need to prove the business model.

That's what many emergent communities, such as the Innovation Commons, are trying to demonstrate. Specifically, there are three features of knowledge transfer (KT) that need attention.

The lean start-up and crowd wisdom

Early-stage commercialization needs early market validation. Done correctly, crowd wisdom is the nearest thing that we have in our toolbox to an external validation. Not only does it provide missing data and information on market application, it provides diverse new perspectives and potential pivots. It guards against group-think. More crucially it moves the validation point for a potential project forward before the commitment of scarce resource. But if the question is 'is the assessment of an early-stage venture too complex to use the wisdom of the crowd as a filter process?' then the response is 'not if you get the right crowd – a crowd of experienced entrepreneurs.'

The community of entrepreneurs and early investors is complementary to an R&D or product or service development crowd, providing external validation; that's what the Innovation Commons and its partner universities have sought to build. The process starts with a simple description of the innovation presented to the crowd, each being asked to vote independently. Business planning is deliberately minimal at this stage on the basis that, as Eric Ries points out, 'Old management methods are not up to the task. Planning and forecasting are only accurate when based on long, stable operating history and a relatively static environment. Start-ups have neither.'

Skin in the game: managing the risk of crowdsourcing

Crowdsourcing provides the prospect of scalability together with overcoming scarcity of skills. However, when adopting a crowdsourced model it is imperative to avoid the risk of 'coin-operated' engagements or consultants. In the complex context of commercialization projects the immediate problem is how best to manage multiple crowdsource arrangements. As Nassim Taleb points out: 'There is no possible risk management method that can replace skin in the game – particularly when informational opacity is compounded by informational asymmetry.'

Again, the Innovation Commons not only seeks to reduce the transaction cost of engaging external agents but it seeks to align the commercial incentives by creating long-term risk and reward sharing. Equity share and royalty share for the entrepreneurs are part of the model and ensures they are commercial and that interests are aligned.

Overcoming scarcity: crowdfunding as a complementary approach

Crowdfunding clearly has massive potential to support new venture creation. But with the often complex and technology-rich innovations emerging from SMEs, corporates or universities for example, they are difficult to present to the crowd 'as is'. IP arising from these R&D bases is earlier than most crowd campaigns are used to. It's often more complex in comparison to a pre-pay Kickstarter campaign, and it often requires the injection of an entrepreneur to drive it. If an SME identifies a tangential but potentially interesting innovation, it is unlikely to have the spare capacity to validate the opportunity or to undertake the necessary business development. So running these early innovation projects 'raw' into a crowd-based funding site is less likely to work. Very early-stage technology commercialization lends itself more to equity-based approaches (such as Crowdcube or other regulated equity sites). The lack of an embedded entrepreneur also needs the matching capability of the Innovation Commons, but crucially it also needs to be further de-risked.

The Innovation Commons is experimenting with addressing all three of these issues: matching grant opportunities to relevant grant funding, matching them to angel investors, and blending this with crowdfunding. This might just allow us to reduce the risk sufficiently for each stakeholder. In addition, if we could raise the aggregate 'intelligence' of the crowd or at least its tolerance of high-tech, this could open up the prospect of novel online (and offline) investment markets. The crowd brings further validation, new routes to funding – all of which are entirely compatible with traditional grant and private investment routes; they simply require some modification to bend them to the needs of high-tech opportunities.

So where next for the crowd?

The potential for the crowd is great, with the internet opening up all sorts of collaborative entrepreneurial and investment opportunities. Now we need to widen this potential up to the general business community. All that is needed is to refine the online processes, to provide the platforms and scripts to direct what could otherwise be a complex set of processes and interactions. New venture creation and product development is not an easy game and the journey towards successful commercialization will only be as strong as its weakest link. Hence, we need to crack all the bottlenecks: simply addressing one link in the chain will not cut it. To quote Nassim Taleb again: uncommercialized inventions are only 'half-invented... taking the half-invented into the invented is often the real breakthrough'. Exposing the 'half-invented' to the right crowd of entrepreneurs, investors and customers is what is required.

But whether it's crowd wisdom, crowdsourcing or crowdfunding, a crowd needs to be a crowd, and critical mass is key to harnessing its power. The effect of opening up the 'half-invented' innovations from a dozen or so UK universities has been impressive to date. We've seen this work for a growing community of universities, which are now turning technologies into start-ups or licensing out to existing SMEs and corporates.

So we're now opening up this approach and engaging the services of the Innovation Commons and its growing community of entrepreneurs and investors to help unlock the power of the crowd more widely. SMEs and corporates – like universities – often have latent innovations and IP that could be validated and unlocked by this mix of investors, entrepreneurs and major technology providers. Our goal is to use this functioning marketplace to open up the wisdom, the skills and the resources of the crowd for the benefit of those businesses and investors that have not yet seen a model that works for them. With the right crowd, the early-stage technology needs of corporates and SMEs can be better serviced, and, conversely, any technology 'haves' that may not be core to a business might be converted from the realm of the half-invented into commercial value.

Brian McCaul is a director at Networthnet Ltd, an innovation system and platform development company. Networthnet works for some of the UK's main innovation intermediaries such as the Technology Strategy Board, the UK Catapults and a range of universities. Brian is the founder of **http://www.theinnovationcommons.co.uk** and has been involved in the start-up of over a dozen companies. He has been an early proponent of the power of the crowd, openness and collaboration in new venture creation.
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How to develop an idea

2.2

Follow four threads to bring an idea to market, says Professor Andrew Pollard at the Caparo Innovation Centre at the University of Wolverhampton

If an idea has any chance of making it all the way through to the market, it will have to pass four tests. Is it technically viable? Is the market strong enough? Is the right intellectual property in place? And can you finance it?

Don't try and answer these questions sequentially. In fact, you need to progress each of these dimensions together, and it is likely you will jump from one stepping stone to another.

By working with a university like Wolverhampton, you can get help to develop the technical and the business case for your idea, often supported by different forms of grant funding.

Grants

So what might be available? It depends in which region you are, but Wolverhampton is typical in the four schemes that are running up to June 2015, each backed by European Regional Development Funding:

- Innovation First – over two days, you can map out what technologies you might deploy in your company.
- Innovative Product Support Service – you can access five days of technical support. For instance, you might opt to design a 3D model; or you could ask for an electronic specification for a circuit board; or you could have an IP strategy written before deciding how to file for any intellectual property.
- I-UEN – another five days can be spent on preparing for a potential collaboration with a larger company or engaging with them through open innovation. You can get help to hone your pitch, put your market research into a coherent form and set out your proposition to a potential partner.
- Technology & Innovation Futures – offers a 50 per cent grant towards the cost of work by university specialists to develop designs and prototypes, which can be claimed once the work is completed.

Each scheme has its own criteria, of course, but are all targeted at smaller companies. In the EU's next funding round, Horizon 2020, this emphasis on innovation and enterprise is likely to be even stronger in supporting collaborative research.

For anyone thinking of trying out a university for the first time, Innovation Vouchers worth £3,000 to £5,000 are available nationally to let you run a project of your choice with an academic. For more experienced innovators, Knowledge Transfer Partnerships are a mechanism for bringing a graduate researcher into your company under the supervision of the university to tackle a specific challenge over two years at a third of the cost you would normally expect.

Applicants

One inventor who has benefited from such schemes is Trevor Wakefield, a lifelong roofer, who was seized by an ambition to create lighter, cleaner roofs, using recycled polymers, rather than heavy clays.

After arriving here at the Caparo Innovation Centre with a couple of bags full of 2D sketches, he participated in a series of schemes: first to develop a 3D design, then a prototype, a technical specification and an installation guide, as well as marketing material.

By last year, he was selling 100,000 tiles a month online and appeared alongside Jaguar, Rolls Royce and GKN at an exhibition that ran alongside the Olympics, Make it in Great Britain, which showcased the best in British manufacturing.

Having started out on the university's Innovation Campus in Telford, Trevor is planning how to grow his sales to £8 million over three years, as well as developing his next idea: manufacturing solar tiles from recycled polypropylene plastic.

Threads

So what are the steps that someone like Trevor has to get right?

Technical viability

Different manufacturers had been trying to prove for years that plastic tiles were a viable alternative. None had convinced the test authority, BRE (Building Research Establishment). Armed with our test data, Trevor was able to prove in a wind tunnel that his tiles could outperform any others on the market.

Market proof

Trevor's 35 years' experience as a roofer paid off. Rather than trying to mimic conventional tiles by making his version as heavy as possible like everyone else, instinct told him to take out as much weight as he could. You could then deliver a roof on a single pallet, rather than on an articulated truck.

So our desk-based research will tell you about the potential market for an idea and how many users you might reach. You can then take a view on your eventual scale. But in making commercial decisions, it is always worth gaining as much input as you can from your potential buyers.

Intellectual property

If you are ever going to realize any significant value in an idea you are developing, then you will have to secure your intellectual property one way or another. The first step is always to work out what is commercially appropriate for you.

In some cases, it will mean taking out a patent, particularly if you are intending to license your idea or you are working with partners. In other cases, you might choose to put your resources into proving that you have a market and then producing it in-house yourself. Either way, you have to ensure that you have created the most effective protection around your business idea that you can.

Finance

Before pursuing an idea commercially, it is best to be clear about how much cash you will require – and when. Remember to factor in all the costs: as well as designs and prototypes, include your own time.

Once you have your analysis, you can think about how you are going to manage your outgoings, as well as how you might defer them. You might opt to fund through a director's loan. Or approach an investor or customer.

Grants are less freely available than they were five years ago, but it is worth thinking broadly about how you might use them to offset your costs. A university is likely to be your first approach, but local authorities might help in deferring your rates and charities might be interested in an aspect of your innovation.

As well as steering you towards grants to offset the costs of your research, universities are likely to be involved in local funds for investments or loans, often sitting on management panels or hosting local networks of angels.

Early resolution

When innovations fail, it is almost a given that it will be for one of these four reasons. Rather than waiting until launch to find out which one it might be, it is better by far to identify any problems early.

Even if it takes you a couple of days to establish the disappointing reality that your idea is unlikely to work, you will have at least saved a lot of wasted resource and effort, which you can then put into developing your next idea.

Andrew Pollard started his career as a research engineer at GKN. For the last ten years, he has been industrial professor at the Caparo Innovation Centre at the University of Wolverhampton, where he leads a team of six engineers in supporting the development of early-stage ideas. So far, over 200 different companies have worked with the Caparo Innovation Centre in commercializing their innovations. Further details: **www.caparoinnovationcentre.com**.

Product design for SMEs

2.3

Design your way round business challenges and open up new markets, says Lynn Oxborrow at Future Factory, Nottingham Trent University

Good product design is a managed process that can lead to innovation, but which is not always well executed, can be hampered by economic, legal and supply chain limitations and is often overlooked by SMEs[1], particularly in challenging times. This chapter explores some of the benefits to SMEs of undertaking product design, and focuses specifically on the advantages of collaboration during the design process.

In a recent survey, SMEs identified rising materials costs, generating consumer demand and entering new markets as among the most pressing issues for their business during the current economic downturn[2]. The experience of SME participants in Future Factory[3], a project that supports sustainable design in SMEs, is that aspects of good product design can help them to overcome these challenges while gaining additional benefits elsewhere. The same survey identified that respondents found support for their new product development, product testing and materials among the priority areas for assistance.

The first stage in the managed product design process is to really understand the needs, context and conditions in which the product is expected to operate. Effective research of the market and product objectives can be resource intensive, but the benefits pay off in terms of developing a realistic product brief, early evaluation of potential solutions and establishing whether the product is really viable. Research in these early stages has enabled SMEs to enter new markets by identifying potential adaptations to their existing products, such as redesign of items in commercial use for domestic applications. One company is now selling planters for use in urban living settings that previously were only available on a large scale for public spaces. Another company, designing a product for use in brownfield reclamation, discovered that their planned product needed substantial modification to be cost effective, saving significant wasted time and investment.

Addressing the issue of rising materials costs is a challenge in the design process. But there are significant advantages to evaluating the costs, benefits and product life-cycle implications of different materials options. SMEs found that alternative materials could either reduce cost or add value and functionality to their products. One interior designer added value to her product by using silk instead of polyester. While this also enabled better after-life and waste degradation, new methods of production were

also designed into the product which saved on process time and cost. Meanwhile a reusable energy installer found that changing the materials used in fittings could significantly reduce cost and fitting complexity, but needed to be undertaken in line with the redesign of other aspects of the fitting to improve functionality.

To support entry to new markets, and to stimulate consumer demand, aspects of the design process can be especially valuable. Undertaking an objective but systematic evaluation of the materials, product and process design options can enable SMEs not only to better match their products to market needs, but also to articulate product features and benefits in a more convincing way. This is especially important as commercial buyers become more and more discerning and dependent on suppliers to reduce risk, and where access to wider consumer markets involves communicating product values online or remotely. One medical devices company found that designing a new product was complicated by the need to provide a product that was functional for clinicians to use, but also compliant with a host of different standards in order to meet stringent healthcare market entry qualifications. Another SME, who developed a new style of sustainable furniture, needed evidence of the qualities of a range of natural materials to update buyers' perceptions and convince them that additional purchase costs could be easily recouped over the lifetime of the product, which is both more durable and easier to repair than conventional alternatives.

This is not to suggest that product design is easy for SMEs to undertake. Research identifies that design projects often over-run, are undertaken in an unfocused way with too many projects at once, are often under-resourced and hampered by poor communications and lack of effective management[4]. In addition, in challenging times, day-to-day survival often takes priority while SMEs, understandably, respond to immediate customer demands or are put off by hard-to-follow regulations. And yet there is also evidence that well managed product design projects can be part of a process of organizational development[5] which in turn improves the innovation performance of SMEs – potentially providing a major boost to their opportunities for success and growth.

What differentiates the SME design projects referred to above is that these have been undertaken collaboratively. Working alongside product design staff and students at their local university has enabled these SMEs to undertake more extensive initial research, access technology and skills otherwise unavailable to them, and generate objective evaluation and test data that is credible in the marketplace. Furthermore, working with multi-disciplinary project teams has enabled SMEs to work through some of the unforeseen issues and benefits that arose as their ideas came to fruition. For example, the furniture company were able to use new technologies to identify a simplified, modular manufacturing process for their product which not only added to the product values, but also enabled them to manufacture in-house – thus gaining control and transparency throughout the process. The medical devices company were able to access both the product design and software design skills needed to refine their product idea and develop a working prototype. Other benefits of collaboration have seen SMEs testing each other's products, exchanging ideas and collaborative efforts in marketing and communications.

Such networking, as part of the design process, can significantly add to the organizational learning aspect of product design. If this ultimately enables SMEs to be more innovative then it should be worth the effort. The MD of the furniture

company suggested that having the additional activity going on outside of his company encouraged him to champion the project, in spite of the other demands on his time and resources. Another SME commented that working collaboratively enabled them to progress their idea further and more quickly than anticipated.

So, in summary, the benefits to SMEs of undertaking product design include the opportunity, appropriate product and evidence necessary to access new markets. Consumer demand can be increased by offering enhanced products with a better fit to customer needs and the information needed to convince potential customers to purchase – again and again. Moreover, product design offers the opportunity not only to evaluate the costs and benefits of alternative materials – potentially overcoming rising prices – but also enables SMEs to incorporate cost and waste-reducing into their operations, as well as value-adding functionality into their products. The lessons that SMEs can learn are that the process needs to be well managed, while flexible enough to incorporate the unforeseen and well-researched to avoid pitfalls and wasted resources. What's more, SMEs can benefit substantially from collaboration, both internally and externally, to broaden their access to skills, expertise and resources, as well as benefit from wider capability and performance improvements.

Notes

1. Fernandez-Mesa, A *et al* (2013) Design management capability and product innovation in SMEs, *Management Decision*, vol 51, No 3, pp 547–65
2. Survey of 413 SMEs undertaken by Future Factory, Nottingham Trent University and three UK-based Chambers of Commerce, autumn 2012
3. Future Factory is funded by the European Regional Development Fund and Nottingham Trent University (2009–2015) to support sustainable product and process design in UK East Midlands SMEs
4. Filson, A and Lewis, A (2000) Cultural issues in implementing changes to new product development process in a small to medium-sized enterprise (SME), *Journal of Engineering Design*, vol 11, No 2, pp 149–57
5. Oxborrow, L and Brindley, C (2013) Adoption of 'eco-advantage' by SMEs: emerging opportunities and constraints, *European Journal of Innovation Management*, vol 16, No 3, pp 355–75

Future Factory enables SMEs to adopt more sustainable products and processes and has, to date, assisted over 170 SMEs to collaborate with the UK knowledge base, many for the first time.

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IP for maximum value

2.4

Matthew Smith at Mewburn Ellis discusses how to pick the right battles for your intellectual property

There is no question that a strong intellectual property (IP) position is vital to the success of a growing business. Equally, a weak or poorly thought-out IP position has often been their undoing.

So, a question often asked is: how can I use IP in my business when I don't have the financial resources of the big established companies?

You need a good strategy. And you need that strategy to provide good value.

Strategy

The *Oxford English Dictionary* defines strategy first as 'a plan of action designed to achieve a long-term or overall aim'.

A second definition is also given: 'the art of planning and directing overall military operations and movements in a war or battle.'

The business battlefield is fiercely fought and gaining a stronghold is tough. IP is a key part of doing so. It plays a dual role:

1. The 'shield': well-planned IP strategy keeps competitors out, leaving you free to consolidate your position and improve it.
2. The 'sword': IP strategy might not only protect your position but may also attack the borders of others, or provide tools for otherwise gaining an advantage.

Both of these roles are important. Ignorance of either, wilful or otherwise, is a mistake. Competitors will also be formulating their own strategies: defending their positions, attacking yours. Too much focus on defence or attack, and opportunities will be missed.

So what do you have at your disposal to help?

The arsenal

IP provides a number of tools you can use. They vary in purpose. They vary in cost. They even vary in how they are obtained.

For example, patents cover innovative technical features, while designs protect the appearance of a product. Trade marks protect things like slogans and logos which help customers identify the origin of a given product or service.

In practice things are not so cleanly divided. For a particular product, a range of potential IP rights might be generated. A product might be protected by a patent covering a technical aspect of the mechanism, a registered design covering the look of the product, and trade marks covering the manufacturer's logo and the name of the product.

Some IP rights come into existence automatically (for example, copyright in the UK). Stronger 'registered' rights, such as patents, registered trade marks and registered designs, must be specifically applied for. Sometimes, keeping something as a 'trade secret' can be just as effective.

Patents are expensive – but can protect a technical idea which applies to many different products. Registered designs are cheaper – but perhaps do not have the same scope for protecting multiple different products as patents do. Trade marks are also less costly than patents – but might not have the same intrinsic worth at the time of registration. Copyright is free to obtain in the UK (since it is automatic), but is more difficult to successfully enforce.

The battlefield

Location of the field has been the turning point of many battles. IP rights are territorial, and which territories you focus on must therefore form part of any IP strategy.

Of course, it would be nice to have patents in every country in the world. Unless your IP budget is virtually unlimited this isn't feasible. Even if you do have an unlimited budget (and are therefore very fortunate!) worldwide patent protection is almost certainly not the best way that money can be spent.

Attack and defence

IP rights act as 'keep off the grass' signs. With some more litigious companies, perhaps 'trespassers will be shot' is closer to the mark.

In any case, a primary function of an IP right is to say to competitors: if you want to do X, you'll need to speak to me first. There may not be a 'battle' as such: maybe a deal can be made for a licence, or even an assignment of the relevant IP right.

Indeed, a good deal of IP strategy looks at how IP can be used to increase the value of a company itself. The function of IP assets in preserving a competitive edge for the holder can be extremely valuable.

You can also consider if (and how) you can take action against your competitors and their IP rights. For example, in many countries patents can be attacked by third parties, who might argue that the patent should never have been granted. If the attack is successful, the 'keep off the grass sign' is torn down.

Furthermore, how rigorously 'keep off the grass' is enforced can be varied. Some companies are very active in this regard, while others are more reticent and seek peaceful agreement as a first resort.

Getting value

The arsenal

No one can sensibly expect to obtain every type of IP right for every activity that might be eligible. Instead they need to focus on choosing the right tool for the job. To misquote Sean Connery, don't bring a knife to a gun fight.

To identify what will be the best choice, you need to ask yourselves some questions:

- **Why does (or will) your company have the edge over your competition?** Be specific: a general answer like 'our better quality product' or 'we are better known' will not be useful. Why is your product better quality? Why are you better known?
- **Are there technical features which make your product work better?** Patents are the way forward.
- **Is your logo particularly recognizable?** Make sure it (and variations you might use) are protected by trade mark registrations.

In particular, identify any trends that appear. Perhaps multiple products share common technical features, or a striking appearance is common across a product range. Then there is the possibility of further value: a patent which protects a feature found in five products might be superior to one which protects a feature found in only one of those products.

The key is: **what do (or will) you need to stop other people doing if your company is going to retain its advantage and success?** Those are probably the things you primarily need to protect, and protect strongly.

The battlefield

If you can't have protection everywhere, where should you focus?

The tighter the budget, the closer to home a company tends to look. Protecting the home front is generally the first stop, before looking abroad. Home is where the heart is, and also where the bulk of a company's initial sales and marketing will be – the heart of the business, if you will.

Where else should be considered?

Large, commercially important markets are the first to catch the eye. The USA, Europe, Japan, China and India are obvious choices. However, depending on the particular business, things may be different. For example, a company selling malaria drugs might be interested in protection in African countries.

You can also peer a little deeper. Where are products (yours and competitors) manufactured? Where are they shipped/transported? By considering this, your supply routes can be protected, and your competitors' closed off.

It is unreasonable to expect to be able to close every avenue to competitors. However, if a competitor's only path is to set up new manufacturing facilities and sell in small markets, they will be significantly discouraged.

By sniping major markets with well-targeted IP protection, then, you can make healthy profits whilst accepting that in smaller markets the spoils must be shared.

Attack and defence

Getting your own house in order must, in IP, come first. The time when you apply for registered IP rights is very important. In particular, for patents, it is important that the first applications are filed *before* the invention for which protection is sought is made public. This is because the question of whether or not protection is granted is decided based on what was known to the public at the time the application was made. Further, registered IP rights in most countries are granted on a 'first come, first served' basis.

As mentioned previously, a strong portfolio will include several forms of IP protection. A patented product, whose appearance is protected by a registered design and whose name and logo are protected by trade marks will be tricky for competitors to replicate.

Furthermore, such a portfolio is much more interesting to potential investors. The more protection, the more solid their investment will be and the more interesting the investment will be to them.

To begin with, attacking might not be on the agenda. In most countries it is a costly process, and might not be the best way forward.

However, it is still important to keep an eye on your competitors' manoeuvres. That can be done by, for example, periodic searches to review patent and trade mark filings. Not only can you then get a better picture of where they are going, you can predict any future collision points. Forewarned is forearmed.

Pick your battles

Throughout IP strategy planning, it is important to be realistic. You can't pursue every type of protection for every country for every product. You can't avoid the fact that sometimes your applications for protection will be unsuccessful.

What you *can* do is pick your battles. With the right tools, applied in the right places and in the right way, a lot of strength can be developed and a lot of room for future expansion created.

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Finance in innovation

2.5

In fostering an innovative culture, finance has a fundamental role to play, says Gillian Lees at CIMA

The way organizations innovate is increasingly important to their survival and renewal. Innovative companies are being rewarded, and complacent ones being punished, with accelerating speed.

The nature and focus of innovative activity is also evolving. The traditional model, dominated by research and development (R&D), is diminishing. Innovation is now accepted widely as a fundamental part of every aspect of a business, including the finance function.

While chief financial officers (CFOs) are rarely expected to be the originators of a breakthrough product or technology, they are expected to contribute to an environment that ensures great ideas are spotted, encouraged, financed and delivered efficiently to market. Finance has an important role in challenging ideas and helping refine them to ensure a stronger business case. It also needs to ensure that the risks are considered properly.

However, it is a huge challenge to strike the balance between an enabling culture and a process that realizes the potential of new ideas. To get this right, we have identified five areas where finance leaders can have a critical impact on the way companies commercialize innovative ideas.

Create an innovative mindset

Successful companies foster a culture in which ideas can flourish. This starts at the top – a recent McKinsey survey showed that over half of respondents cited C-suite support as a driver of innovation success. The innovation culture must then permeate throughout the company. Innovative companies use a variety of employee incentives and initiatives to achieve this.

Finance should be deeply involved in creating the right environment for innovation. At a 2012 CFO Network conference, CFOs overwhelmingly felt they should have a large role in driving innovation through creating incentives and ensuring funding.

They may need to apply a different mindset to early-stage projects, where the premature application of too many key performance indicators (KPIs) and metrics can kill a good idea.

Respect and nurture creativity

Innovative companies understand that they need a distinct financial approach to judging and measuring innovation.

According to Edward Hess, Professor of Business Administration at the University of Virginia Darden Graduate School of Business: 'The goal of operational excellence is to drive businesses towards certainty, while the goal of promoting innovation requires a high tolerance of uncertainty, ambiguity and constant change.' Managing this conflict is at the heart of an innovative culture.

Companies need to align their financial processes and metrics with the stages of the innovation life-cycle. Typically, early-stage R&D projects should be governed by a more relaxed approach to financials – for example, by ring-fencing budgets and shielding idea generation from scrutiny. Only when ideas approach implementation should tighter controls be introduced.

Help partners plan for profit

Companies generally innovate in expectation of long-term rewards. Finance can keep innovation projects grounded by 'pushing for at least a sense that there is a conceivable path to profits,' explains Scott Anthony, author of *The Little Black Book of Innovation*. By putting discipline around the process of moving from idea to implementation, finance can help commercialize a new product.

Finance also plays a key role in resource allocation and in sourcing finance. As well as focusing on costs and efficiency, finance leaders increasingly need to understand which value drivers will protect success.

The key question is how to establish good financial management that manages business risk without stifling innovation. To achieve this, finance and risk management needs to move from being seen as a constraint on innovation to becoming a valued contributor: from saying 'no' to helping assess 'how'. This can be about challenging the ideas and measuring the opportunity scientifically.

At Diageo, finance professionals are embedded in the innovation process, says Group Controller, Stephen Bolton FCMA, CGMA: 'Their role is decision support in the process, from idea right through to launch.'

For John Beswick ACA, Group Capex Controller, BT Group, it is less about controls, more about:

> ... strong execution of plans with great project management discipline. It is not always about being first, but sometimes about executing a plan in an excellent way. Look at our fibre rollout in the UK. It's one of the fastest on the planet. Fibre is not new but our customers love it because we offer a great product. It's the execution that really separates winners from losers.

Finally, the best companies know when to call time on an innovation project that isn't right for the business. Limited resources inevitably mean that choices must be made.

Apply the right metrics at the right stage

Innovation KPIs and other metrics have a valuable role to play when managing a portfolio of innovation projects. But companies must beware the dangers of trying to put firm metrics around nascent or experimental initiatives.

As a study of Australian biotech companies has shown, firms that staged investments in innovation projects – increasing or discontinuing funding as the project progressed – were the most successful innovators, as measured by patents. Firms using traditional financial criteria, such as market size and cashflow estimates, were less successful innovators than firms that had no set financial criteria for innovation projects.

Balancing the needs of the operational business and the innovation pipeline requires a finance chief and department willing to 'create and manage dual financial systems simultaneously,' explains Professor Hess. Some recommend separate budgets for different types of innovation.

The stage-gate process used by many companies allows them to tailor financial metrics to the stage the innovation has reached. When starting, the innovation has to meet only modest criteria to continue. The funding is also modest, limiting risk if the project is later abandoned. Early-stage project selection criteria may include, for example, analysis of basic questions about whether competing products have been identified and what advantage the new product or technology offers over alternatives. But as it passes each 'gate', it must meet higher hurdles to release the next level of funding.

If it does not achieve expected results at any stage, determine why. If outcomes are better than expected, a company could accelerate the programme and invest more resources.

Take a balanced view on risk

Ernst & Young's Jonathan Blackmore says: 'Risk and innovation are two sides of the same coin.'

Anita Menon, Chief Risk Officer, Prudential BSN Takaful, a joint venture between Prudential PLC and Bank Simpanan Nasional, says: 'Risk management is not there to apply the brakes but to encourage the business to understand that it needs balanced strategies to grow.'

Recalibrating attitudes to risk is a key way for finance professionals to help innovations flourish.

They can do this by ensuring that an organization's risk appetite is well defined, understood, and set out in its strategy. They can use risk management as a strategic tool for managing risk–reward trade-offs across innovation projects. Companies need to build both tangible ('hard') and intangible ('soft') risks into their strategies. This requires a step change in attitude because a soft risk (such as the risk of not innovating) is hard to quantify.

Perhaps the most difficult risk to understand and manage is that associated with disruptive innovation.

Steven Marshall FCMA, CGMA, Chairman of construction firm Balfour Beatty, says:

> It is much easier if you are small and have nothing to lose. If you are a market leader, you will think very hard before you disrupt your own marketplace. But the real issue is value maximization and there will be occasions where a disruptive approach is sensible.

Kodak provides a salutary case study for those unprepared to countenance disruptive innovation. The company invented the digital camera in the 1970s, but failed to exploit the technology fearing that it would cannibalize its traditional film products, which dominated the market. The decision presaged several decades of decline as the company struggled to catch up with competitors and define a new business model. Eventually, in 2012, the company filed for bankruptcy protection.

Conclusions: innovation challenges and opportunities

With the right attitude, finance can be an effective co-pilot on innovation, helping guide the business towards its goals. But getting there may require new thinking. The goal for finance must be to create a supportive culture that fosters creativity and ideas, and underpins them with checks and controls, so that the organization can successfully turn ideas into commercial success.

CASE STUDY Royal Dutch Shell: A less mechanistic mindset

Royal Dutch Shell has a huge innovation programme. It allocates around US $1.5 billion to R&D annually and invests an estimated US $4 billion on deploying innovation efforts. The role of finance in this is multifaceted, explains CFO Simon Henry FCMA, CGMA:

> *A finance function needs to understand the business well enough to know what is a worthwhile activity; but also, in this part of the business, to have a more open mind. It is less mechanistic and can live with ambiguity.*
>
> *We want to encourage innovation, but in a controlled way. We have a well-defined, 10-stage-gate process. At each gate you can say, 'Shell is going to fund this to the next four stage-gates, at which point we'll take another decision'. Or we put it into a joint venture and we keep an equity stake. So there are different routes to commercialization.*

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Collaborative partnerships

2.6

As long as you get your intellectual property issues in order, collaboration can be a good thing. Otherwise it can easily let you down, says Avi Freeman at Beck Greener

To many small and medium-sized enterprises, collaboration with another entity provides a cost-effective and strategically beneficial way to grow and develop. However, issues associated with intellectual property (IP) need to be carefully considered and planned for. Rushing into some form of collaboration without paying due care to IP issues can store up problems down the line.

IP is a key part of a growing business's strategy. It serves as a way of measuring return on investment in research and development (R&D) and also of building a legally sound protective infrastructure around your business. With the recently introduced 'Patent Box' UK tax regime, obtaining patents in the UK and Europe can actually provide a quick and direct return on investment in IP. There are a number of different types of IP. In this article we will concentrate predominantly on patents, but before we do, a few brief words for the uninitiated …

IP is the umbrella term for a bundle of rights that can be used to protect new inventions, ideas and artistic creations. Perhaps more generally they can be thought of as the way to legally protect your company's creativity. IP includes different types of legal right that protect different aspects of a new invention or idea. A patent would protect the technically innovative development. A registered design might protect the way the invention looks. Trademarks would be used to protect the name of the company or the product under which you wish to sell it. Copyright protects the words you write down that describe how the product works, eg in instruction manuals or advertisements.

IP ownership in collaboration

When innovating and investing in R&D it is essential to make sure that you have agreement with your collaboration partner as to who owns the rights in anything created as part of a joint venture. The specific law for each type of IP is different and the agreements that you have in place at the time the innovation is made can be key.

Example – IP associated with a new product

Let us consider a specific example of a new type of vacuum cleaner (it really could be anything but we will use the example of a vacuum cleaner as it is easy to understand and brings many issues to light). Let us imagine that you are the MD of a company that has for many years made vacuum cleaners of one type and yet you have had an idea for a new product that can detect when certain types of dust particle are sucked up by the mechanism.

As a company you know lots about the mechanics for lifting dust particles off a floor, but very little about the technology needed to determine what the particles are. You have come up with the idea of routing different types of particles within your device to different parts of the system for different processing. Doing this has a beneficial effect on the life of many parts within the device and generally makes the cleaner last longer. You need to collaborate with a company that specializes in the detection of particles. Whereas you know about cleaners, you need someone who knows about particle detection. How do you start and what do you do?

First steps – file a patent application for your invention or get an NDA

Ideally, before you make any disclosure of anything that is new or potentially inventive you should have a patent application filed for it. You will need to seek professional input from a qualified patent attorney.

If you have not had time or resources to file a patent application, it is essential to protecting your innovation that at the very least, before you disclose your idea to anyone, you have a written non-disclosure agreement (NDA) in place.

Identify potential 3rd party collaborators

Once you have an NDA and/or preferably have first filed a patent application to the broad idea, you conduct research into potential partners who are experts in the field of particle detection. You approach them asking them first to sign an NDA. Even if you have filed a patent application it can be beneficial to have an independent third party sign an NDA.

Your first approach to a potential collaborator should not disclose more than a basic idea and not in terms that give away anything about how it works. It will need to be enough to get their attention but not so much as to give away the details.

Agreement with 3rd party collaborator

Assuming all goes well at this stage and you obtain agreement with the third party to work together to develop the product then the project can proceed. It is important to have in place agreement as to who will own any new IP that is generated from the collaboration. In some cases you might start a new company in which both parties own a share.

Alternatively you can decide that any IP developed jointly or through the collaboration will be filed jointly in the names of both parties. It is important to remember that in most countries the employer of an inventor has the rights in law to any related patent for the invention. That means the agreement between you and the third party must contain some provisions as to what happens to the IP as soon as it has been filed, eg a share to be assigned to the third party so that both parties can then proceed as joint owners.

Potential pitfalls – problems to look out for

When all is going well collaboration works very well. It provides a means by which the investment and risk of innovation can be spread so that one party does not have to bear it all. At the same time the creative energy of two parties working together can often spur a project on to more than either party would have been able to achieve alone, or indeed to more than their combined individual efforts; the product is greater than the sum of its parts.

However, there are pitfalls that can occur and you need to do everything you can to avoid them.

One problem that can arise is when an agent or distributor files your IP in their own name. It is important to have in place in any agreement with a third party provisions that prohibit this and make it clear which party owns what IP.

When commissioning a third party to design or create something for you it is important to stipulate that IP created will belong to you. This can arise in situations where students are commissioned by SMEs to create material for no money. Without any agreement to the contrary the student can be taken as the owner of the IP so it is important not to fall into this trap simply by being unwary.

Getting a friend or family member to design your brand/website for free can also cause problems if there is no agreement as to ownership of IP generated. Make sure that the agreement in place between you is clear on this.

Overall, in today's connected world, the trend is towards a model of open innovation where companies and individuals collaborate so as to generate new ideas. This is all well and good, but it is essential that you have protected whatever you can before you expose your ideas to the world and prompt others to innovate in the same area, or worse, simply to copy you.

Collaborating with large companies

Looking forward to trends and developments in this area, some issues are particularly worthy of mention. Large corporations are often on the look-out for smaller innovative companies. Being small provides a great degree of freedom in terms of versatility in direction and methods of research. It may well be that some specific technologies are better suited to developments in small companies. However, at the inevitable interface with the large corporation IP needs consideration.

Many large corporations will not, as a matter of principle and practice, sign an NDA. They do not want to enter into any agreements that may limit their own independent avenues for R&D. They will expect an SME to have its IP ducks in a row and to have filed patent applications before opening negotiations. Having done this says a number of things to the large corporation over and above the fact that you have the IP. It says that as an SME you have the confidence and belief in your own technology to invest in the IP. Some forms of IP are not cheap, and by being prepared to pay for a professionally drafted patent application you are telling the world that you mean business.

Choose the right partner

When seeking a third party with which to collaborate it is important to choose the right type of partner. There are numerous different types of organization with which you can choose to partner, and depending on your desired goals or 'exit', the decisions as to who this might be will vary. For example if you want a simple financial collaboration then a bank or financial provider of some sort will be required. This is not a research-oriented collaboration of the type outlined above but nonetheless a funder has an interest in your technology and so may seek to exert some influence over direction and strategy. It is important in this case to have your IP situation, eg filing, ownership etc, sorted.

Some financial investors will only invest if you have your IP in place. For example, some banks or VC funds will only invest if you have filed patent applications for your innovation. This is for the reasons given above but also because before you have made and sold a single product it can often be only your ideas and IP that you actually have.

Other types of organization have their own similar issues, whether they are universities, public sector organizations, 3rd party commercial organizations or even individual investors or inventors.

Conclusions

In conclusion, collaboration is often essential for an SME wishing to develop its technology or take it to the next level, whatever that may be. In general this is good and should not be feared, but for a number of reasons there are IP factors that need

to be taken into account and the earlier you do this, the better. Make sure you do not publish your ideas before disclosing to third party or filing for protection. If possible file for all types of registered protection before contacting an outside party and disclosing anything to them. If possible get a signed NDA from anyone you are going to disclose your IP to, even if you have already filed for patent applications. Where your collaboration is likely to lead to the development of more IP make sure you have agreements in place that clearly and fairly stipulate who owns what and what rights each party may have to it.

This article is not (and is not intended as) formal legal advice. It should not be taken as such. It merely presents an introduction to issues encountered in certain areas of IP and should be read in this manner. Any specific questions that a reader may have should be referred to a qualified IP professional for advice.

Avi Freeman is a partner in Beck Greener, a highly-regarded Intellectual Property firm based in Central London. With over 20 attorneys specializing in different fields, the firm covers all areas of intellectual property including patents, trade marks, designs and copyright.

Heading up the electronics and mechanical engineering team at Beck Greener, Avi has over 15 years' experience as a European and UK patent attorney and works in a number of fields including computer software and hardware, engineering, electronic, optical and mechanical devices in both light and heavy engineering, telecommunications and business methods.

Avi writes and publishes in the field of computer implemented inventions, and travels widely to the United States, Asia and the Middle East, speaking and presenting on matters of European law.

Avi's client base ranges from large multinationals to small and medium-sized companies. He enjoys helping SMEs develop their intellectual property to support their growth, and also working with hi-tech companies to help protect innovative new products.

Prior to Beck Greener, Avi worked in-house as a patent attorney for a large photographic company where, as well as working regularly with inventors and engineers in the filing and prosecution of patent and design applications, he advised in respect of the development and implementation of IP strategy. Working in an in-house role such as this has provided Avi with a broad overview and understanding of the importance of IP to a company.

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PART THREE
Building the brand

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Content for social media

3.1

Geri Richards, CEO at Publicis Blueprint, discusses why every CEO needs a content marketing strategy

Entering the brave new world of content marketing can at first glance appear somewhat overwhelming to those unfamiliar to it. The sheer pace of its development, the different and conflicting 'received wisdoms' and apparent best practice out there, and the number of content specialists, reveal this to be a sector that has grown at an unprecedented rate in recent years.

In truth, there is little to be feared of this vital discipline for brand communication because this world is not really a new one at all. Many brands have already been doing it for years through customer publishing, which delivers appropriate content directly into the hands of any brand's customers.

Strong examples include in-flight magazines for the aviation industry – it's likely that you've browsed through one when travelling as research shows they are read by the majority of plane passengers, where available (source: Arbitron). The retail sector, too, has used content marketing to great effect, with retailer customer publications being the top three most-read titles in the UK (source: Audit Bureau of Circulations). Readers spend an average of 25 minutes reading a customer magazine, according to research by Millward Brown. And one in four people actually pick up a magazine three or more times before they finish with it. It's not just for business-to-consumer brands, either – business-to-business (B2B) practitioners are also embracing content marketing, with 30 per cent of the Content Marketing Association's members being B2B specialists.

Where historically the sector has focused on magazine publishing, technological developments and the explosion in digital and social media channels has resulted in a further liberation from the old scheduling restrictions and editorial curation. This means that brands and consumers can now have a deeper, more meaningful and ongoing conversation than they ever could before. It's therefore essential to ensure that you have in place a content marketing strategy that delivers what your customers want on whatever platform they want it, online or offline.

Because it is 'pull' rather than 'push' marketing, content marketing is one of the most effective disciplines that a brand can use. It can drive word-of-mouth and take customers on a seamless brand journey. In this respect, it presents a golden opportunity

for brand owners not only to ensure the retention of existing customers or maintain brand awareness, but also to generate a relationship with prospects and convert them into new customers and brand advocates.

A content strategy is broad, and it will depend on what you want to say and to whom. Nowadays it can also extend to social media, specifically when a brand considers how it should respond and react to the growth of social media sites, such as Facebook and Twitter. Whilst these are an important part of the content marketing armoury they are restricted – usually – by the context of the platform. So content needs to be tailored to the particular requirements and the expectations of its users: for example, the publication of short information messages on Twitter, or the creation of games and quizzes on Facebook. Generating a 'like' on a brand's Facebook page is all very nice, but there needs to be a detailed editorial plan so that customers are taken on an engaging journey – Facebook alone is not the answer. Nonetheless, for many brands that are just starting out on a content marketing journey it's a good and relatively cost-effective place to create a dialogue with consumers before embarking on something more sophisticated.

As with any communication, whether online or offline, the starting point for content marketing should always be 'who are we talking to?' and 'what will interest and delight them?' To help answer these questions, an important consideration is what benefits a content marketing agency could bring versus an in-house content model. Whilst brands may know their own customers and markets inside out, what a good agency adds is experience, as well as strategic and editorial intelligence. Together, the agency editorial team and the brand marketing experts can deliver and share brand messages that consumers want and need – regardless of the content distribution platform.

Content marketing agencies specialize in customer engagement using multichannels. These include responsive online solutions, tablet publications and apps. Their mission is to reach customers wherever they are, and to drive marketing objectives forward using content for deeper customer engagement and experience, that informs, entertains, intrigues and amuses. This is done using a mix of data planning, analysis and insight, and the set-up of a content hub which pushes targeted content out based on each customer segment's needs. Bringing data into the mix is vital for more targeted communication – whilst generic content might provide mass entertainment, customer-driven data can be used to provide customers with more relevant, targeted content that is proven to deliver even stronger results, drive customer action and increase propensity to influence desired behaviour.

For one of our clients, for example, we create monthly in-store print magazines, segmented bi-monthly HTML digital magazines and supporting e-mail for business customers, and a quarterly iPad catalogue app for reseller partners. The blend of complementary channels means that we can help to offer a holistic approach that delivers genuinely exceptional results.

For those brands that are looking to create such a relationship with the consumer where content is shared, it is important to think of it as one communication stream rather than a disparate array of disciplines. As well as offering major efficiencies and reducing the number of agency suppliers, it ensures a consistency of messaging across all platforms, whether they be traditional print, blogs, social, electronic direct marketing or mobile marketing.

Ultimately, what is pivotal to any content marketing strategy is that brands need to understand consumer needs – are you as a brand owner moving as quickly as they want you to, and are you answering their requirements? As consumers ditch the practice of bookmarking traditional media channels for themselves, the balance of power between brands and consumers is shifting. However, the competition for their attention has become more fiercely contested – as long as it's any good – so it is crucial to have a content strategy in place. There's no escaping the fact that it will become increasingly important to your business.

Geri Richards is CEO of Publicis Blueprint, the content marketing agency and part of the Publicis Network. They work with clients including Asda (producing their customer magazine, which is the second most-read title in the UK), Vue Entertainment, HP and Orange (EE). Telephone: 0207 830 3979, e-mail: **geri.richards@publicis-blueprint.co.uk**, website: **www.publicis-blueprint.co.uk/**

Building the customer highway

3.2

In your growth strategy, it pays to map the journey of how customers experience you and your brand, says Carol-Ann Morgan at B2B International

More and more companies now actively recognize that customers are their biggest asset: with no customers to buy products and services, there is no business at all. People who have a positive customer experience are more likely to spend more with that supplier, pay a premium for that service, and recommend the supplier based on the experience it delivers (as opposed to the features of the product or service). People who change to another supplier/brand are more likely to do so because of poor service, and they are equally likely to broadcast this.

In order to achieve growth plans, a company needs to widen its scope in seeking new markets, leveraging existing markets and/or developing its product or service portfolio. The link between positive customer experience and business success is compelling. Therefore, any company seeking to realize its growth plans ignores this link at its peril.

Differentiating on customer experience

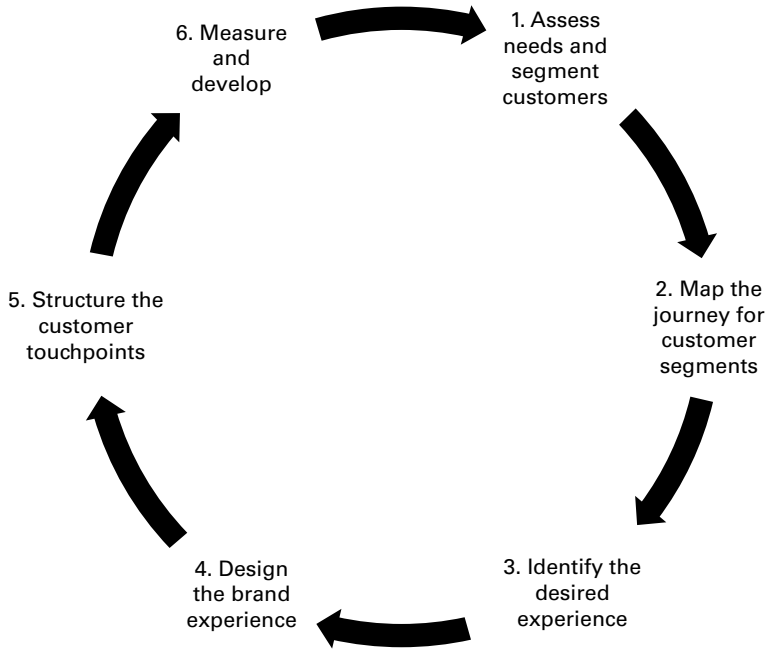
In an increasingly competitive business environment, the ability of a supplier to deliver positive customer experiences with the product or service, which reinforce the brand at all points, can make a significant difference. This is the basis of 'experience-based differentiation'. Advertising campaigns of many leading brands today communicate the *experience* of a brand or product, rather than its product features. The most successful brands have delivered an outstanding customer experience over the lifetime of their customers.

Customer experience management is defined by Bernd Schmitt (2003) as:

> the process of strategically managing a customer's entire experience with a product or company.

The key elements of his definition are, firstly, that it is a strategic process and thus embedded in all a company does; and secondly, that it is a process which travels the entire length and breadth of the customer's journey, from start to finish. Ideally, it even extends beyond this point, as a company seeks to re-engage and win back any lost customers.

FIGURE 3.2.1 A typical customer experience strategy approach



A typical approach for a customer experience strategy involves a process of several stages commencing with an understanding of the customer position, and including customer journey mapping.

This gives the opportunity to examine the experience and identify what the desired experience is. The loop is closed by structuring the experience to ensure it happens and then putting controls in place to ensure the desired effect has been achieved.

What is the customer journey map?

In order to design great customer experiences, it is critical to understand the current customer experience; creating a Customer Journey Map (CJM) is an ideal framework for this. The CMJ is described by Schmitt as:

> documents that visually illustrate customers' processes, needs, and perceptions throughout their relationships with a company.

The CMJ is a visual representation of customer interactions with a company and thus a tool to investigate, analyse and ultimately lay the foundations to improving customer experiences. Customer journey mapping requires us to step into the shoes of the customer and understand how our processes impact on the experience that he or she has with the brand and the company.

CJMs should include:

- a flowchart giving a diagrammatical representation of the journey which customers take;
- all interactions and interfaces (touchpoints) between the customer and the company/organization/brand;
- likely 'pain points' in the journey, ie areas where the customer is likely to experience difficulties or negative emotions;
- key 'moments of truth', ie areas where there is the opportunity to 'make' or 'break' the relationship.

Once maps have been developed, it is also common to then populate them further, to include:

- identification of departments, regions and people responsible for the delivery of the customer experience at each touchpoint (eg customer service, technical support, HR, sales and marketing, etc);
- linkages between touchpoints;
- emotions elicited and desired in the customer at each touchpoint;
- importance ratings for each touchpoint. This can include looking at the internal perception of importance compared to customer measures;
- performance of the company/organization/brand at each touchpoint. As with importance, the gap between the internal and external perception can be identified.

Types of customer journey maps

Customer journey maps can take several forms, depending on the needs of the business and the extent to which business processes are incorporated into their recording.

The typical business-to-business map

This type of map provides a strategic overview of the stages of the customer journey, along with the component touchpoints where a customer can interact or engage with the company at each stage of the journey (see Figure 3.2.2).

The tactical map

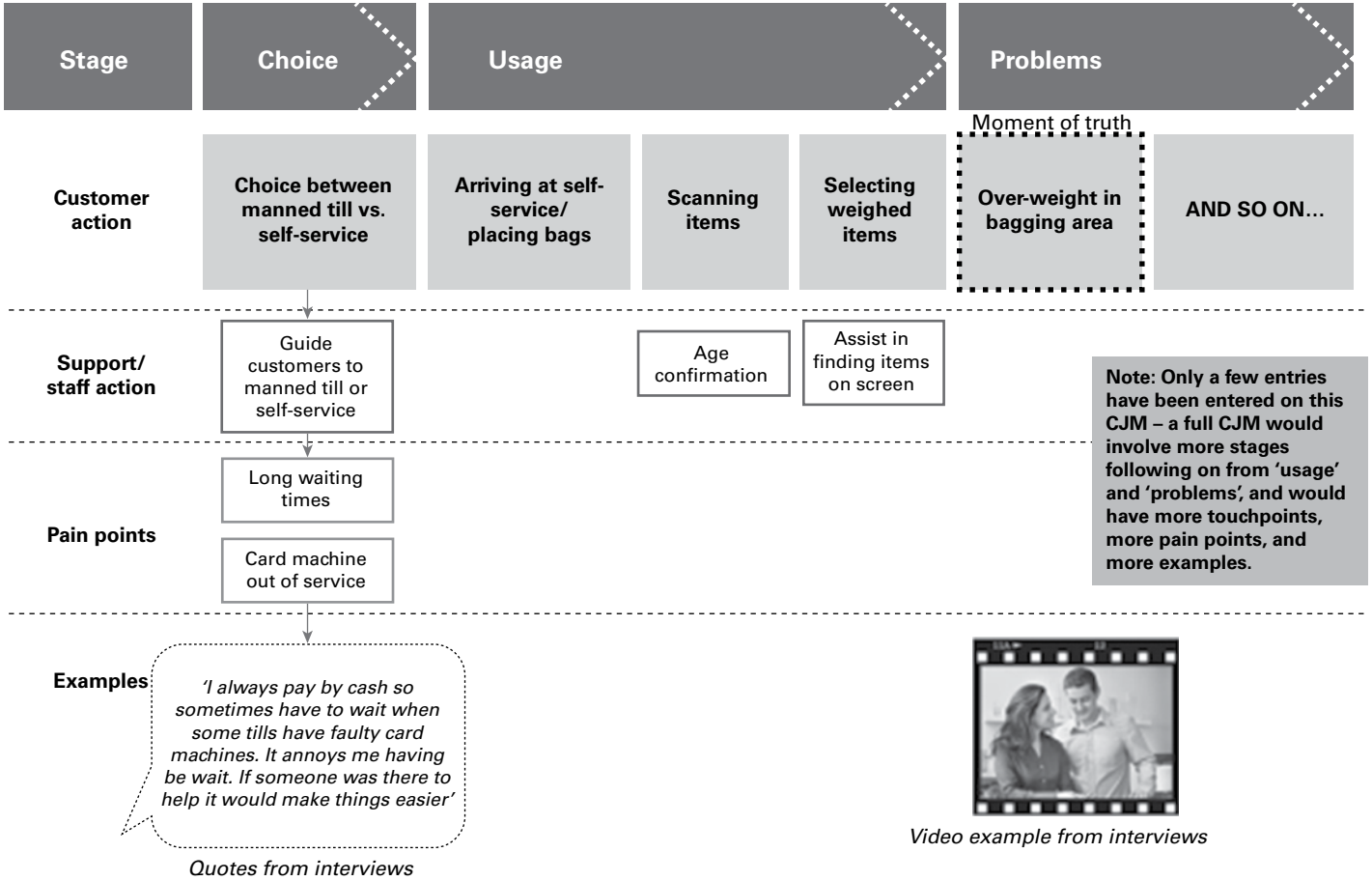
The tactical map focuses on a particular touchpoint (or cluster of touchpoints) to highlight the journey that the customer goes on at that stage.

This is particularly useful when looking at an important (or painful) touchpoint where performance needs to be at a high standard. Tactical maps can also be a useful tool for training teams that are responsible for a particular stage of the customer journey (see Figure 3.2.3).

FIGURE 3.2.2 Customer journey: Typical B2B map (with importance shading)

Awareness	Interest	Decision	Service set-up	Service delivery	Relationship strengthening	Concern	Leave	Return
How customers become **aware** of Company X	How customers become **interested** in doing business with Company X	The things that help customers make the **decision** to do business with Company X	What Company X does when **setting up** a new customer account	The **day-to-day elements** involved in the delivery of the agreed service	What Company X does to develop **ongoing relationships** and delight its customers	How Company X **deals with** concern and complaints	What Company X does when a **customer wants to leave**	How we **win back** previous lost customers
Trucks/Livery	Prospect material	Proposal/ presentation	Customer site visit	Phone/fax/email for order	Additional product installs	Receiving complaints	Leaving phone call	Prospects lists
Brands – portfolio	Promotional offers	Face-to-face visits	Customer site assessment	Customer places order	Customer training	Following up complaints	Stop ordering altogether	AM contact plan
Brands – umbrella/ corporate	Existing product lines	Agreement	Welcome call	Customer places order – phone call	Business Dev. Manager	Price rise letter	Visit	Lapsed customer call
CSR	Customer referrals	Negotiations	Account creation	Product delivery	Free service extras	Standard AM calls	Last chance visit	
Website	Key advisors	Site visit	Credit check	Couriers	Hospitality/contact	Missing deliveries	Debt recovery	
Trade press	Cold calling	Ongoing contact	Credit application	Account manager visits	Key account programme	Failed deliveries	Debt chasing	
Advertising	Pre-decision visits		Credit follow-ups/ verification	Account manager phone calls	Account manager	Incomplete deliveries	Find alternative supplier	
Sponsorship	Hospitality		SLA/T&Cs	Invoice	Site visits	Late installs	Collection letter	
Company reps	Warm calling		Handover	Credit notes	AM visit	Staff churn	Account manager contact	
Employees	Customer service		First order	Follow-up credit control	Forum venues	Credit control		
Customer referrals	Lending		Regular contact with AM or similar	Customer communication	Loans/commercial manager			
Word of mouth	Brand's literature		Face-to-face rep visits	Customer service calls	Promotional support			
Site/Plant visibility					AM phonecall			
Prospecting					Customer audit			
Charity involvement					Face-to-face visit			
Social media					Favourable credit/ increase limit			

FIGURE 3.2.3 Customer journey: Tactical map



The performance and improvement map

The performance map is similar to the tactical journey map, though it goes into more detail around the performance at each step of a process, and provides key recommendations at each stage.

These can be useful in identifying 'pain points' and 'bottlenecks' for the customer, and identifying how processes impact on customers. Therefore, they can be very useful for circulating information to those responsible for making the improvements on a day-to-day basis (see Figure 3.2.4).

Why do customer journey mapping?

Most large corporations operate in ways which separate different functions of the service delivered to its customers, eg ordering, technical support, complaint handling, warranty claims, general enquiries, etc. This is generally felt to be necessary to build expertise and manage operations. However, unless the various functions are joined up, the customer can feel the disconnect or even fall between functions. By tracking and describing the customer's experience at each stage of this 'journey', a company is able to:

- deliver seamless, streamlined products and services that cut across departments within the company;
- tailor services to meet the needs of both customers and the business;
- understand the experiences, thoughts and feelings of customers;
- develop compelling propositions.

Undertaking customer journey mapping has obvious advantages within a company, not least in developing a customer culture and the internal buy-in with the brand. Customer journey mapping focuses the business on the customer. Simply by spending time considering what the customer's lifetime experience is with the company highlights the strategic positioning the customer has within the company, the customer culture, and the degree to which the customer is considered in service design and delivery.

Problems and pitfalls

Customer journey mapping is not without its problems. Knowledge and perceptions, both internal and external, are required to develop the CJM, particularly in more complex B2B markets. Pitfalls which can be experienced when embarking on the process can include:

- getting buy-in from senior management;
- getting cooperation from staff who are responsible for the various elements of the customer journey;
- availability of resources to undertake the process;
- 'blank sheet syndrome' – having difficulty getting started.

FIGURE 3.2.4 Customer journey: Performance and improvement map

	Navigate website	Visit FAQ section	Submit a request	Follow up from customer service	Resolution
Customer process	• *Arrive at website* • *Navigate to help section*	• *Look for relevant question* • *Look for topic answers* • *Search for contact numbers*	• *Find query form* • *Enter personal details* • *Find account number* • *Submit query*	• *Wait for call back or email from customer services* • *Can it be dealt with, or does it need to be referred?*	• *Problem is solved by customer services*
Internal process	• Internal process example • Internal process example	• Internal process example • Internal process example	• Internal process example • Internal process example	• Internal process example • Internal process example	• Internal process example • Internal process example
Experience	• Examples of positive experience • Examples of positive experience • Examples of positive experience	• Examples of negative experience • Examples of negative experience • Examples of negative experience	• Examples of negative experience • Examples of negative experience • Examples of negative experience	• Examples of average experience • Examples of average experience • Examples of average experience	• Examples of positive experience • Examples of positive experience • Examples of positive experience
Improvements and key learnings	1. Improvement, or learnings to maintain high performance 2. 3. 4. 5. 6.	1. Improvement, or learnings to improve poor performance 2. 3. 4. 5. 6.	1. Reduce the form down to improvement, or learnings to improve poor performance 2. 3. 4. 5. 6.	1. Reduce the form down to improvement, or learnings to improve average performance 2. 3. 4. 5. 6.	1. Improvement, or learnings to maintain high performance 2. 3. 4. 5. 6.

How do you do it?

Depending on the industry in which a company operates, the range of its operations and the type of products and services it offers, the starting point will be to define the different groups of customers and to establish how different their 'journey' with the company or organization can be. Typical approaches here are to segment customers on firmographics (ie, classifications which make them different such as geography, age, SIC code), behaviours (ie, what they buy) or needs (what they are looking for). This exercise is required before any journey mapping can take place.

The next step is to map the journey of each of the customer segments from end to end, detailing all the customer touchpoints with the company/organization, and the customer responses to these. This can be done using a variety of methods which engage stakeholders involved in the process, and ensures their input into the development of the maps. A combination of workshops, staff interviews or focus groups, and customer interviews are normally indicated. These are then validated externally with customers (current, potential and lost) to ensure the maps encapsulate the customer experience, and no critical touchpoints are missing.

FIGURE 3.2.5 Customer journey mapping: Stakeholder engagement

Through internal workshops (usually senior management)	Through internal interviews (usually departmental)	Through customer interviews
• To establish a high-level view of the customer journey • To establish buy-in at a senior level • To start thinking about things from the customer's point of view	• To validate the high-level map • To ascertain more touchpoints at particular stages • To understand pain points and important touchpoints	• To validate the journey both in terms of stages and touchpoints • To understand important touchpoints for customers • To understand pain points for customers • To understand gaps in internal vs external perception

The value of customer journey mapping

Customer journey mapping is just one stage in the move towards a customer-centric approach. It marks the starting point: placing the experience of the customer at the heart of what the company does and how it operates. It provides a single overview of how customers interact with the business, focusing the organization's thinking on the customer and how the service appears from an external perspective. It is all too

easy for large corporations to think in terms of departmental tasks, and journey mapping facilitates cross-departmental working to understand the impact on the journey for the customer.

However, customer experiences, rather than being neat and linear, are often convoluted and complex, particularly in B2B markets where tendering, multi-site requirements, and technical product and service requirements define journeys. These complexities can confound the journey mapping team, resulting in maps which are either overly complex or overly simplified, failing to capture the most important touchpoints from the customer perspective. Resultant actions can then be *process*-rather than *experience*-driven.

The outputs from customer journey mapping deliver a tool for identifying outstanding and problematic areas, as well as 'delight' and 'choke points' in the journey. As a result, valuable resources can be targeted where they will have the greatest impact for the customer coupled with efficiency for the organization.

Closing thoughts

As a key element of customer experience management, customer journey mapping is a 'step back' exercise, and one which affords the opportunity to design truly innovative experiences which differentiate. However, it has real value in engaging staff at all levels within an organization with its customers and their experience of the company and brand.

Customers are the greatest advocates of a brand or specific product or service: they tell stories and they make recommendations. They have the power to infect others with their enthusiasm for adoption, and therefore have to be seen as a core element of long-term strategic growth.

A former lecturer and social researcher at the University of Salford, *Carol-Ann Morgan* has been a director of global market research specialist B2B International for the past 15 years. In this role, Carol-Ann is responsible for research techniques, both qualitative and quantitative. Highly experienced in all types of research study, Carol-Ann has written extensively on the subjects of employee satisfaction and customer loyalty/experience research. She is also co-author of the book *Market Research in Practice*.
Website: **www.b2binternational.com**

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Inventive marketing

3.3

It takes more than belief to launch an innovation. Chris Jenkinson at Jenkinson & Associates gives an insight into how to create a marketing strategy without blowing the budget for product development

For the inventor, bringing a product to market is probably one of the most difficult barriers to success. For the inventor, costs can spiral as the development of their invention moves from idea to possible production model.

The costs of patents, sourcing materials, tooling and quite often retooling can make a serious dent in the cash available to develop and bring this new product to market: a problem that is quite often revealed on programmes such as *Dragon's Den*, where the inventor believes they have a product that is sellable but have run out of cash and ideas of how to sell their new product.

For many inventors, marketing can be one of the last considerations with the excitement of development sometimes overtaking the need to sell.

For many inventors, the belief in their own product success is their marketing strategy, but once the difficulties of getting the new product seen by retailers or consumers are realized, the inventor looks for some marketing help.

But marketing a new product doesn't need to be difficult or costly. For new companies the initial approach is publicity – this can be quite costly and may have little effect unless there is a large budget or the new product captures a large journalistic and consumer demand interest.

Your marketing doesn't have to be everywhere

A logical approach to marketing a new product is that your marketing doesn't have to be everywhere. By thinking about your end customer and where they may be actively looking for similar products, you can define where your marketing should be taking place. Sometimes this requires a bit of 'thinking outside the box'.

Take the example of Innocent Smoothies. Three friends from Cambridge University, Richard Reed, Adam Balon and Jon Wright, had a dream to create a company selling 'additive-free' real fruit smoothies. As you may also be aware, initially they struggled to find funding for their concept, until they managed to persuade US businessman Maurice Pinto to invest £250,000 to help them launch the business.

So Innocent Smoothies began to gain momentum with distribution deals agreed with many provincial independent shops, delis and cafes. But still the entrepreneurs didn't have the one key 'ingredient' they needed to really make their brand take off – namely, a major supermarket on board.

So what did they do?

They researched the key buyers from the four major supermarkets they wanted to target. They knew where each of the buyers lived and where they worked. They also plotted their likely route from home to office. They then ran a billboard campaign featuring Innocent Smoothies in those specific geographical locations. Adam Balon recalls: 'To them it must have looked like we were everywhere, but in truth, we were just everywhere for them.'

The upshot of the campaign, which began in June, was that by December of that year, Innocent had completed distribution deals with all four supermarkets. Their marketing campaign was specific, highly targeted, well thought out – and it worked spectacularly.

Internet marketing

This same process can be used very effectively with the internet. Many times though, a business will say: 'but we're not an internet business', because in their mind the internet is about buying clothes or holidays. But when asked if they use the internet to research what their competitors are doing, or to source suppliers and to read up on the latest in their industry, the answer is yes.

So, if you are using the internet in this way it is very likely that people, businesses and trade buyers will be searching in the sector you want to be found in.

Internet advertising can have all the flexibility and targeting you want. From advertising on major search engines or on websites that are to do with your industry, where people are searching for and researching similar products to yours, your advert appears. Social media is another great way to get your product noticed by the people you want to be seen by. By using Twitter you can search out the industry users that could be interested in your product and follow who is following them to build up interest. On LinkedIn you can advertise by geography, by industry and by job title so you can be very specific about whom you want to advertise to.

What is SEO?

You have probably read about and are continually bombarded with e-mails to do with search engine optimization (SEO). It may all sound like a foreign language but it isn't that complicated to make sure your website is found by people who are searching for what you are selling.

Optimizing your website isn't about having the home page content full of keywords – your website should be designed and written with your customer in mind. The bit that you can influence search engines with is what are called the 'meta tags'. The most important of these is the 'meta page title'. You can see what the meta page title of your website is by looking at the very top of your computer screen when you

are on your website. If you just see 'Home' or your company name then your website is unlikely to be found for what it is you would like to be found for. Adding a few important search keywords to your meta page title will make the difference. By all means if you are unsure of what you are doing then do ask for an expert to assist you, but do make sure that they can prove to you they can do the work for their own website and have plenty of examples of work they have done for other websites.

If you are in a very competitive online industry then SEO may take a while till you get ranked and so prove order viable, but there are quick alternatives. Using online advertising such as Google Adwords can get your website appearing at the top of Google page one near enough instantly if you are prepared to pay. The great thing about this form of advertising is that it is matched advertising – your potential buyer types their search into a search engine, the search query matches the words you have inputted into your campaign to trigger an advert. Your advert displays and your potential buyer will click on your advert to go through to your website and if your website matches what the searcher is looking for they will probably make an inquiry – and you only pay when someone clicks on your advert.

Again it may be worth getting assistance from a marketing expert to set up your online advertising account, so the advertising is structured, targeted and the advertising message is attractive to potential buyers.

Using internet marketing to market a new product

Does this work? Yes, a recent new business marketing an interlocking plastic roof tile – the Envirotile – needed to get orders. An online marketing campaign took place optimizing the website to be found for searches related to roofing, roof tiles and roofing suppliers. Within a few weeks the website was highly ranked and being found on the internet amongst some of the UK's largest roof tiling manufacturers. From this came a continual stream of orders from consumers which in turn created demand from suppliers as customers were asking their local building suppliers if they stocked the product. With all this activity it wasn't long before a deal was struck with a large roof tile company to stock and distribute this innovative roofing tile.

So as you can see, your marketing doesn't have to be everywhere. It only has to be concentrated in areas where your target audience is located – and be presented to them in a format they will respond to.

Chris Jenkinson is the Managing Director of Jenkinson & Associates Ltd, a marketing company providing full service marketing including internet marketing, SEO, web design, graphic design, exhibitions, POS, marketing research, PR, advertising to directors and business owners looking to increase sales and profits. Telephone: 01455 556201, e-mail: **chris@jenkinsonassocco.uk**, website: **www.jenkinsonassoc.co.uk**

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Investing in the brand

3.4

Hamish Pringle at 23red discusses how up-and-coming brands can de-risk and secure a return on their marketing

The word 'marketing', particularly in the context of 'marketing communications spend' seems to have become synonymous with 'waste' amongst the senior management in many companies. This has happened because too many marketers fail to speak the language of the boardroom, are perceived by their colleagues as lacking in financial rigour, and weak in making a proper business case for their proposed investment in brand building.

But few would argue against a professionally justified and well-orchestrated investment in marketing communications. And history has shown that fortune favours the brave. Apple, then an upstart challenger brand, was prepared to take calculated risks in order to grab market share from its competitors. Their epic '1984' TV commercial was aired only once during the Super Bowl of that year, but was the clarion call which led to the undoing of IBM's personal computer empire.

Any investment like Apple's is a risk. But without risk there is no reward. Therefore the responsibility of the marketing director is to help the board understand the assumptions which underpin the marketing investment plan, see that they are reasonable, and recognize that a calculated risk is therefore worth taking. This is especially important in the case of a challenger brand. So here are ten factors which should be addressed in developing the marketing investment proposal to the CEO, CFO, and other key directors:

1. Life stage of the market in which the brand operates.
2. Market category and its distribution chain.
3. Legal or regulatory constraints.
4. Strength of the brand leader.
5. Competitor brands' media spends and brand shares.
6. Creativity of competitor brands' communications.
7. Conservatism of the directors.
8. Nature of the customer journey and purchasing behaviour.
9. The company's capacity for delivering extra sales.
10. Profitability of these incremental sales.

1 Life stage of the market in which the brand operates

We know that the return on marketing investment (ROMI) diminishes as a market ages. The best returns are when a market is new and the all-action pioneers are building the category and their brands within it. The return is still good if the market is in growth, but as it slows with maturity, and then starts to decline, the payback reduces significantly too. So from the outset the new venture or challenger brand must assess the life stage of the market category it's in. For a new venture, mature and declining markets are to be avoided – remember a rising tide floats all boats – so go for new and growth markets. If a challenger brand finds itself in a growth market, all well and good, but if its sector is mature or in decline it's much tougher and calculated risks are required. Though not a challenger brand, Marmite's polarizing 'love hate' campaign is an excellent example of how to trigger consumer reappraisal in a declining sector.

2 Market category and its distribution chain

Most of the analysis of ROMI has been conducted amongst FMCG brands, but there is some data on other sectors such as consumer durables and services. The general principle is that in sectors where there is a mature distribution chain controlled by relatively few and dominant players, the returns are lower per £ spent on advertising and marketing communications. So in assessing the risks, the new venture or challenger brand needs to scrutinize their market sector's distribution system and whether it's accessible or locked up. If the latter, is there an innovative way to get around the problem? For example, Morrisons' out-of-left-field deal with Ocado is an immediate way for it to solve its lack of an online channel.

3 Legal or regulatory constraints

Increasing numbers of markets are wrapped up in legalities and regulatory codes of varying degrees of strength. Worse, an entrant can start a new segment very successfully and then face a massive backlash and threat of legislation, which could close their business down. This is happening in the financial services sector with online payday loans, and Wonga is bearing the brunt of the attack. So if your intention is to launch into a sector with these kinds of legal risks, maybe think twice. If you can see your way through the red tape, then it's a good tip to make contact with the Committee of Advertising Practice (CAP) Copy Advice at the Advertising Standards Authority well in advance so you can fully understand the self- and co-regulatory codes.

4 Strength of the brand leader

Few marketers, and even fewer agencies, have ever heard of Andrew Ehrenberg, let alone the phenomenon of 'Double Jeopardy'. It's technical stuff, but all you need to know is that brand leaders have an unfair advantage: they need to spend less to hang on to their market share than challengers have to spend in order to steal it from them. So take a good, long, hard look at the brand leader in your market category. If you see a well-run company which continues to re-invest in itself, then you've got a real fight on our hands, especially in a sector where the distribution is locked up. On the other hand, if you suspect the brand leader's being milked as a cash cow and run by management that's been put out to grass – think HMV vs Spotify, Yellow Pages vs Google, and Kodak vs iPhone – then you could be in for a killing.

5 Competitor brands' media spends and brand shares

There's another 'marketing law' which is vital to know. This is the proven relationship between share of voice (SOV) and share of market (SOM). In short, if a 5 per cent market share brand spends on media at 5 per cent share of the total spend in its sector, ie 'par', then it'll be in equilibrium and will neither win nor lose share. If a brand under-spends its market share percentage, then it's effectively disinvesting vis-à-vis its competitors and will lose market share. In FMCG the return on 10 per cent extra share of voice (ESOV) is 0.5 per cent sterling market share per year that the brand spends ahead of its 'par' SOV. The challenger brand manager needs to understand the SOV/SOM relationship and set the budget accordingly. The board has a stark choice to make: either invest in ESOV to achieve market share growth, or accept a static situation.

6 Creativity of competitor brands' communications

Happily there is another choice they can make, which is to invest in outstanding consumer insight, strategic development, channel planning, and content creation. Peter Field was commissioned by the Institute of Practitioners in Advertising (IPA) to carry out a cross-analysis of two 'gold standard' databases, the Gunn Report (creativity) and the IPA Effectiveness Awards (ROMI). He was able to prove that the creative award-winning campaigns which had also won an IPA Effectiveness Award were twelve times as efficient in terms of payback. So if the board won't vote for an ESOV investment, then you should propose a 'par' budget with sufficient fees to afford the best agencies to deliver an award-winning brand campaign, in both creative and effectiveness terms. Look how well John Lewis and Waitrose have done it.

7 Conservatism of the directors

However, this strategy will never fly if the directors of the company are risk averse in creative terms. If your company CEO came up via the law or accountancy routes, then the chances are he or she doesn't 'get' marketing, is conservative, and highly unlikely to let you commission outstanding work. On the other hand, if you're lucky enough to have a marketing-savvy CEO, then the creativity route to market is for you – just make sure the originality of your fame-building, word-of-mouth (and -mouse) -generating campaign is rooted in a brand and consumer truth. Most of Virgin's various franchises have been able to under-spend their competitors for years because of the PR generated by Richard Branson's outrageous publicity stunts and cameos in TV commercials.

8 Nature of the customer journey and purchasing behaviour

People are creatures of habit and cognitive dissonance is a reinforcing factor. It means that it's hard for a challenger brand to get the brand leader's customers to pay it much attention, and even harder to get them to think and feel good things about it. This is because they buy more of the brand leader, and hold positive attitudes towards it, and they buy less of the challenger, so the converse is true: 'Double Jeopardy'.

However, there is an increasing realization that it's not just a one-way system with attitude change leading to behaviour change. In fact it's a two-way street and behaviour can change attitudes. A piece of behaviour can out-manoeuvre cognitive dissonance and selective perception, to resolve a person's internal conflict, remove their blinkers, and disrupt their purchasing habits. Behaving as if they are a brand buyer enables them to become a brand buyer: do, feel, think. So the challenger brand's campaign should aim to get people to do things close to the point of purchase or behavioural decision.

9 The company's capacity for delivering extra sales

Having persuaded the CEO, CFO and the rest of the directors to agree a brand share growth target, then, as we've seen above, they need to set a marketing budget to achieve it. Either an 'investment' ESOV budget (assuming a conservative mindset), or a 'par' budget with a determination to beat the ratios with an award-winning campaign in creative and effectiveness terms. That's all well and good, but is the company capable of delivering the increased growth in terms of product or service? Manufacturing, supply chain, sales and distribution have all got to be brought on board as early as possible in the planning process. If this isn't done well, and if the marketing team alienates key colleagues, then the lack of integration becomes a major risk to the enterprise.

10 Profitability of these incremental sales

Assuming that there has been a genuine inter-departmental team inputting into the brand plan, and that the marketing specialists have taken into account the nine risk factors summarized above, then the last remaining question is that of profitability. If the market sector is mature and legally hidebound, the brand leader strong and consumers happy, the distribution locked up, and the campaign limited to a 'par' budget, does the likely ROMI lead to an acceptable payback? If not, it's time for a rethink and to do something a bit bolder. Apple anyone?

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PART FOUR
People and performance

Becoming an employer

4.1

Ready to expand, but worried about maintaining the quality of your contact with customers? Nick Soret at RBS Mentor has five keys for building up your team

So – business is good. You're successful. You're making – or doing – something the public wants to buy and you're looking after your customers. They're coming back. They like you. They like what you do. They want more of it.

So what do you do? The answer's simple – you scale up. You do more of the same but gain some economies of scale, so your unit cost is cheaper and you make more profit. And you gain more and more satisfied customers so you can scale up even more. The perfect virtuous circle.

But there is a problem – or, rather, a 'challenge', as we must say these days. Making your business bigger will involve bringing more people in. And the greater the number of people who are involved, the more difficult it is for you to maintain consistency and quality.

The 'make or break' moment

It is a critical moment in the life of any business when it takes on its first employees. Perhaps up to now it's been you on your own, or a family business, or a group of like-minded individuals. But taking on your first 'real' employees – or expanding significantly from a long-term established workforce – is a 'make or break' moment for a small business.

There are several reasons for this, and once you understand them the solutions become much more apparent.

People like you: but do they like your staff?

First, whether you are making a product or are in a service business, it is a truism that 'people buy from people'. A large part of the success of your business is down to the personalities and qualities of you and the other people in it. So it's crucial that

any new people you bring into the business share your enthusiasm and attitude to customers.

What does that mean in practice? It means recruiting effectively and devoting sufficient time to training, especially early on in the employee's time with you. We know first impressions count – so why do so many small businesses leave 'front of house' duties and call answering to staff who don't seem to know what they are doing or don't seem to want to help? Your loyal customers might forgive you a bad experience, but new customers may not.

Learn to be a good parent

Second, when you become an employer you have to form a new type of relationship. You're good at customer relationships because you're expanding. As we have seen, your customers like you. But being an employer means having a relationship with your workforce as well. And recognizing that this will be a different sort of relationship to the one you have with your customers is essential.

You treat your friends differently to the way you treat your children. Being an employer is similar in many ways to being a parent. You have the family's best interests at heart (meaning the business in this case), but to achieve the best outcome for the family as a whole, you need to set clear ground rules and standards of behaviour and be prepared to take action when those standards aren't met. That might not be an easy thing for you to do.

And like a parent, you'll need to have a close relationship with those who work for you – and that can include dealing with stuff you'd rather not have to deal with. So you'll need to understand what to do when they get ill, or inform you they are pregnant, or tell you they can't work with a fellow employee.

Welcome to the wonderful world of employment regulation

Third, it's often said that 'red tape' is killing business. While the prospect of navigating this uncharted jungle can certainly be off-putting for business owners planning to recruit their first employee, there is no point fighting the system if expansion is necessary.

In fact, the vast bulk of employers have no problem with the concept of employment regulation, it's just the detail they can't get to grips with. So recognize this early on, and be realistic about your prospects of suddenly becoming an expert in employment law – and ensure you have access to appropriate support.

Expanding a business and employing people for the first time means identifying what it is that's made your business successful so far – and getting more of it. It's about reinventing yourself (or at least part of yourself) as an employer, and it's about being honest about where your expertise lies – and where it might be best to get some outside help.

Five keys to employing staff

1 It's your business: set your rules and stick to them

As with parenting, being an employer is all about setting clear rules and boundaries.

For example, think about what you want staff to do if they are absent. Will they receive sick pay? If so, how long for? Will that just encourage absenteeism? How should they book time off for holidays? Are there any rules you want to set about behaviour at work? And outside work – what are staff allowed to say about the business on social media? Who is going to deal with disciplinary matters? Who will handle grievances?

It's all up to you – as long as you act within legal limits.

2 Take the time to recruit effectively

Many future problems can be averted if you put the right effort into the recruitment process to get the right people for the jobs available. This involves giving consideration not only to the skills you require but also to the behaviours that are essential or desirable. What is it about you and your business that keeps the customers coming back? That's what you want more of.

3 Start things off well with good induction training

OK, you've made your rules and you've hired the right person. Now take the time to ensure they know what the rules are and the basics of doing the job. But remember that whatever they are employed to do, chances are they will end up dealing with customers at some point – perhaps when they are the only person in the building or on the end of the phone or e-mail. So make sure they know enough to make the right impression and are able to help the customer.

4 Communicate

Communication will involve a lot of telling but it will also involve a lot of listening. That way, you'll avoid grievances and claims because you will see problems coming. But you'll also pick up on ideas for improving the business.

5 Treat people consistently

Unlike customers, employees are not always right. But if you deal with problems as they arise in a consistent and even-handed way, you'll avoid storing up grievances or worse – discrimination claims – for the future.

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The flexible workforce

4.2

Clare Gilroy-Scott at Goodman Derrick discusses how to make sure you have the right people on the right contracts

The prudent employer will want to ensure that it has a workforce that is able to adapt to confront the changing demands of the business. Most will want to retain flexibility without compromising on control and quality. For a start-up business, this will mean a careful assessment of the anticipated staffing needs of the business. For an established business, this will mean the regular review of the make-up of its workforce. For both, it means ensuring that you have the right kind of people on the right kind of contracts. Recruitment and retention of the right people will be a matter for the individual business, but what is the right kind of contract? Is it possible to have flexibility in your workforce without compromising on control and quality?

This chapter will provide an overview of the main contractual options for engaging staff and the various employment rights connected with different types of engagement, taking into account the evolving nature of the working relationship and how the business can retain control of this.

Staffing options

There are various staffing options for a business. These can include permanent employees, fixed-term employees, casual workers, self-employed individuals and agency workers. Key to this decision will be the needs of the business in terms of cost, hours of work, commitment, integration into the business and attracting the right level of skill and experience. These will need to be balanced against the various employment rights that each category attracts.

Employees

Employees can be full-time, part-time, permanent or fixed-term depending on the business requirements. The formal definition of 'employee' is an 'individual who has entered into, or works under, a contract of employment'. A contract of employment is an express (whether oral or written) or implied contract of service or apprenticeship.

Having comprehensive employment contracts will allow the employer to control the employment relationship in some way. Employees are entitled to be provided with a written statement of certain key terms such as pay and hours, but contracts can be used to give the employer a degree of flexibility to adapt duties, place of work and hours of work, subject to this being 'reasonable'. Contracts can also be used to ensure that the business and its confidential information are protected as far as possible when an employee leaves to join a competitor.

However, what makes an employee is not a just a contract of employment. The key tests for 'employment' are (i) that the individual provides personal service, (ii) there is control of the individual by the employer, and (iii) there is 'mutuality of obligation' (the obligation of the employer to provide work and of the employee to accept the work).

Clearly, having individuals who are employed under employment contracts will have advantages in terms of certainty, control and a workforce that feels part of the business and its success. Conversely, an employee has considerably more core legal protections than other categories of worker. As well as terms being implied into their contracts, such as the implied duty of trust and confidence (the material breach of which may entitle an employee to resign claiming 'constructive' unfair dismissal), an employee has the right not to be unfairly dismissed and the right to receive a statutory redundancy payment (both subject to qualifying periods of service). The ACAS Code of Practice on Disciplinary and Grievance Procedures, which sets out minimum standards expected of employers in dealing with employee grievances or disciplinary situations, only covers 'employees', not workers or the self-employed. Performance and conduct issues with employees have to be addressed carefully. Whilst the reason for a dismissal may be fair, a flawed procedure may still result in a finding of unfair dismissal.

Workers

Whereas an employee agrees to serve the employer, a worker agrees to provide certain services, personally, to the business. The worker does not provide services as part of carrying on their own business (see 'self-employed' below). 'Casuals', 'bank staff' and 'freelancers' generally fall within this category. This is the simple distinction between a worker and an employee and the self-employed. The reality can be blurred in practice.

Why engage a worker rather than an employee? Generally speaking, a business will have more flexibility in its relationship with a worker and the ability to terminate that relationship simply by giving notice. On the other hand, the business may have less certainty or control in matters such as the work provided, when it is provided, where it is provided and how it is provided. Such matters can be specifically set out in a contract for services with a worker, but the more control and express obligations on both sides that are incorporated into the contract, the more the contract may look like one of employment, regardless of the label given to the relationship.

Furthermore, it is a common misconception that a worker has no employment rights. Whilst they do not have rights in respect of unfair dismissal, disciplinary and

grievance issues or redundancy, increasingly statutory rights are being granted to workers as well as to employees. These include (but are not limited to) rights in relation to holiday, holiday pay and rest breaks under the Working Time Regulations, rights under the National Minimum Wage Regulations, and rights under the Part-time Workers (Prevention of Less Favourable Treatment) Regulations.

Self-employed

It can be difficult to distinguish between a 'worker' and those who are 'self-employed' but, in simple terms, someone who is self-employed carries on a business (as a sole-trader for example) so that services are provided to clients of that business, whereas a worker cannot be regarded as carrying on a business.

What flexibility does the engagement of self-employed individuals provide to the business? Generally speaking, they will take some financial risk and short notice periods are common for either party to terminate the relationship. Their work is often linked to a particular project so there is no obligation on the business to find other work upon the completion of a project. Cost may be a deterrent, but in return the business would benefit from the specific expertise and experience that such a worker will have obtained from working for other businesses.

The genuinely self-employed have no rights in relation to unfair dismissal, redundancy, holiday pay etc. However, they are likely to have protection under discrimination law which covers those with a 'contract personally to do work'. Most self-employed, even if they are providing service in the course of running a business, will be providing it personally.

Agency workers

Agency workers are often referred to as temps or contractors. They are provided by an employment business to work for a client of the employment business (the end-user). The worker has no direct contractual relationship with the end-user and similarly is not, generally speaking, employed by the employment business. The end-user client benefits from the agency worker's work and the agency worker is often integrated into their business and is controlled by them on a day-to-day basis. However, the employment agency pays the worker for that work, ordinarily holds the power to terminate the assignment with the client and arranges for benefits such as holiday and statutory sick pay.

Agency workers may be engaged on a short-term basis, sometimes to cover a temporary period of demand or the absence of an employee. However, in many cases the engagement can last for several years and sometimes past the qualifying service required for an employee to claim unfair dismissal (currently two years' service for those engaged after April 2012).

This is often an attractive option for the end-user client, particularly as the current case law indicates that an agency worker may not be employed by either the client

or the employment business. Many agency workers are highly skilled and prefer to work as contractors. However, agency workers will still have protection in respect of discrimination legislation and the principle of equal treatment as regards pay and certain benefits as set out in the Agency Workers Regulations 2010. The end-user client will also need to ensure that it minimizes the risk of an implied employment contract by regularly reviewing its use of agency workers, assessing the scope of their work, using them for specific projects or for fixed periods for cover. It is advisable to pass issues of holidays and discipline through the employment business.

A comprehensive contractual arrangement with the employment business will also be a necessity to benefit from the advantages of this type of working relationship. This could include, for example, an indemnity from the employment business in respect of employment-related claims or a warranty about the worker's employment status.

The evolving relationship

The employment relationship can change over time so that what was intended at the start of the relationship is no longer the case in practice. Given the basic test for 'employment', it may be that a casual worker who started out with the right to refuse work offered has, over the course of time, provided regular work to a business for so long that it is assumed that they will be available for that work and that work will be offered to them. This may result in an implied contract of employment. Regular assignments over a long period could indicate an 'umbrella' contract covering periods where there is no work, meaning the employee builds up sufficient continuous service to benefit from employment protection associated with being an employee, such as unfair dismissal. The only answer is to anticipate this and regularly review how the working relationship with each employee, worker, self-employed contractor and agency worker operates in practice.

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Skills gaps

4.3

Make sure your business has the skills it needs, says Sean Taggart, head of the Albatross Group

For businesses, recruiting staff can be an expensive and time-consuming process. And it can be hard to find people with the right skills and experience. For small businesses these costs add up, and can have a major impact on the bottom line.

Across the UK, over a quarter of a million businesses have at least one vacancy. While this is generally positive – allowing people to move jobs or get into work, and businesses to bring in people with outside experience – some businesses find it difficult to fill particular roles. This might be because of location, conditions (such as working hours), or not being able to find people with the right skills or experience to do the job.

Businesses that can't recruit people with the right skills face a number of challenges, and these can have a negative impact across the board. These include an increased workload for existing staff, problems providing good levels of customer service, or delays in developing new products and services – all of which can lead to lost business and reduced profits.

Recruiting people with the right skills can be difficult at all levels and in all business sectors, including for entry-level jobs as well as jobs that require some training. For example, employers report that 27 per cent of vacancies for care workers and home carers, 30 per cent for nurses and 47 per cent for chefs exist because they can't find recruits with the right skills. And SMEs, especially those based on a single site, are most likely to find it difficult to fill entry-level vacancies.

What skills are missing?

Businesses say that the skills most often lacking in potential recruits to entry-level jobs are job-specific skills (followed by customer-handling skills and communication skills). Businesses want people with skills that are typically learnt through working. So, potential recruits find themselves in a difficult situation: they don't have the right experience to get a job, but the only way of gaining that experience is through work.

For individuals, a lack of relevant skills can be a problem. People with low skill levels are more likely to be unemployed. With the advent of Universal Credit, some claimants will be required not only to obtain a job, but to progress in work. If they do not have the skills required, they may find this very difficult.

Nearly a million 16 to 24-year-olds are currently unemployed in the UK, and the top reason employers reject a young person's job application is because they lack

experience. But most employers who recruit young people say they are well-prepared for work. Where they are not, it is because they lack practical experience. However, only one in four employers offer work experience.

Even where people have work experience, they may face problems in accessing sustainable jobs. Unfortunately, even when employers are faced with a lack of skilled candidates for entry-level jobs, most do not provide more training. For example, only 4 per cent of employers with vacancies for sales-related occupations expand trainee programmes in response to recruitment difficulties. We see people cycling between low-paid, often temporary work, and out-of-work benefits. They can't progress in work as they don't have the right skills; and entry-level jobs are blocked for other potential recruits.

What do employers need to do?

Employers need to address the skills gaps that impact on their businesses. They need to provide training, work experience and opportunities for people to develop their skills. This is a win–win situation for employers and employees. Higher-skilled employees tend to have higher job satisfaction and lower absenteeism. For employers, this results in lower staff turnover and an increased likelihood of business survival. For individuals, higher skills lead to higher wages and a reduced risk of unemployment.

Training also improves the likelihood of firms surviving. Firms that do not provide training are twice as likely to close than those that do. In some sectors, the implications of not training are even more serious: in the hotel and restaurant sector, firms are nine times more likely to close. The hotel and restaurant sector employs a relatively high proportion of people with low skills, and is a relatively low-pay sector.

Some employers feel that their employees are not interested in training and progression. However, this may be simply because they lack confidence in their ability to learn.

Many employers do provide training and opportunities to progress. For example, employers tend to provide training when recruiting young people – nearly than 9 in 10 businesses that recruited young people to their first job had provided training in the past year (compared to 6 in 10 businesses providing training overall). However, for those that don't – SMEs in particular – it can be difficult to know what practical steps to take.

What steps can I take?

Work with others

Work with other local businesses or support services to access training and recruitment support. For example, businesses in Westfield Stratford City can use The Skills Place, Newham, which provides pre-employment training, specialist customer services courses, and training designed to meet specific company needs. Potential recruits know

that their training will meet the needs of a range of employers, and as a result smaller employers do not have to arrange time-consuming and costly individual recruitment and training.

Provide work experience

Only 27 per cent of businesses offered work experience placements to young people in the past year. There are over 1.1 million SMEs in the UK. Imagine if just half provided work experience – over 500,000 people would gain valuable experience and develop new skills. Providing work experience also helps you find out if a new employee is a good fit: for example, at Eastgate Primary School in Kings Lynn, 14 of the current roster of teaching assistants began as volunteers.

> '...you don't need to find an engaged employee; you get the right raw materials and you can build one.'
>
> Private sector SME

Identify support available

You may think recruiting young or unemployed people will be time-consuming and expensive. This isn't the case, and there is lots of support available. For example, in England, you can claim a wage incentive worth up to £2,275 if you take on a young unemployed person.

Progress existing staff

Employers which develop progression routes for low-skilled staff see increased staff retention, increased loyalty and reduced employee turnover. Staff benefit from a better understanding of different roles across the business, and are more flexible – able to cover when colleagues are absent. The business is more attractive to potential recruits as they can imagine a career there. In addition, people with higher skills are more productive at work, which more than makes up for any increase in wage costs.

> At Centrax Turbine Components, all staff are expected to focus on quality. Progression is supported as a way of improving quality and reducing errors, as employees understand what is expected of them and how the firm works.

There are different ways of progressing staff in work. For example, employers can increase their hours, move to more senior positions or take on more responsibility

while staying at the same employer (lateral progression). They can also change employers (vertical progression).

You can support low-skilled or low-paid staff to progress in a number of ways:

- **Career development and progression routes –** Think of your employees as a talent pool, with a unique understanding of their business. Encourage managers to think about what skills people need to make progress into another job, either to broaden their experience or move up the career ladder. This means thinking about an individual's training needs over a longer time period, rather than training for a single role. Identifying progression routes can support recruitment and retention, as people understand and are clear about what roles they can aim for and what skills and experience they need to progress within the organization.

At Acorn Court Care Home, progression is considered even at interview stage. The manager tries to identify where a potential recruit might progress, and employees are encouraged to 'act up' and gain experience.

- **Integrate learning into work –** Develop an environment which supports and provides opportunities for learning. This could include job placements; secondments; and identifying opportunities for employees to take on more responsibility.
- **Encourage employees to use their skills –** 'High Performance Working' is an approach to management which focuses on making sure that employees have the opportunity to use and develop their skills at work. It includes some simple steps: clear induction processes; developing teams to work on specific projects; increasing employee consultation; and providing opportunities for work shadowing. These don't need to be expensive – in fact, most are free or low cost.

Trinity Conferences, a small venue-finding agency, worked with Investors in People to improve its approach to staff development, resulting in internal promotions. Staff saw opportunities to progress and to add value to the business. Financial turnover increased by 27 per cent over 18 months, and sales rose by more than 30 per cent.

Sean Taggart is owner and Chief Executive of the Albatross Group of Companies, and a Commissioner at the UK Commission for Employment and Skills. For more information, visit **www.ukces.org.uk**

Access to expertise

4.4

Frances Trought, an employability specialist at I Brand, explains how SMEs can draw on universities for the skills and knowledge to drive their growth

Imagine if, as a business, you could readily access experts to solve your business problems; if you had the ability to hire talented employees, who could inject your business with innovation and creativity utilizing the latest technology; or even access bespoke training tailored to the needs of your employees to ensure they are continually updating their skills. This all sounds too good to be true. How can you access this resource? Many businesses would be surprised to find that all of these services are available at their local university.

In today's economy businesses face challenges not just from international competition, but also from the changing landscape upon which business is conducted. Technology is continually developing and emerging markets continually advancing, forcing businesses to recognize the need to either maintain pace or take the lead in skills development in order to compete.

As stated in the World Economic Forum Report (2012): 'talented human capital will be the most critical resource differentiating the prosperity of countries and companies'.

As a result it is paramount that SMEs forge links with universities in order to ensure that they are not only taking advantage of the knowledge and skills that university experts can provide, but also that they are able to benefit from the skills and knowledge of new graduates.

> The students and graduates of today will in the future be providing us with the cutting edge research that will help to ensure our prosperity.
>
> Department for Business, Innovation and Skills, June 2012, p 7

The importance of human capital and the recognition of the importance of skills development are evident in the increase in enrolment in universities worldwide. In 1995, 33 million students were enrolled in university and by 2005 this figure had increased to 63 million (Brown *et al*, 2008), reinforcing the fact that skills development is paramount in the ability to compete as an SME.

How can SMEs access the skills and expertise contained within higher education? Below is a series of contributions outlining various services and support available.

Accessing university services for business

'Approaching a university may seem daunting', says James Landon, Head of Business Development at Kingston University, 'as they are often very large institutions.' However, many universities have dedicated teams that manage relationships with businesses. Initial contact can be made via the university website where there are specific areas labelled 'research and enterprise' or 'for business'.

Depending on the particular organization, your business may be able to access the following:

- **Consultancy Services –** academics in your particular area of interest can be hired to carry out *consultancy* and *bespoke research*, giving your business a unique edge over your competitors.
- **Work with graduates –** schemes such as *Knowledge Transfer Partnerships* (KTPs) are an excellent way to achieve a strategic goal when perhaps your business may not have the skills or resources to manage in-house. A KTP is a partnership between an organization, an academic and a recent graduate who is recruited to work on a specific project for up to three years. Up to 60 per cent of the costs can be funded by the government.
- **Work with students –** engaging students as consultants on short-term projects is a great (and free) way of 'testing' university services.
- **Continuing professional education and staff development –** as well as postgraduate courses, universities can offer bespoke business training tailored to specific business needs, as well as other short courses and workshops.
- **Business advice –** many universities are involved with helping to nurture start-ups and young enterprises.

Internships and work experience opportunities

In an increasingly cost-conscious, highly competitive and constantly changing market, SMEs are more than ever looking to work with universities and interns to help develop and support their business.

According to Gareth Lewis, Business Development Manager, Coventry University London Campus, the benefits of offering students intern opportunities include:

- a low-risk, cost-effective solution to your important business project without the need to add to your headcount and without the need for a long-term commitment;
- an opportunity to progress a business project which may have otherwise stagnated due to a lack of a particular skill or resource;
- new ideas and perspectives pumped into your business through a motivated and enthusiastic student looking at your organization with a 'fresh pair of eyes';

- the chance to work with a student before committing to a possible full-time job offer;
- an informed international perspective to business development opportunities (see case study on p 104).

Developing internship and work experience opportunities can be an excellent way to breathe life into your organization. Current students and recent graduates can provide a different perspective, but it is important to take the time to plan how you will engage students in your business. Andrew Scherer from Inspiring Interns offers some top tips on how to develop an internship.

Internships: Top Tips from Andrew Scherer, Inspiring Interns

- Advertise and recruit for your internships properly to ensure you identify a candidate who is enthusiastic about your industry and company.
- Carefully structure the internship, with clear project aims and defined deliverables.
- Cover the intern's out-of-pocket expenses if it is a learning position; you need to pay if you expect them to contribute from the word go (**https://www.gov.uk/employment-rights-for-interns**).
- Make sure one person has specific responsibility for the intern.
- Provide regular feedback to your intern, both formally and informally.
- Give them the opportunity to try new things and develop new contacts.

Recruiting and attracting graduate talent

A good degree helps students develop a mix of theoretical knowledge and practical skills that are tailored to the workplace, but the process of engaging with your local university may seem daunting at first. Careers services exist to demystify that process for employers large and small, and building a strong relationship with your local careers service can open the door to a range of graduate talent. A good service will act as a bridge between employers and students, encouraging interactions which bring benefits both sides whatever their needs.

'Recruiting graduates is a great way for small businesses to bring new talent into the workplace', says Gary Argent, Director of Careers, City University London, where the careers service works closely with a range of employers to help them figure out the best way to promote their opportunities to the university's students.

The service can promote opportunities to the student body, as they understand how students think and act, and can tailor engagements with them to make sure businesses are reaching the right students at the right time, in a way that will catch their attention. For example, the City University London careers service can help businesses to identify:

- temps for short-term placements, utilizing their Unitemps temping agency;
- graduates for permanent roles;
- work experience or placement opportunities within the company.

University careers services can help you to understand how to reach out to great student talent right on your doorstep!

CASE STUDY China entry

'As a global provider of pre-employment screening services, we were keen to further develop our business in the Chinese market,' says Dan Shoemaker, Senior Managing Director, HireRight Limited.

> *We were excited to engage with Coventry University London Campus and to take on a Chinese MBA student on an internship to undertake the research, analysis and to provide recommendations. It was a genuine win–win situation as we could progress a strategically important project utilizing a talented MBA student with a local understanding of the market.*

CASE STUDY Students and your business

Arina Sprynz completed a product design course at London South Bank University (LSBU), where she embraced inspirations created from blending technological innovation with new contemporary fabrication techniques. On completion of her course Arina created the world's first Recycled Glass Speakers and set up Rinz Sound Ltd.

Having limited financial resources, she decided to employ two students through the Enterprise and Entrepreneurship Link Scheme at LSBU. She has employed a graphic designer and an accountant to help her to move her business forward. Arina has found the

scheme extremely helpful as the university helped her to find and recruit the right person. Both students are still working for Arina after the completion of their placement and supporting growth of the company. Arina has also gained experience in managing members of staff, which was new to her.

http://www.rinzsound.com/designer/.

Conclusion

SMEs should contact their university to make links with the enterprise department, as there is so much on offer to help with the development of the business regardless of the stage of your venture or the industry within which you operate. Utilizing the services of university enterprise units can expand the ability of your company to address challenges, which at first may appear insurmountable. Working with universities allows the business to share their challenges and seek potential solutions.

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Frances Trought is the author of *Brilliant Employability Skills* (2011) and has 10 years' experience in higher education, with a primary focus on enterprise and employability. In 2013 she launched her business I Brand Ltd to develop employability resources and build bridges between university students and SMEs. She can communicate at all levels within an organization and engage varied age groups. She shares a passion for employability skills, as it underpins the success of all students, regardless of academic achievement. Further details: **www.myibrand.com**

Health and safety

4.5

Potential liability or positive safety culture? Jerry Hill at RBS

Mentor draws the difference

'Health and safety' – three little words, but what do they mean to you? Do you see unnecessary bureaucracy and containment to growth? Or do you see the opportunity to grow a successful, well-run, profitable business. A business that sets high standards and one that people want to work for?

From the late 1940s, industry in the UK strove to reduce high accident rates by improving hardware. They made guards more effective and built safer machines. And indeed this did reduce the accident/incident rates, but by the early 1960s, this reduction had levelled out. Next on the industry agenda was improving employee performance by providing them with better training, incentive schemes and rewards. This revitalized the downward trend in accidents for around 20 years, but as the 1980s dawned, again, the reduction in accidents had stalled. So where to from here?

The organizations themselves began to look inwards, at the way they managed their businesses, and this was further boosted with the introduction of safety management systems. It is widely known that most accidents and other forms of business disruptions often stem from employee error or disregard for specific safety standards. So the next stage is to now address these errors and flagrant disregard for standards and this is being done by encouraging positive behaviours. So just how important is it, to create a positive health and safety culture within your business? What's in it for you?

It has long been recognized that leadership of an organization is tremendously important in creating a robust safety culture that encourages strong health and safety performance, and that safety culture must be developed ... because it sure won't happen spontaneously.

But what do we mean by 'safety culture'? The Confederation of British Industry describes the culture of an organization as 'the mix of shared values, attitudes and patterns of behaviour that give the organization its particular character'. But put more simply, it's 'the way things get done' in a business. So safety culture can probably best be described as the shared ideas and beliefs of everyone, at all levels within an organization.

So what can be done to develop such a culture? Well, one thing is for sure. There isn't just one, gold-plated way of doing things. Clear leadership is one of the top priorities for any establishment trying to develop a positive, robust safety culture. Senior management must 'walk the talk'.

Five ways to demonstrate a good safety culture

Make safety a top commitment

Not always easy, when you'll have many competing priorities such as productivity, cost implications and the like. But it is imperative that safety is given an equally high priority amongst your other business objectives. You should be making regular, useful visits to the front-line areas of your company and seeking every possible opportunity to show your commitment to safety in all areas of the business. If you see unsafe behaviours, challenge them, or your unwillingness to act will be viewed as condoning them. And never be afraid to put time and money into safety such as purchasing safety equipment or funding safety training for your workers.

Active participation by workers

Never overlook the importance of worker involvement. Workers at the metaphorical 'coal-face' are often much more aware of safety issues and potential hazards than their supervisors or managers. And just doing enough to secure legal compliance. This will send the wrong message to your workforce. Involving your people in the creation of robust policies will invariably promote buy-in to any safety regime you put in place for their safety and actively promote the formation of a safety committee.

Trust

Don't always expect your employees to carry out regular safety walkabouts on your behalf. By undertaking them yourself, your employees will see your commitment first-hand and this will be one of the first steps towards development of trust between you. You should also actively encourage all employees and even contractors to challenge poor safety standards on site, without fear of recrimination or reprisal.

Communicate clearly and effectively

Some of your workers will learn by reading information. Others will get their 'fix' from being told. Ensure that you provide good, clear, concise safety materials and ensure that health and safety is a regular agenda item for all meetings, no matter which department is holding them. You should also actively encourage your people to report accidents, near-misses and safety concerns, but it's equally important that you report back to them if appropriate, explaining what you've done to manage the issues they've raised. Encourage your workers to suggest areas of the business and specific topics that they have concerns over or would like to hear more about. Again, this promotes a positive buy-in when you deliver. And make sure of just that ... that you deliver. There is little worse than management speaking up a good safety culture but then doing nothing to promote it.

A competent workforce

This isn't just about making sure people are competent in the roles they're employed to fulfil. If you want your workers to be aware of safety issues, then ensure they receive sufficient training to make a positive contribution. A robust training needs analysis can be a good idea.

Strict liability

So, you're doing your bit towards demonstrating a great safety culture, but you've heard some dreadful stories of civil compensation claims following breaches of health and safety legislation, even when businesses couldn't possibly have foreseen the issues arising. It is estimated that there are about 78,000 civil claims for compensation following accidents at work, compared with 1,000 criminal prosecutions.

But there's good news. Recent amendments to the provision of strict liability within the Health and Safety at Work, etc Act 1974 mean that, in future, civil claims for breach of health and safety duties can only be brought where it can be proved an employer has been negligent. It also establishes the principle that employers should always have the opportunity, even where a strict duty applies, to defend themselves, on the basis of having taken all reasonable steps to protect their employees.

It is hoped that the removal of strict liability will mark a shift towards common sense in the workplace. As an employer, you'll be able to fulfil the basic requirements of health and safety law without the worry of potential unforeseen claims against you, and be driven by the principles of good risk management, rather than the fear of being sued. This should increase your confidence not only to be able to protect your employees, but also to develop and grow your business.

Jerry Hill is Head of Consultancy Support – Safety, Health and Environment for RBS Mentor, a national health and safety consultancy offering a complete safety health and environmental service to businesses throughout the UK. Telephone: 0800 634 7002, e-mail: **info@mentor.co.uk**

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PART FIVE
Managing cashflow

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Access to finance

5.1

Options are opening up in commercial finance: Irene Graham at the British Banking Association gives five pointers for finding the right finance to grow

We are often asked if banks are open for business and the simple answer is yes: lending is what they do and what they all want to do more of.

Currently £10 billion of new lending per quarter is going out to SMEs in overdrafts and loans alone. On top of this, banks are also providing businesses with critical access to specialist finance such as trade finance for those exporting, asset finance for those seeking new equipment and invoice finance for those seeking to improve day-to-day cashflow.

Banks are very focused on ensuring businesses get the right type of finance at the right time and the major banks operate the Better Business Finance Programme (BBF), targeted at improving customer service, improving access to finance and improving information and transparency.

Help is at hand

Under the bank-led BBF programme businesses now have:

- Access to a national mentoring programme (**www.mentorsme.co.uk**) helping businesses seek finance and develop their growth plans. The bank mentor programme, available through Mentorsme.co.uk, can provide your company with guidance on everything from preparing a business plan to understanding the complexities of accounting. And the best thing ... it's completely free! Mentorsme.co.uk enables you to search for a local mentoring group to work with, based on the specific needs of your business and location.
- Support tools such as **www.businessfinanceforyou.co.uk**, which lays out over 500 finance options available to businesses across the country and simplifies the search for finance, making it easier for entrepreneurs to find the right source for their business needs.

- An appeals process for businesses declined finance, which is operated by the largest banks and ensures businesses have the right to challenge the bank decision as well as appeal any conditions of finance (**http://www.betterbusinessfinance.co.uk/help-support/appeal-process**).
- New equity-based finance from the Business Growth Fund (BGF), which is backed by five of the largest banks and provides long-term patient capital to growing firms in the form of £2–£10 million of equity finance with minority shareholdings. The BGF has now invested over £200 million in a range of growing businesses and sectors including the oil and gas and automotive industries (**http://www.businessgrowthfund.co.uk/**).

Top tips for seeking finance

It is really important that businesses have the right mix of finance for their needs and growth plans, and also that they plan ahead for what their needs may become.

We are often asked for the top tips in applying for finance. Helpful tips and guidance are available at **www.betterbusinessfinance.co.uk** but we would stress the following.

1 Talk to your bank and keep the dialogue open

This cannot be emphasized enough. Banks are in the business of lending and businesses who want to borrow should go and talk to their bank about the financing they need. By opening up a dialogue early, you can get guidance on what sort of finance might be best for you, and on some of the steps you should take in applying for it. It is important to communicate often and clearly with your bank and to seek feedback. Ask your bank how you could adjust your business model to help secure funding and what elements of your plans may need further consideration. Be sure to check around and compare different banks and their small business offerings.

2 Develop a robust business plan

Business plans are more important than ever and you should demonstrate your business's financials, showing the all-important repayment ability factor. A business plan should give a business owner or director confidence in their decisions, way before it is used to give confidence to a lender. Business plans are all about testing and measuring, helping make informed decisions that are based on fact and sense. In your plan you should demonstrate that you have done your homework, by researching your market and competitors. Identify clear routes to market and highlight in your plan when you expect to start bringing money in.

3 Build your financial understanding

To be successful, you must understand your numbers. To have a successful credit application you must be able to clearly demonstrate your understanding and show how the business will manage/maintain the credit it is asking for. You should also be able to clearly outline what you need the money for and how you will pay it back. Work with a business mentor or accountant to ensure you know what makes a sound balance sheet and cashflow projection. A range of resources are available on the Better Business Finance website or you can look to work with a mentor through Mentorsme.co.uk.

4 Check your track record

When making a lending decision, banks will take into consideration how you have managed your finances in the past. It is therefore important that you know your credit rating and understand the key elements that might affect it. If you believe your credit rating is incorrect or inaccurate you should challenge it.

5 Be honest

Do not underestimate how much money you will need. If you need to return to the bank and request further funds, it will be more expensive. It may also affect the lender's confidence in your ability to manage your company finances. Do not over-forecast revenues or under-value the costs you will incur. Be honest about any reasonable living costs you will need to take out of the business.

Plenty of offers are available

Banks are in the business of lending and want to support viable businesses in their growth plans with the right finance options. There are many very good offers out there at the moment for finance including those supported by the Funding for Lending scheme providing a range of price incentives.

Our simple message is: prepare well, use the support available from accountants and mentors, speak to your bank about your finance needs and work with them on the options available to you. Keeping the dialogue open is crucial.

The right of appeal: how it works

Did you know all SMEs have the right to appeal against their bank's lending decisions? This is part of the Independent Appeals Process that was launched two years ago. If you request an appeal, a separate team within the bank will reassess the decision, overseen by an independent external reviewer. And the scheme is delivering: in 4 out of 10 cases, the original decision is overturned, and the business gets funding after an improved dialogue with the bank and often the provision of more information by the business. So far, there have been almost 5,500 appeals, which have put an extra £30 million of funding into SMEs.

The process is independently overseen by Professor Russel Griggs, a business owner himself and former chair of the Confederation of British Industry's SME panel. He has been working with banks and companies over the last two years to see why SMEs are unsuccessful when they apply for finance, how they can be more successful – and why banks sometimes get the decision wrong.

His second annual report shows that the main reason applications are declined is credit rating. Either the company itself has a poor credit history, or the owner has a poor personal credit rating. But firms should understand that a poor credit score need not be the end of the road. Reviewers regularly came across situations where a customer applied for a loan but was turned down, yet with a little extra information provided by the customer during the appeal, the decision was overturned.

For further details go to: **www.bba.org.uk**

Keep the cash flowing

5.2

Philip King, Chief Executive of the Institute of Credit Management (ICM) offers advice to SMEs on managing payments

When money is tight and cashflow is critical, prompt payment can be absolutely vital to the survival of small and medium-sized enterprises in the UK. SMEs need to be mindful that the fragility of the supply chain is an extremely common factor in the collapse of UK businesses; approximately 10 per cent of all business failures can be attributed to non-payment, and 20 per cent are down to the failure of a trading partner.

What's more, according to recent figures, the combined total of all outstanding invoices owed to British SMEs is estimated to be around £24 billion. The average amount owed to an SME at any one time stands at £25,000. This gives some idea of how much cash is tied up in unpaid invoices – cash that could be freed for wont of a better payment culture, and a greater focus on the basics of credit management.

Prompt payment, however, is a two-way street. Most media coverage tends to highlight the poor treatment of SMEs by larger customers. But why should large companies pay SMEs on time when they have their own cash position to manage? And what about the relationship the SME has with its own suppliers?

Practical advantages

For some, it may sound counter-intuitive to part with precious cash more quickly. However, there are practical advantages to prompt payment that go far beyond being seen to treat a supplier fairly. Paying on time, or even sooner than expected, establishes a strong customer–supplier relationship which enables customers to negotiate better deals, avoids issues like late payment interest charges and is far more likely to lead to more business. Furthermore, a business that makes prompt payments communicates confidence and financial wellbeing to the market, meaning that other companies will feel more secure doing business with them.

Much of this ethos is enshrined in the Prompt Payment Code (PPC). Developed by the ICM and the Department for Business, Innovation and Skills (BIS) and supported by such high profile firms as Barclays, RBS, HSBC, Lloyds and NatWest, the PPC is a simple statement of clear and consistent policy between customer and

supplier. Through this pledge companies commit to paying invoices on time, giving clear guidance to suppliers and encouraging good practice throughout the business community. The PPC (which can be found at **www.promptpaymentcode.org.uk**) includes a facility for suppliers to raise concerns about late payers.

Practical advice

As well as the Code, there is practical help available to SMEs to manage cashflow through a series of online 'Managing Cashflow' guides. The guides, written by the ICM for BIS, offer indispensable advice to companies on how best to manage their cash, and have proven so successful that over 450,000 have been downloaded since their launch four years ago. These guides can be found in the resources section at **www.icm.org.uk**.

In terms of specific 'tips' or advice, SMEs can reduce the risk of late or non-payment by following a few guiding principles:

- **Knowing your customer –** ensure you are clear as to the exact name and legal status of the business you are supplying. Failing to know exactly who you are trading with means you won't be able to check if they are good for the amount of credit you need to grant them, you won't be able to invoice them correctly, and you won't be able to commence legal action effectively if it becomes necessary.
- **Payment terms –** if you think you are going to be paid on one date, and your customer has a different date in mind, you could be heading for trouble. Making assumptions is dangerous and formally agreeing payment terms in advance and in writing is vital.
- **Invoicing –** if you don't raise an invoice, you won't get paid. Invoicing should not be seen as a back-office administrative nuisance, but rather a vital first step in achieving healthy cashflow. The sooner you ask, the sooner you can get paid.
- **Treating suppliers fairly –** you want your invoices paid on time and you should do the same. It's not just good business practice and ethical behaviour; it also demonstrates a wider corporate social responsibility. Make sure payments due are in your cashflow forecast so that you're not caught unawares.
- **Chasing payment –** a sale is only complete once you've been paid for it. Until then, customers are hanging on to money that is rightfully yours and you should ask for it. Routines should be in place as standard for following up on non-payment that includes letters, e-mail, and telephone, with the need to stay flexible if the amount outstanding is large or you have concerns over the customer's financial viability.
- **When cash runs short –** cash keeps business in business. Plan your cashflow requirements carefully, allowing for differences in the payment terms you receive from your suppliers and those you give to your customers.

- **When all else fails** – sometimes, however disciplined you are, you just can't get paid. The longer the debt remains unpaid, the more likely it is to turn into a bad debt and bad debt seriously affects cashflow. Legal action is an option, but so too is employing a debt collection agency (with the new EU Directive on Late Payment you can recover your costs) or issuing a statutory demand.
- **When your customer goes bust** – inevitably businesses fail, and when one of your customers goes bust, your resources can again be depleted. It helps in these cases to understand the different types of insolvency, bankruptcy, IVAs, CVAs, liquidation and administration, and how each affects your chances of recovery.

Credit manager

Of course the best advice for an SME is to equip themselves with a professional credit manager, someone to whom the above is second nature. The remit of a credit manager can of course vary from one organization to another, depending both on that organization's size and the sector in which it operates. But it is not a surprise that successful businesses have certain characteristics, and one of those characteristics is good credit management, and that means good credit managers.

So what does a good credit manager do and what value can they deliver? At its most fundamental, a credit manager will oversee the sales ledger function, including raising invoices in a timely and accurate manner, speedy cash posting and accurate allocation of that cash, agreeing invoice formats with larger customers, and ensuring sales teams are capturing data accurately to prevent subsequent invoice queries. In times of crisis, as now, it is these 'fundamentals' that become more important than ever.

Credit managers may be assessing risk on new accounts and existing customers by way of credit information providers, reading financial accounts and establishing trading histories, something that is becoming increasingly important as they are obliged to share greater risk with their insurers; they may be involved in the creation, maintenance and management of a full credit policy – internal documents that identify all set and agreed procedures and policies that govern the credit function.

They may also be negotiating and agreeing terms of business with new and existing customers or suppliers, including payment terms and setting up service level agreements and credit limits, and reporting to directors on age and profile of debt, potential risks of bad debt, over-trading accounts, areas of suggested training and general customer service observations. They are also likely to be overseeing or monitoring the activities of tracing agents, debt collection agencies, solicitors, insolvency practitioners and other third parties, and finding alternative ways of doing business such as escrow accounts, guarantees, back-to-back deals, etc when other methods may have been rejected.

Conclusion

Of course there are a good many challenges still ahead, and one of the biggest challenges is access to credit. Credit, in the future, is not going to be ours by right; we will all have to earn it, and that means being able to demonstrate best practice. And best practice comes from professional credit management. Those SMEs that manage their credit – and their cash – effectively will be those who succeed.

Philip King is Chief Executive of the Institute of Credit Management (ICM), Europe's largest credit management organization, and the second largest globally. As the trusted leader in expertise for all credit matters, the ICM represents the profession across trade, consumer and export credit, and all credit-related services. Telephone: 01780 722912,
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Asset-based finance

5.3

Kate Sharp at ABFA discusses the role that asset-based finance plays in the growth cycle

As businesses evolve, from a one-man band to the largest multinational corporation, finance is probably the most important single element in their growth and success.

Yet finance is often seen as less of a priority than product innovation, marketing or lead generation. Without having in place from the start funding which really meets a company's needs it is so much harder to grow and trade successfully, and in time it can easily become a serious impediment to a firm's future prospects.

A business should always consider the nature of its funding requirements and then look at what funding solution is best for them. An overdraft or a term loan might work for some businesses; if a firm is looking to acquire a piece of equipment, then leasing or hire purchase could be the best solution. But, if what a business really needs to do is to unlock its cashflow and/or raise additional funding based on its other assets, then asset-based finance products could be a significant part of the answer.

What is asset-based finance (ABF) and how does it work?

The term 'asset-based finance' (ABF) is used to describe a number of commercial finance products available to businesses. Put simply, they involve funding provided by a financier on the basis of the assets contained within a client business.

One of the most significant 'assets' that a business will have will be the debts owed to them by their clients – represented by their unpaid invoices. For this reason ABF is often referred to as invoice finance, but strictly speaking the terms are not interchangeable as ABF also includes asset-based *lending* (see below).

In the UK there are two well-known invoice finance products: *invoice discounting* and *factoring*. Both products provide a business with the ability to draw money against its unpaid sales ledger. To provide this, the financier advances an agreed percentage of the value of the sales ledger to the business, effectively using the unpaid invoices to secure the funding. Each offers an immediate availability of funds of

around 80–85 per cent of the value contained within the sales ledger. The remainder is available to the client when the customer pays, less the financier's fees. The two products are as follows:

- **Factoring –** provides firms with the working capital to operate their business, together with an outsourced sales ledger and collections service, plus the option to transfer the risk of debtor failure to the financier.
- **Invoice discounting –** is similar to factoring but for businesses that prefer to carry out their own credit control. It provides funding together with the option to insure the debtor risk and can be provided on a confidential basis without disclosure to the debtors.

In addition to the two main invoice finance products, *asset-based lending* (ABL) is the third product offered under the ABF banner. Where invoice discounting and factoring are pure revolving cashflow facilities secured against the debt purchase, ABL solutions normally offer a combination of such a facility based upon the debts and assets such as stock, and an amortizing loan secured on other assets within the client business.

What type of ABF suits smaller firms?

Factoring is often used by smaller businesses which may not have in-house credit management resources. This product offers businesses access to the funding they need with the added bonus of a credit management service to take the administrative strain. As well as significantly improving cashflow, this added expertise and support can free up management time to focus on growing the business. Additionally, one of the key advantages of factoring is that it provides expertise and local knowledge at both the debtor and creditor ends of a transaction. This is particularly attractive to exporters as the factoring company will generally make arrangements to collect payment in the jurisdiction of the importer.

What type of ABF suits larger firms?

Invoice discounting is an increasingly popular form of funding for larger 'Ss' and 'Ms' which require funding but wish to retain their own credit control functions. In addition, ABL becomes more of an option for mid-sized and larger businesses which may have a larger asset base. It delivers sophisticated solutions for a variety of scenarios including growth, MBOs, MBIs, mergers and acquisitions, refinancing, turnarounds, and public-to-private transactions. Depending upon the required size of the ABL facility it is not uncommon for several providers to work together as a syndicate to increase the funding available.

Advantages of asset-based finance

- No other form of finance will provide as much cash against your assets. A receivables-based facility is likely to generate far more funding, possibly in the region of twice as much as an overdraft.
- ABF is highly suitable for growing businesses as the funding grows in line with sales, eliminating the need to constantly rearrange funding lines. Knowing that the available funding tracks business growth is a huge benefit to many companies where predicting cash requirements is onerous and subject to significant fluctuation.
- ABF offers the customer the option to add value through cost-effective outsourcing solutions such as credit control and debtor insurance.
- The range and variety of ABF facilities means that there is a solution for businesses of all sizes, across many industries, and at different stages of the corporate life-cycle.
- Funding decisions are based upon the inherent strength of the business (ie the product and the customers) and not just on the strength of the balance sheet, making it available to a wider range of potential consumers.
- ABF facilities are based on the actual purchase of the debtor balances with much less reliance on additional security, such as personal guarantees.

What size of firm and industry sectors use it the most?

The ABFA's latest figures (Q1 2013) show that 83 per cent of the UK and Irish businesses that use asset-based finance fall within the £0–5 million turnover bracket. Many smaller companies find the advantages of factoring in particular extremely useful, such as allowing the outsourcing of credit control, freeing up management time to focus on actually running the business.

Invoice discounting and ABL are increasingly popular choices for growing and larger businesses, however, and a considerable proportion of the increase in funding provided by the industry overall is being delivered via these facilities. The industry provides more funding to clients in the £100 million+ turnover bracket than any other segment, providing £4.4 billion to businesses in that bracket at the end of Q1 2013.

In terms of sectoral analysis, ABFA's latest data indicates that asset-based finance is being used extensively to support manufacturing, with over 12,600 manufacturing

businesses using these types of funding. The figures show distribution, services, transport and construction sectors also drawing significantly on asset-based finance products.

CASE STUDY Invoice finance takes Oak Exports coast to coast

When starting the business in 1987, company directors Stuart Dunbar and Richard Harvey saw a gap in the market for exporting British foods to foreign shores. Now, 26 years down the road, Oak Exports is a successful exporter of non-perishable British food and drink, to retailers, wholesalers and distributors across 40 overseas markets.

However, Stuart soon discovered there was a gap to be bridged between the 30-day payment terms he had with his British suppliers, and the 60-day payment terms his overseas customers worked to.

'Differing payment terms across the world are only to be expected, but we needed to address the problem quickly to maintain excellent relationships with our suppliers,' Stuart explains.

Stuart found an invoice finance package to be the perfect solution because it allows them to fulfil all customer orders on time and as smoothly as possible. Utilizing credit control facilities has also allowed the firm to focus on generating new business, rather than chasing customer payments.

Stuart explained: 'The service means our cashflow is freed up by releasing a percentage of our invoice value providing a smooth, consistent source of funding that grows in line with our sales. Moreover, we have been able to grow the business without the usual headache of handling our own credit control.'

Is there funding available?

Yes, funding is available. According to the Breedon Report, the funding shortfall facing small businesses is expected to be as high as £190 billion in just five years. Yet the asset-based finance industry has sufficient funds in place right now to help both small and large businesses with their funding needs. Its popularity and importance to the UK's economy can be seen in ABFA's figures: the industry in the UK and Eire supported clients with a total turnover of £104 billion in 2002. In 2012 the figure was £250 billion and in 2013 client advances are predicted to rise by 7 per cent to £17.8 billion. Put simply, for companies looking to grow and trade successfully, asset-based finance is one of the best types of finance available.

Protecting users

The industry has just launched an enhanced self-regulatory framework to demonstrate the standards that clients can expect from ABFA's members. The new framework covers an enhanced ABFA Code, a new independent Complaints Process overseen by Ombudsman Services and a new Professional Standards Council. Building on the core strengths of the industry, the framework makes the products more accessible and provides client businesses with even more confidence when using asset-based finance.

As Business Minister, the Rt Hon Michael Fallon MP, commented on the launch of the framework:

> Asset-based finance is a useful option for small businesses seeking finance. It is therefore important that small firms are confident that lenders will behave responsibly. By establishing the new [framework] the sector is showing its ambition to make the step up and play a much greater role in the economy.

Kate Sharp is Chief Executive of the Asset-Based Finance Association (ABFA). For more information on asset-based finance visit ABFA's website (**www.abfa.org.uk**) which lists all of its members, representing over 95 per cent of asset-based financiers in the UK and Eire. On the website there is an easy-to-read guide to the different types of funding available (**www.abfa.org.uk/public/industryinformation.asp**).

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PART SIX
Digital technology

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How to stand out digitally

6.1

Professor Simon Thompson, director of research and enterprise at the University of Kent's school of computing, considers how smaller companies can build a dynamic presence on the web and in social media

If you are searching for growth, look online. In the UK, the web economy now accounts for 8.5 per cent of all activity, which is a higher figure than any of the world's other main markets.

To give you a sense of scale of the change that is happening, consider online groceries. They already account for 4.5–5 per cent of the market. If they continue growing at their current rate of 15 per cent a year, their share will be 10–12 per cent by 2020.

So how can you as a small enterprise start capturing this potential? Here are a series of relatively easy steps that you can take that might end up transforming your business without saddling yourself with too many extra costs.

Phase 1: Web presence

First, change your mindset. It is no longer a matter of thinking whether you should be online, but about how you must build your presence.

At a minimum, whether you are a florist in Canterbury, a curry house in Margate or anyone else, you have to create a basic webpage. It is how your customers now find you. So make sure you have a clear domain (for instance **www.york-flowers.com**) that you can publish in local online directories, most of which are free.

As well as saying who you are and where you are, you can start adding details that your customers will find useful, such as what you have on the menu or what bouquets you might recommend for different occasions.

Alongside your own activities, it will be worth placing yourself within a wider picture. As a florist, you might point customers towards your preferred maker of vases and carry a link to an online ordering service like Interflora.

Similarly, at the restaurant, you might plug yourself into a national infrastructure for making bookings. Any visitors are likely to go through one of these networks in

planning their trip. Like most of us, they are likely to rely on recommendations from other customers on sites such as TripAdvisor. These reviews can be highly influential in how anyone unfamiliar with your area makes their choices in how to spend their time.

Phase 2: Social media

So far, you are still taking a relatively passive digital approach. On the web, you generally rely on customers to come to you. On social media, you can connect with them more directly.

If you build your own page on Facebook, you can start sending out messages to those who choose to like you, highlighting any special offers you might be running.

On Twitter, you can create an account for yourself by finding a name that no one else is using and put @ in front of it. Anyone who follows you will then receive your tweets. It is a powerful way of starting to build a relationship.

When you tweet, you can highlight any words or phrases, such as flowersforeaster, with a hash tag. Anyone who is searching will then find you.

You will find lots of advice about how to attract followers. Probably the simplest way is if you follow them they are more likely to follow you. Then, once anyone comments on you and you respond, all their followers will see what you have to say.

Another way to generate traffic is by taking paid-for links on search engines, so you appear at the top of the page for any results. Unlike other forms of advertising, you only pay when someone responds by clicking on your link.

The cost will depend on the level of demand for any combination of words. 'Cheap booze' is likely to command a premium. 'Curries in Margate' or 'flowers in Canterbury' are likely to be much more affordable.

Phase 3: E-commerce

Once you have worked through all these options, you will have essentially created your online presence. The next stage is to start making sales directly through e-commerce. Again, you can go a long way without incurring too many upfront costs.

You can create your own shop on eBay, who, as well as running auctions, let you sell direct through its option 'buy it now'. Or you can become a partner on Amazon and appear on its listings when customers search for your type of product.

For services, like hotels and restaurants, sites like TripAdvisor are now moving beyond their origins in customer advice into making bookings directly.

If you want to sell off your site, companies like PayPal will process payments for you, saving you the complications of managing credit cards.

Potentially, such activities will transform the nature of your business. Think about second-hand books. We used to travel the country, dropping into shops in the hope of finding a title. Now you can essentially see the whole stock of the country's stock second-hand books on a site like AbeBooks in an instant.

Equally, in your own business, you might start expanding into areas you never thought possible before. Our florist in Canterbury, for instance, could look at selling animated cards to attach to bouquets.

Phase 4: Brand dialogue

By inviting your users to start conducting a conversation with your brand, you are moving from a static presence online to a more dynamic two-way flow. But how do you keep yourself fresh and ready to engage?

Right at the start, you want to make sure that you retain the option to manage your content. Many of the companies we see at the University of Kent tend to create a striking first site, which they struggle to adapt as the nature of their business changes and expands.

Later, as you move into social media, you have to be ready for the eccentric and unexpected comments that you might attract. So it is worth thinking in advance about the tone you might adopt. If a slip-up happens, rather than being defensive, it is generally better to be graceful. That way, you can keep building your audience.

Social media policy

- Define what type of company you want to be seen as – informal, formal etc. Remember your target audience.
- Time online promotions and monitor the response.
- Monitor the sentiment toward your business and topics related to you.
- Respond to the key topics that are related to your business and to your target market.

The Kent IT Clinic is an IT consultancy, which is part of the School of Computing at the University of Kent. Its mission is to support the community by solving business problems with technology, as well as providing its Student Consultants with the skills to make them more employable.
Website: **www.kitclinic.com**

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When to start worrying about data privacy and security

6.2

In a world of apps, Marco van Beek at Forget About IT signals his concerns about data privacy and security in the cloud

More and more we are being told that we should be using 'apps' and storing our data 'in the cloud'. It is, we are told, good for many things, all things to all men. It is seen as cheaper, more secure, more dependable, more 21st century. But is it? Or are the cracks starting to show? Should we really be worried about storing our data in someone else's hands? There is a mysticism surrounding what is loosely called the 'cloud'. There is an element of the emperor's new clothes. If you object to the cloud, it is because you are not enlightened, and you dare not speak up in case you reveal your ignorance and your status as a Luddite.

Or maybe, just maybe, you feel something is wrong. It all sounds too good to be true. You can't see the catch, you cannot see how they can be making money from you, so you worry. But your worry is without form because it is just a gut feeling, and everyone else you know says the opposite.

So should we be worried? The simple answer is yes. For many reasons. And if you can quell all these worries to your satisfaction, then the cloud is for you. But if you can't, *caveat nube*.

The 'cloud' is just a catch name for many different services. None of them are that new, none of them are that clever, but some clever marketing people have done their job well. To continue their own metaphor, they have surrounded it with a layer of mist, so that you, the end-user, are paying for something you do not necessarily understand.

The cloud is not contiguous. It is not all run by a single faceless company. It is not inherently evil, or good. The cloud is simply a collective name given to all the services of some sort that are run over the internet instead of from within your own office.

Follow the money

So the first question to be asked of any cloud solution is, 'Who runs it?' Who are they, where are they based, and are they, as a company, dependable, reliable suppliers? Can you talk to them, can you run a credit check on them, can you find out who the directors are? All the questions you would normally ask as part of your due diligence of sourcing a new supplier should be able to be answered in the same way as any other supplier. In many cases you may find out that they are simply a reseller of someone else's product. It may be white-labelled, so you cannot tell who the actual provider is.

Trust

With many cloud solutions, you have to trust the provider 100 per cent. If you are using a software-as-a-service solution, you often have no way of exporting your own data or backing it up to a third location that is not part of the original provider's system. So if their system goes down, so does access to your data. The cloud is no more inherently secure, stable or reliable than anything you could put together yourself. Your provider will tell you their systems are the best, the most reliable, the most secure, but even in the short space of time we have been using cloud solutions, even the biggest and best have gone down. Office 365 and its predecessor, Business Productivity Online Suite (BPOS), experienced eight outages of varying lengths between May and September 2011.[1] Figures released by Microsoft in August 2013 indicated they were now running at an average of 99.97 per cent uptime. That translates to around 2½ hours downtime a year, but on August 29th, there was a ~3hr-long outage.[2] The important thing to remember is that a service level agreement (SLA) is a legal agreement between you and the provider. There is usually nothing in there that says they will fix the problem within a given timeframe, just that if they fail to deliver the required uptime, they will give you some money back. Don't expect to be able to sue them if your business goes down the drain because of one of their outages.

So whenever a supplier offers you an SLA, do the maths: 99 per cent uptime is over 3 days' downtime a year. In comparison, the generally accepted minimum uptime in the communications industry is what is called '5 nines', or 99.999 per cent, or just over 5 minutes of outages in a 12-month period. Some are now heading for 6 nines.[3]

Exit strategy

So just as you would have a plan B if the solution was located within your own office, you need a backup plan for the cloud solution as well. As a minimum you need to be able to get access to the most recent copy of your live data, in a format you can use. Some providers will give you a facility to export your data as a spreadsheet, but you would still need to task someone in your office to download it at regular intervals.

Most systems will allow you to print reports, and as long as you have a way of dumping this into a PDF, then you might be able to get all of tomorrow's work requests in a format you could use to get you through the day.

Beware of the wolf

Some of you may have heard of Kim Dotcom and Megaupload. A New Zealand-based business, Megaupload was a cloud-based file storage service which was shut down in January 2012 at the request of the FBI, allegedly for operating as an organization dedicated to copyright infringement. All of its servers were shut down, denying its users access to all their files, regardless of whether they were legitimate users or not. It took until May 2013 before the New Zealand courts ordered that items not relevant to the case should be returned. Megaupload.com expressly informed users through its Frequently Asked Questions (FAQs) and its Terms of Service that users had no proprietary interest in any of the files on Megaupload's servers; that users assumed the full risk of complete loss or unavailability of their data, and that 'Megaupload could terminate site operations without prior notice'. But how many people who sign up for online services bother to read the terms and conditions?[4]

Privacy

In order to avoid being shut down like Megaupload, most legitimate file storage systems check for both child pornography and copyright infringement media automatically. It is but a short step for them to look for other things that may help pay for the service. Gmail, for example, checks the contents of all your e-mails, so that they can better tailor the adverts they show you. They are currently being sued in the USA by some of their users who allege this constitutes illegal wiretapping.[5]

So if you store your data on third-party servers, there should be an expectation that your data will be examined by the people who host the system, either as a way of improving their revenue, or in order to protect themselves from the consequences of illegitimate use.

If you agreed to the terms and conditions without reading them, or even downloading a copy for someone else to read, how do you know what you agreed to? If you store confidential and propriety information on that server, you may have just allowed that third party to access that data and use it to help pay for the service. Worst of all, you will have no idea if that data has been accessed and resold. No matter how good and well-meaning a company is, if the company has access to the data, so do at least some of its employees, and complex audit systems are expensive to implement and maintain, so the weakest link is usually a disgruntled employee looking to supplement their wages.

So all that money you invested in your intellectual property could be sold on without you even knowing. Encryption, when provided by the third party, is no barrier,

since they also have the keys, and many claim that they must have the keys in order to comply with US law.[6]

Under the EU Data Protection Directive, European firms are prohibited from transferring personal data to overseas jurisdictions with weaker privacy laws, unless the recipient of the data has voluntarily agreed to meet EU standards as part of the Safe Harbor provisions of the directive.[7] So by using a cloud service without checking, you may, in fact, be breaking EU law.

Client confidentiality

Some of the data you need to store might not actually belong to you. It may belong to your clients, who may have placed you under a non-disclosure agreement. You may be acting for them legally, involved in a dispute, or be responsible for them medically. Imagine their surprise if the data they entrust to you turns up in the hands of the opposition because they were able to take out a search warrant and gagging order on the company that hosts the cloud server inside their jurisdiction, without you knowing (due to the gagging order), or if it is sold on to an insurance company which is suddenly able to enquire about a prior medical condition to deny or delay a claim.

The recent revelations by Edward Snowden came as no surprise to most in the IT security industry. Microsoft have been fending off accusations of collusion with the NSA and providing them with a backdoor since at least 1999[8] and Lotus Notes had an agreement with the NSA in 1997[9] to allow them easier access to encrypted data. However, it has raised public awareness of the issue and therefore, if you have a client who expects a high level of confidentiality, expect all your cloud services to come under scrutiny. And if you have built your business methodology around a service they deem to have inadequate security, you might just lose a lot more than you thought you were saving by moving to the cloud.

Conclusion

So in conclusion, there is no such thing as a free lunch. Cloud solutions are cheaper for a reason. Sometimes it is because you are benefiting from scale. Sometimes because they are making money in other ways. Sometimes because they are providing a worse service than if you did it yourself (and there is such a thing as a private cloud). And sometimes they are just plain unsafe and dangerous to your business. Never did *caveat emptor* have a greater significance than in the foggy world of cloud computing.

If you can see a clear value-for-money case, and you are happy with all the provisions that you have to put in place to protect your business, then please go ahead. There are many benefits to cloud systems. But if you still have that nagging doubt that it is all too good to be true, then it probably is. And even if you do go ahead, have an exit plan and make sure accounts department is keeping an eye on their credit rating.

Notes

1 http://www.theregister.co.uk/2013/08/09/office_365_uptime/
2 http://www.zdnet.com/office-365-outage-thursday-night-7000020069/
3 http://en.wikipedia.org/wiki/High_availability#Percentage_calculation
4 http://en.wikipedia.org/wiki/Megaupload
5 http://www.huffingtonpost.com/2013/09/05/gmail-ads-email-scanning_n_3871246.html
6 http://academhack.outsidethetext.com/home/2011/why-i-might-be-although-i-would-rather-not-leaving-dropbox/
7 http://en.wikipedia.org/wiki/Safe_Harbor_Principles
8 http://en.wikipedia.org/wiki/NSAKEY
9 http://en.wikipedia.org/wiki/IBM_Notes#Security

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 specialises 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.

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PART SEVEN
Leading growth

Design for growth

7.1

Growth might be your goal, but it will never happen unless your organization can make a series of transitions, says Ken Russell at Aberdeen Business School

It is now 27 years since Eric Flamholtz produced his book *How to Make the Transition From an Entrepreneurship to a Professionally Managed Firm*. It is 29 years since Charles Hofer and Ram Charan produced their analysis of the transition process that they observed from entrepreneurial style to a managerial approach. In 1972, Larry Greiner first presented his ideas of 'Evolution and revolution as organizations grow' in the *Harvard Business Review*. The premise of this chapter is that it is useful to revisit some of this work to help today's owner-managers develop some appreciation of likely transitional issues and what actions they should consider taking, in order to develop a cadre of professional middle managers.

Do you want to change?

Fundamentally, if you are happy with the status quo and you believe there is no need to grow your business then please move on to the next chapter – but you may be risking losing your organization. As Hofer and Charan put it: you must be prepared for major change in your own behaviour as an owner-manager. They outlined a series of seven steps in making the transition:

1. The entrepreneur must want to make the change and must want it strongly enough to undertake major modifications in his or her own task behaviour.
2. The day-to-day decision-making procedures of the organization must be changed. Specifically, participation in this process must be expanded. Greater emphasis should also be placed on the use of formal decision techniques.
3. The two or three key operating tasks that are primarily responsible for the organization's success must be institutionalized. This may involve the selection of new people to supplement or replace 'indispensable' individuals who have performed these tasks in the past.

4. Middle level management must be developed. Specialists must learn to become functional managers, while functional managers must learn to become general managers.
5. The firm's strategy should be evaluated and modified, if necessary, to achieve growth.
6. The organizational structure and its management systems and procedures must be slowly modified to fit the company's new strategy and senior managers.
7. The firm must develop a professional board of directors.

The earlier work of Greiner put forward a 'phases of growth' model where he suggested that there were a number of stages of growth followed by crises which then led to adjustments that supported the next phase of growth. For example, early growth was identified with creativity which led to a crisis of leadership followed by growth through direction which led to a crisis of autonomy which was addressed through growth by delegation leading to a crisis of control, etc.

Flamholtz and Randle (in later editions) are clear that there are five choices for owner-managers, given some of the types of transitions outlined above:

1. You can try to develop new skills and behaviours – something that Flamholtz and Randle believe is possible but difficult.
2. You can retire and let others create a professional management team to run the business.
3. You can move up to be chairperson and turn over the operations to a professional manager whilst staying involved. (You should be wary of micro-managing – see my earlier article in the 14th edition of *The Growing Business Handbook*: 'Too much control, too little freedom? The case of the micro-manager'.)
4. You continue to operate as before, ignore the problems and hope they go away.
5. Sell your holding and start a new entrepreneurial venture.

Points to ponder

1. At what stage is your organization in terms of the transitions (Hofer and Charan) or crisis (Greiner) outlined above?
2. At what stage are you in terms of preparedness to change and the options outlined by Flamholtz and Randle?

Pinch points

Jim Collins refers to 'getting the right people on the bus'. Have you got the right team around you to help grow the business – your business? Here are some of the pinch points – signs that you need to put more effort into developing a cadre of professional middle managers – and a few pointers to help you identify them.

1 **Have you had an honest appraisal of your team of direct reports?** Have they grown with you and the needs of the business? Many businesses run into problems because of a lack of management capacity/competence and there is a mismatch between the rate of business development and staff development. This can often be detected by a pervasive sense that there are not enough hours in the day and that many staff have their 'nose to the grindstone' such that they are unaware of what others are doing. In the early stages of a business, the entrepreneur may be able to keep on top of things through what Handy describes as a 'star culture', ie everything flows through the entrepreneur. As the business grows this approach is no longer possible through a combination of growth in volume and complexity. Therefore you need to look not only at your team but also at yourself.

   Key question: how can you 'let go' of having to oversee everything alongside developing existing staff and bringing new ones on board?

2 **In 'letting go', have you provided the (new) middle managers with a clear sense of direction and delegated appropriately?** Micro-management is a form of disempowerment whereby decisions are taken away from those who could usefully make them. One of the tensions for an entrepreneur is that in professionalizing the firm, they are creating more formal and explicit approaches and these may be the very things that they escaped corporate life to avoid. The middle management team do however need a stronger sense of direction and this can be provided through a combination of vision, mission, objectives and priorities. It need not become a 'cottage industry' and involve lots of meetings but it does require clear, coherent and consistent communication with all staff. If new members of the team are added then induction processes need to be handled appropriately.

   Key question: how can you maintain existing operations, develop new business and bring new people on board?

3 **In bringing new people on board have you given time to getting the structure right and clearly defining the roles?** Not only is it important to set clear direction for the company and communicate this to the team, it is also crucial that staff are clear about their expected contribution. In forming the middle management team there are a number of dangers related to conflict management. Too much conflict and there is too much emotional energy wasted. Too little conflict and there is no creative tension and business development suffers. In an attempt to be in a zone where there is the 'right amount' of conflict the following should be considered:

- Don't create a team comprised of clones of yourself who will be sycophants: you need to develop the organization by bringing in people who have values aligned to your own but who bring specific expertise that you don't already have.
- Don't create posts with significant role overlap: the post holders will simply spend too much time 'fighting the alligators rather than draining the swamp'.

Key question: are your plans going to contribute to better ways of working rather than adding to the problems of managing the business growth through a failure to manage conflict?

4 **In developing the organization are you continuing to fight the same fires?** Too much energy in organizations is wasted in reinventing wheels, fighting the same fire each day and failing to learn. Over time certain practices can become habit and go unchallenged as that is just the way it is. In informal approaches to managing, often the management information systems are fairly rudimentary but as an organization grows there will be a need to have improved information systems. At some point there will be some recognition that processes need to be improved, simplified, standardized, etc. In a transitional phase where new members of staff are recruited there will be a key period whereby other ways of working can be 'captured', otherwise there is a danger that new staff will simply become 'natives'.

Key questions: how do you avoid using 'idea killers' and thus failing to capitalize on ideas to improve your business? Is your management information system up to identifying wasted effort?

5 **In going for growth, are you generating cash and enhanced profits?** In the short run you may well have increased staff costs but you need to find ways of channelling effort into profitable sales. All too often it is easy to take your eye off the ball and increase revenues but not profits simultaneously. In any change scenario, it is usually the case that performance may get worse before it gets better. It is important to 'weather this storm' but also to provide clear direction, manage expectations and support staff through the transition. Many entrepreneurs manage by 'walking about'. In the transition it will be important to ask better questions and listen more.

Key question: are you asking better questions of your staff that will lead to the focus on performance but also find out how you can help them to do their jobs better ***without*** *doing their job for them?*

6 **Are you following through on feedback?** In picking up on information from your team and outside sources are you taking the time to reflect on this in a strategic fashion or are you getting sucked into too much operational detail (and micro-managing)? It is important that when staff raise awareness about challenges and opportunities they know that it is safe to do so and that their contributions are valued. Feedback does not have to mean that every point is accepted but it is important to explain why something is inappropriate at this juncture. There is nothing worse than recruiting a new member of staff and then creating a sense of insecurity such that they feel that they have made the

wrong decision in joining your company. Such a situation would waste everyone's time and your money. Equally, if people leave the organization, it will be important to conduct exit interviews to ascertain what you can learn from them to improve the business.

Key question: is your communication a considered two-way dialogue with room for strategic reflection to support growth?

Summary

This brief chapter has been written with the intent of provoking some reflection on your management style in relation to supporting growth and in dealing with the 'pains of growth'. A number of commonly found themes have been explored in an attempt to focus attention on issues and to raise challenging questions about your actions. It would be useful to refer back to my chapter on micro-management in the 14th edition to ensure that you capitalize on the new capacity and capability arising from a more formal middle management team. In drawing the strands of this chapter together, if you are seeking to grow successfully then ensure that you strike balances that:

- support business development, organization development and management development of the middle managers;
- create space to be more strategic whilst delegating operations to your team;
- build on existing strengths and complement the team with new capacity and competence so that you maintain existing business and grow new spheres of activity;
- provide the right mix of support and challenge to staff that empowers them;
- develop your leadership communications to provide the right blend of sense-making and sense-giving that provides the scope and direction for others to act without overly telling them how to do it;
- reflect on your investment in people and management information systems.

In developing this chapter, I fully recognize that managing a transition is difficult and complex but hope that you will find the content helpful.

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Aberdeen Business School is one the leading providers of management and professional business education in Scotland. Robert Gordon University has achieved a number of recent accolades including Best Scottish University, Best Modern University and is continually in the top rank for graduate employment in the UK.

Leadership in the upturn

7.2

You have led your enterprise through the tough times, but are you ready to make the most of the upturn? Graeme Rainbird and Charlie Irvine at Questions of Difference highlight three qualities that leaders now require

Through the years of economic crisis every organization that we have worked with has, in one way or another, rationalized, made cuts and challenged their costs. The leaders with responsibility to deliver the tough changes required have had to develop an approach to respond to their environment – a leadership suited to cut, trim, retrench and focus on the core. They have shown the leadership needed to ensure survival. Leading through austerity can be a lonely business – many of our choices will be taken at a senior level without consultation. Our language betrays the harsh reality as change is 'executed'. It has been a tough time and leaders feel the weight of responsibility of the many lives that their decisions impact upon.

The good news is that many organizations have steadied the ship and are now starting to see opportunities to build on the strong foundations they have established. The clear message is 'go for growth' – with an urgency to act now and get ahead of the competition. But in many organizations we see that a key part of the puzzle is missing – we need to recognize that the leadership that delivered survival through the lean times will not now deliver growth. Our leaders are perceived to be isolated, lean processes have taken a stronger focus relative to customers and our people are conditioned to the 'command and control' style that dominates recent memory.

Growth requires a different mindset and a different leadership. So what can leaders do to achieve and exceed the growth aspirations they have for their organizations? This chapter outlines three challenges that we have seen transform leadership and performance.

Challenge 1: The change starts with you

As we all know, we are measured by our actions, not our words. Simply saying 'Now it is time to go for growth' will cut little ice without a visible demonstration that we, as leaders, are ourselves behaving differently. So make some time with your leadership team to really think about what you have achieved and what you are now up

for. What is your burning ambition for growth and what is required of you to show you are prepared to do what it takes to get there?

Task: Develop statements of intent with your leadership team

'Statements of intent' are descriptions of leadership behaviour. They highlight the challenge and the change that you need to show in your behaviour to make the most significant difference. When you are able to rate yourselves 100 per cent on all of your statements of intent you will be creating an environment that is ideal for growth in your organization. They are concise and provocative – statements to stop you in your tracks, challenge your decisions and remind you to show a different leadership. Examples include:

- we hold unrealistic ambitions – and do what it takes to get there;
- our decisions are always in the best interests of our customers;
- we never create obstacles or barriers for our people;
- we always get honest feedback from our people and therefore know what leadership they need.

Facilitate a dialogue with your leadership team to:

- Acknowledge what you have achieved through the tough times and recognize how you have worked as a team to secure your future.
- Create a collective ambition for the future – what does growth mean and what will it look like when you have succeeded?
- Articulate the leadership that will now be required to deliver this agenda – what needs to change to lead growth?
- Create approximately five statements of intent that capture your ambition to work differently.
- Identify how you will individually and collectively commit to work to start to match your intent.
- Give yourself time to make it happen. Agree a simple review process every 2–3 months to score the team on each of your statements, discuss what has been achieved and set a renewed focus for the coming months.
- Reflect on the process to understand what the team have enjoyed about the discussion and what excites you for the future.

Challenge 2: Get curious about what our customers *really* want

Austerity leaves a legacy of navel gazing. Having trimmed and honed our operation to lean perfection we think primarily in terms of our process and how *we* operate. Growth does not require us to take our eye off process and efficiency – but it does require an explicit refocus on our customers. What is now important to *them* – and how have *their* needs changed as a result of the economic environment?

Resist the urge to put a process in place to solve the problem – you are still navel gazing. Let's be clear, we are talking culture change here. The good news is that (contrary to popular belief) culture can change significantly in a very short period of time. Your people probably recognize that growth relies on your relationship with customers better than you do. They don't need to be taught that – they just need to believe that their passion for your customers is top of the agenda again. All culture change takes is a little leadership to make a shift in mindset.

Task: Obsessively ask questions that lead in the direction of 'customer'

People and organizations go in the direction that we question them. If you want your organization's culture to bring a stronger focus on your customers simply ask one or two of the following questions in *every* meeting, *every* conversation, *every* product development, *every* leadership team meeting, *every* recruitment ... you get the picture: ask a lot!

- What do our customers value about what we do and how we operate?
- Would our customers care?
- How can we make it easier for our customers?
- What decision would our customers want us to make?

Try it for three months and see what is different. People will soon get the message: notice how discussions and actions are shaped by the questions you ask. Listen to the questions you hear others asking – and notice as your questions are adopted by others. Craft questions of your own: think about the direction you want to lead and craft a question that points that way.

Challenge 3: Release pioneers across your business to challenge the status quo

Our senior leaders are not superheroes and none of us can achieve growth in isolation. Perhaps the most exciting aspect of a shift to leadership for growth is letting go of the control we took in austerity – and releasing our people to take the lead. We have been getting fascinated by the results that can be delivered when people at the cutting edge of an organization – often (but not always) at the beginning of their careers – are inspired to take the lead in organizations. What would happen if you released the passion, commitment and sense of possibility that is currently bottled up in your front line talent? Rather than slowly trickling the message 'top down', take a leap of faith and mobilize those that have the energy and passion to make a difference.

Task: Create a diverse network of pioneers for growth

Recruit a diverse network of people to create a micro-representation of your organization. The more innovative your application and selection process, the more likely you are to entice those that are creative and passionate enough to impress. With little investment – some time with a senior leader who can inspire them to step up, a few simple tools to give them the confidence to take action, a network of like-minded souls who are prepared to share their intrepid journey – amazing things can happen. Only embark on this task if you are prepared to commit to all of the following:

- A senior sponsor who is prepared to spend time and energy working with and championing the team.
- Support to nurture your pioneers' confidence that they make a difference – to develop their leadership with a small 'I'.
- The courage to invite them to try something different, take a few risks, make mistakes and inadvertently ruffle a few feathers.
- Demonstrate to them that they are not victims of the system or hamsters running around a wheel – they are proactive leaders who make the system work for them.
- Trust your pioneers to take on a gritty (insoluble) growth challenge – and then back them to solve it.

Give your pioneers the freedom to fail – and recognize their success in that failure – to take a risk, try something new, challenge the status quo, and give them the confidence to keep going.

Conclusion

So what does growth really demand of us? Yes, of course the innovative products, the marketing strategies, the harnessing of technology are all essential in different ways in our different industries. But the question is, what does it demand of *us*? It takes leadership for growth. Our leaders need to acknowledge that our changing context and focus requires a different approach. When we start by taking action to role-model a different approach; when we are constantly curious to create a culture that is fixated on our customers' changing needs and when we light the touch-paper to launch a few pioneers that will create a ripple effect throughout our organization – then the products, the strategies and the technology will inevitably follow.

Graeme Rainbird (Senior Consultant) and *Charlie Irvine* (Managing Director) work with Questions of Difference, an organizational development consultancy with over 20 years of practical experience in organizational change and development, leadership, team development, conflict management, mediation and strategic business consulting. You can contact us at further details at: **www.questionsofdifference.com** **Graeme@questionsofdifference.com** or **Charlie@questionsofdifference.com**

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The leadership challenge

7.3

Without clear, purposeful and ethical leadership, organizations will fail to grow. David Pardey, head of research and policy at ILM, examines how increased expectations from employees and customers alike put pressure on the people who lead organizations to demonstrate these qualities

2008 was a watershed. Not only did it lead to the near collapse of several major banks (and the complete collapse of Lehman Brothers), it made people acutely aware of an apparent ethical black hole in the sector. Then there was the PPI mis-selling scandal, the Mid-Staffs Hospital crisis and phone hacking at the *News of the World*. People started asking if the people who lead these organizations lacked any clear moral code.

There is a belief, in some quarters, that ethics and ethical practice diverts attention away from the need to build a profitable business, or that it is something that is driven by a 'do-gooding' mentality that ignores the reality of business. Neither is true. Putting ethics at the heart of what you do represents a sound business strategy; being good doesn't mean being soft – quite the reverse sometimes.

Where to start? For the leaders of businesses, this has to be their own values, beliefs and attitudes, since these govern what they believe is the right thing to do. We all have our own individual perceptions of what is ethical and what isn't; not everybody shares the same values, but knowing what you believe in is important, and one of the strengths of the best leaders is that they are clear about their own ethical standards. Be prepared to reflect on what you regard as the values, beliefs and attitudes that guide your own behaviour, and discuss this with your colleagues. Through this process, you will get an insight into what you believe in common, and that provides a strong basis for demonstrating ethical leadership, and expecting others to do the same.

Research undertaken by the Institute of Leadership & Management (ILM) in early 2013, produced in partnership with Business in the Community, explored managers' experiences of ethical (and unethical) practice at work, at all levels of organizations, large and small. The results (published as *Added values: The importance of ethical leadership*) demonstrated the widespread dislike of unethical practice (which nearly two-thirds of managers had experienced at some time in their careers) and how it affected their levels of commitment to their employers. One in ten respondents told us that they had left their employer because of what they had seen or been asked to do, which imposes a hidden cost on the organizations they worked for.

And it's not just employees. Customers are equally interested in whether or not a company is behaving ethically – for example Starbucks. They suffered from customers boycotting them when their tax arrangements were publicized, because their laid-back image was at odds with their careful tax avoidance strategy. Google also suffered when their 'Don't be evil' motto seemed to sit oddly with their willingness to accept Chinese censoring of searches. People judge your ethical stance by your perceived standards, which makes those who are particularly keen to espouse good behaviour particularly vulnerable.

Of course, that isn't an excuse to avoid making any ethical commitments (or worse, to boast of a lack of ethical standards) to avoid being criticized. Both Starbucks and Google used their perceived high standards as brand building strategies – they knew it would bring in the customers. Being seen to be ethical builds trust (see ILM's research reports on the Index of Leadership Trust for evidence of that) and makes all the difference in creating loyalty and in attracting new customers. Any business trading online needs to be seen to be trustworthy and when there is little difference in price or quality between suppliers, the more trustworthy business has the advantage.

However, it's not enough to know what ethical standards you want your business to live up to; you need to be sure that everyone else not only knows them but buys in to them. Again, our research showed a disturbing gap between senior managers' and directors' perceptions of how ethical their organizations were and the perceptions of first-line managers. This disconnect was most marked in larger organizations, and in those which lacked a statement of values. In small organizations, CEOs are able to demonstrate easily their values and ensure that these are understood and adhered to by their employees. As firms grow, this gets harder, which is why ILM recommends that all organizations discuss openly the values that they will live up to and agree a shared statement of values for the whole organization. That way, not only does everyone know what is expected of them, they will police it themselves.

One of the other features of the research was the relative importance of three distinct ethical stances; these have been around since the time of Aristotle and are widely debated by moral philosophers. They are, quite simply, *doing the right thing*, *achieving the right outcome*, and *following the rules*, and the managers we spoke to put them in that order of importance. For them, doing the right thing was the number one imperative, and an organizational statement of values can ensure clarity about what that means in practice. The challenge for any business, but especially one that is subject to external regulation (and there are few that aren't), is to ensure that employees don't 'bend the rules' because they think something is the right thing to do, or leads to the right outcomes. Again, this is where a statement of values can help establish that compliance with the rules *is* the right thing to do.

Having clarity about what is expected of people is a waste of time, however, if the leaders of the business ignore those standards, or fail to take action when other people do. That is what is meant by leading with integrity – behaving in line with the values that you espouse, and holding others to account if they fail to do so. Leadership is all about modelling best practice, and that is as true for ethical practice as it is for good customer service or proper record-keeping. The other side of leadership is followership, and leaders lead where they want others to follow. 'Do what I say not what I do' is a recipe for poor performance, low morale and high levels of staff turnover.

Small business owners must learn how to be effective leaders if they are to elevate the operation of their companies onto 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.

Setting high standards of behaviour yourself enables you to identify those who show real commitment to meeting those standards, and these are the people whom you can look to to provide the distributed leadership that you will need as the business grows. Leadership doesn't just happen at the top of organizations, it can happen at all levels. Managers are appointed to roles, but leaders emerge. They are the ones that other people choose to follow, and the skill of organizational leadership is to recognize which of your employees exhibits that ability and encourage them to demonstrate their leadership potential. They can ensure that ethical standards are adhered to and that they are embedded in the culture of the organization – in the way we do things around here. That's much easier than making lots of rules and expecting people to prove they are adhering to them. Again, this promotes greater efficiency in operations: ethical leadership – leadership integrity – is a low-cost way of building high-value organizations.

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. Each year we help over 85,000 practising and aspiring managers to fulfil their potential and achieve success through a range of flexible leadership and management development solutions.

Backed by an in-depth programme of research, ILM operates internationally, improving leadership and management skills, across all sectors, from financial services to the armed forces. Institute of Leadership & Management (ILM), **www.i-l-m.com**.

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PART EIGHT
International expansion

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Getting into exporting

8.1

David Millett at UK Export Finance discusses how to make the most of international sales

Many companies find themselves exporting by accident when faced with an unexpected order. That transition is likely to be easier, more successful and more sustainable if the exercise is planned. The following tips are designed to help you start the process of a comprehensive and planned approach to exporting. Throughout, references are made to potential sources of help and some links are contained in a reference section at the end.

1 Create and embed a 'whole company' vision and practice

Exporting is not a 'bolt-on' activity. The caricature of an under-trained salesperson 'throwing an order over the fence' to an under-prepared production team nonetheless illustrates how risk can readily be imported into a business. Effective exporting requires adjustments to a number of processes across a range of functions. Each function needs to be fully engaged to contribute its part in delivering practical responses. Table 8.1.1 captures just a few examples of the impacts differing functions need to consider.

2 Devise a coherent strategy

The choice of approach to a new market should reflect how the leaders of your business balance factors such as: risk, ease of implementation, control maintained 'in market' and desire for strategic flexibility. This will draw out options that fit somewhere in the spectrum between sales direct from the UK to establishing a local presence. In between there are variations involving local collaboration, such as working through a distributor or joint venture.

TABLE 8.1.1 Examples of impacts business functions must consider when exporting

Sales	Marketing	Legal	Finance	Purchasing	Production	Delivery
• delivery terms • duty relief • extra costs	• language • local custom • position in market	• local law and practice	• tax • reporting • funding	• impact of any disruption • end-to-end timeline	• local standards and taste	• time • cost • risk

Whichever approach is used several elements need to hang together, for example:

- harnessing a product, service or capability where you already have a track record;
- going for an accessible market*;
- adapting your offering for the target market;
- undertaking relevant research;
- gearing up your business;
- planning for the additional funding requirement;
- planning in detail how you will deliver on your contracts.

* An accessible market does not need to be close to home. For example, some products and services will have far more relevance and appeal in targeted markets. Equally, a lot of success is achieved through exploiting cultural linkages. Such factors serve to make access easier to achieve. Where historically markets in Europe may have been suggested as an initial entry, the scale of opportunity is encouraging more exporters to look more extensively to markets such as Asia or the Middle East.

UK Trade & Investment (UKTI) is the natural place to start for help and information. Practical, local support is available through International Trade Advisers, the website is comprehensive, and it offers a gateway into a wide variety of sources of further assistance. However, this is just the start.

3 Implement functional responses in parallel

One way of looking at the process of exporting is to strip it down into three elements:

- establishing and maintaining the trading relationships;
- devising a robust way of delivering under contracts established;
- ensuring the contracts can be funded and you end up getting paid.

At one level these statements hold equally well for any trade. However, exporting is complicated by distance, culture, customs and regulations to a heightened degree. Therefore, these three elements need to be shaped and developed in parallel and come together at key points in the process. As you reach the final stages of negotiation, understanding options for delivery and their costs is vital. Similarly crucial is understanding the range of payment terms you can offer with credibility, and how you can cover the risk of non-payment.

Whilst initial help on developing the trading opportunity can come from UKTI, for delivering physical goods, a reputable freight forwarder is a good source of help. There is also a wide range of information available through HMRC. Such sources can help you begin to identify and negotiate the series of obstacles to effective delivery.

There are a number of potential sources of help in shaping finance and determining terms of trade. Within banks there are trade specialists who can be accessed. The major credit insurers can provide an indication of cover. There is also a wealth of credit information available.

You don't have to negotiate your way through these in isolation. UK Export Finance (UKEF) has a team of Export Finance Advisers primed to help exporters identify and access such sources of support. UKEF will also step in to allow exports to happen that might not otherwise get financial support. For example, it will share the risk of export finance facilities with banks, and will also provide credit insurance cover for exports when it becomes difficult to obtain it from the private market.

When considering finance, as part of the exercise, do also consider whether you can improve funding from sources within your own business and trading relationships.

4 Consciously develop your network of support

As already highlighted, there are some immediate sources of information and support. However, you will know through your own assessments where further gaps potentially lie and where, therefore, you need to most actively engage. Trade associations and chambers of commerce are two examples of bodies that exporters leverage to good effect. Think also about your network of support in target markets. Access to a well-recommended consultant in some circumstances will be worth the upfront cost. British embassies can help with work on identifying agents. You may be able to leverage a law firm's network if you envisage local legal advice will be required. But this can be shaped over time, based on trusted advisers and experience.

5 Assess and continuously develop your competence

Whilst networks are invaluable there will be areas within your business where you will wish to build your own professional and sustained competence. It is worth thinking carefully, therefore, about a formal programme of training that underpins

the day-to-day practice. In which case, the Institute of Export offers a range of training that spans a broad range of attainment. Keep this under review as you seek to expand the scope of your business.

6 Initial stepping stones

These tips are high-level and illustrate where to start looking. Successful exporting begins a change in approach that transforms the culture of your business. That culture will help drive the business much deeper into the areas touched on in this article, but also beyond.

Further information

British Export Association guides: http://www.bexa.co.uk
British International Freight Association: http://www.bifa.org/content/home.aspx
HMRC Guide to Importing and Exporting: http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageImport_ShowContent&propertyType=document&id=HMCE_PROD_008051
Institute of Export: http://www.export.org.uk/http://www.export.org.uk/
UK Export Finance: https://www.gov.uk/government/organizations/uk-export-finance
UK Trade & Investment: https://uktradeinvest.gov.uk/

David Millett is Manager, Trade Product & Process Development, Trade Finance and Insurance Solutions, UK Export Finance. He was until recently Deputy Chair of the Institute of Export and still sits on the board and council. David has extensive experience in trade roles within the banking sector and has contributed to a number of publications on the subject, including the BExA guides listed in the references.

UK Export Finance (UKEF) is the UK export credit agency. It provides guarantees, insurance and advice to UK-based exporters large and small. UKEF works across sectors and supports exports to over 200 countries. It has its own risk assessment framework and is focused on helping UK exporters maximize the opportunity to do more business overseas.

The rise of the ASEAN consumer

8.2

Paulius Kuncinas, Asia editor at the Oxford Business Group, discusses the implications of greater spending power in the markets of south-east Asia

Growing prosperity, improved wealth distribution and a burgeoning middle class are set to fuel a rapid rise in private consumption within the ASEAN (Association of Southeast Asian Nations) bloc countries in the coming years, a trend that will be given further impetus by the greater regional integration that will follow the launch of the ASEAN Economic Community (AEC) in 2015.

According to the prevailing consensus the ASEAN economies should average growth of 5 per cent next year, in part driven by firming global demand. This rise in global economic growth will impact countries that are more export oriented in their economies, specifically Malaysia, Singapore and Thailand. However, the strongest force pushing expansion of ASEAN economies will be domestic consumption.

This growing consumer power within ASEAN is a reflection of the rising strength of the member states' economies and the more even distribution of wealth within those economies. Over the past three years, the economy of the ASEAN region has grown by an average of just over 6 per cent, its net worth rising from some $1.8 trillion to $2.3 trillion.

This rise is set to continue. At their latest summit, held in Brunei in October, ASEAN leaders set the ambitious target of all but doubling the bloc's GDP to $4.4 trillion by 2030 and reducing the rate of those who live in poverty within the region from the present level of around 18.6 per cent to 9.3 per cent in the 15 years following the launch of the AEC. If the GDP target is reached, and given the current compound annual growth rate within ASEAN it could well be achieved, this would create a massive expanded consumer market within the bloc, which will also see its population base increase over the coming decade and a half as well.

Consumer playing field levelling out

Whilst consumer purchasing power is nowhere close to being even within ASEAN, with high degrees of disparity in income levels, national economic development or even access to services, the playing field is beginning to level out. In 2012, the average growth of Indonesia, Malaysia, Philippines and Thailand (the ASEAN-4) was

6.21 per cent, whilst average growth in Cambodia, Laos, Vietnam and Myanmar (CLVM) was 6.52 per cent. Although there is not much difference here, this is set to change in the future. The CLVM countries are still in the early stages of their development whilst the ASEAN-4 are slowing down. By 2018, the growth rate of ASEAN-4 is estimated to be 1.4 percentage points less than that in CLMV. With the narrowing of the gap between national economic growth, consumers in the countries on the second tier of ASEAN's ladder will be better positioned to enjoy the benefits of the AEC, a spending pleasure that in turn will further promote growth within the bloc.

Not all of ASEAN economies will grow at the same rate, and no economy national or regional is immune to peaks and troughs. With the AEC in place, export surges in some member states of the bloc can benefit all, with the main beneficiaries of demand in foreign trade. Inversely of course, a sharp downturn in overseas trade for export-driven economies within ASEAN can affect internal trade and regional consumer demand, though this will likely be offset to a degree by the bloc's own dynamics.

Still greater integration within ASEAN should smooth out some of the worst effects of future downturns. Intra-bloc trade already accounts for 25 per cent of all exports by member states, a figure set to climb as final trade barriers are lowered and increased localized investment means higher capacity of ASEAN members to meet regional demands for products.

Consumer confidence in the future

Another factor that should encourage investors in the retail and trade sectors is the underlying confidence of the ASEAN region consumers. According to a recent study conducted by the US polling firm Nielsen, south-east Asian consumers are among the most positive in the world. In its latest survey of global consumer sentiment, Indonesia was ranked first for confidence on 124 points, followed closely by the Philippines on 121, with Thailand (114) fourth and Malaysia (103) on the ninth rung of the Nielsen ladder.

With any score above 100 indicating a positive outlook, it is clear that ASEAN's leading economies offer strong opportunities for those serving the consumer, with the regional average being 105 points. This is far better than elsewhere in the world, where the global average on the Nielsen index was just 94, showing international sentiment still well into negative territory.

The Nielsen study said the solid prospects for economic development and a burgeoning middle class were the main causes underpinning the buoyant consumer sentiment in the ASEAN region.

Regional consumers were feeling increasingly optimistic about the economic outlook compared to the rest of the world, according to Vishal Bali, Managing Director of Nielsen's Consumer Insights business in south-east Asia, north Asia and the Pacific.

'Minimum wages are increasing, as are foreign investments and a growing number of consumers are entering the middle class,' he said in a statement accompanying the release of the survey results in the third quarter. 'As the middle class population

across south-east Asia continues to grow at a rapid pace, consumer spending in these markets is reflecting their new-found wealth.'

The Nielsen survey also found a rise in non-essential spending among consumers in the region, with outlays up on holidays, out-of-home entertainment, new technology products and new clothing leading the way. This suggests a broadening of consumer activity, away from a focus on spending on basic needs towards a more active and commercial, middle class consumer society.

The Nielsen study bore out the findings of research by financial services provider MasterCard leading into the second half of 2013, which found consumers in most ASEAN member states were optimistic over the medium-term economic outlook for their countries, with consumers in Myanmar ranked as the most positive of all, ahead of Indonesia, Thailand and Malaysia.

Overseas recognition of consumer strength

Since 2008, foreign direct investment (FDI) inflows to ASEAN have trebled to $111 billion, with more than 8 per cent of global foreign investment being drawn to the region. Solid FDI growth is expected to continue into the AEC era as the increasing economic strength and consumer buying power of the bloc attracts more overseas businesses looking to tap into the region's rising prosperity.

Whilst the ASEAN region will face challenges on its path to achieving a more advanced level of economic integration, the overall result will be a net benefit to member countries and the consuming public. Stronger integration will cushion the region from global external shocks such as the 2008 financial crisis, whilst at the same time developing the world's largest emerging market. Most of all, a more affluent ASEAN society, with greater economic security, will propel the rise of the ASEAN consumer.

Paulius Kuncinas, Regional Editor for Asia at Oxford Business Group (OBG) produces research on fast-growing ASEAN economies such as Indonesia, the Philippines, Thailand and Malaysia, and oversees editorial coverage of the relatively new frontier markets of Myanmar, Mongolia and Papua New Guinea. Based in Kuala Lumpur, he heads a team of analysts to produce OBG's flagship annual Reports which offer unique insights coupled with a comprehensive review of investment opportunities in key growth sectors. A frequent commentator on country development models at international conferences, Paulius also contributes editorial columns to a number of regional newspapers where he shares his views on investment risks in specific sectors like mining, energy and infrastructure. He is a staunch believer in the ASEAN integration process which he thinks investors have failed to fully appreciate. Website: **www.oxfordbusinessgroup.com**

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Export for growth

8.3

Clive Lewis, head of enterprise at ICAEW, considers the questions to ask in growing through export

There have been a number of press articles about UK companies exporting to high-growth, developing countries such as the so-called BRICS (Brazil, Russia, India, China and South Africa). Others suggest that potential export markets should also include the 'next eleven' fast-developing countries. For businesses with little or no experience of exporting it can all be very confusing.

Why should UK businesses export?

Perhaps the first issue to address is why should UK businesses export? The answer is that research by UK Trade & Investment (UKTI, the government agency set up to assist exporters) reveals that UK businesses that export experience on average a 34 per cent uplift in productivity in the first year and become one-third more efficient subsequently.

Secondly, many export markets are expanding at a much faster rate than the UK and offer businesses vastly greater growth potential. The argument that 'the UK has 62 million citizens in a world of 7 billion' is very compelling.

Finally, exporting can help spread the risk of a market downturn and strengthens the resilience of the business.

OK, so where do I start?

So, if you decide to explore exporting where should you start? You will need to invest some time and money so it's best to have a plan. Here are the main aspects of a plan:

- SMEs should be clear about their strategic objectives, have a clear strategy to achieve them and ensure it is stress tested.
- Research is critical. This may be difficult but it should not be neglected especially as many decisions to export are opportunistic.
- Assess the product range and identify which products or services to export and the modifications that will be needed to enter different markets, eg images and language on packaging etc.

Europe may be a first port of call

When planning, a key early decision is which countries to consider as potential markets. A well-tried-and-tested method for businesses new to exporting is to start with Europe, particularly Scandinavian countries. They are geographically closer (which means less time and cost in travelling), are generally more affluent, are more likely to understand English and have a more familiar culture. In addition, the EU common market makes for less bureaucracy with documentation and, if the country is in the euro, it will have a more stable currency. Some of the same advantages are offered by the other favourite markets of UK exporters: the USA and Canada.

Why consider developing countries?

So what about the so-called high-growth markets? UK exporters have traditionally not done well compared to others in these markets, most notably German and Japanese manufacturers. But the developing countries' needs are changing to being more consumer orientated, which gives greater opportunities for UK companies. Other factors are working in favour of UK exporters – the London hosting of the 2012 Olympics has raised the profile of the UK. And as more of their population travel overseas to destinations such as the UK the 'Made in Britain' label appeal increases. This is particularly true of retailers of luxury goods, service sector businesses such as architects and designers, and professional services firms such as accountants, banks and insurers.

Which markets offer high growth?

In the context of high-growth developing economies China and India are most frequently mentioned. China is the world's second largest economy and whilst average GDP per head is low by developed economy standards, its affluent middle class is expanding rapidly.

India's development has been less spectacular than China's over the last 30 years but it started from a higher base. Like China it has a growing middle class. UK businesses which have traditionally targeted a few key cities – Mumbai, Delhi and Bangalore – are now expanding to the next tier of cities.

Other UK businesses choose to tackle other developing countries such as Indonesia, Turkey or Nigeria.

Are there recognized distribution channels?

China and India are vast countries and distributing goods or supplying services will be a key issue. Overseas offices and staff take time to establish and can be very costly.

Some UK businesses prefer to tackle these markets as part of a supply chain, or use local distributors or sell through the internet. Visiting overseas trade shows is a good way to meet local distributors.

The internet offers a channel to overseas customers. The website should be a shop window for all businesses. Amazon and eBay have global customer bases in the hundreds of millions. Driving traffic to the website requires a considered marketing plan. Language and product standards are issues that must be addressed. Many marketplaces offer specific services to support fulfilment of orders. Selling online has hidden costs including higher stock levels, good product descriptions and fulfilment within specified periods. However, the increased growth in internet business means businesses cannot afford to ignore its potential.

How to evaluate the opportunities

Having researched potential markets the key issues to then consider are: how profitable will exporting be and does the potential profit justify the risks? This brings to the fore issues such as:

- What can I sell my product or service for?
- What will it cost me to make this product or deliver this service?
- What are the selling costs?
- What are the risks?

The majority of international trade is conducted on open account (ie goods are shipped and delivered to the customer before payment is due). So there is a risk of non-payment. In addition, goods may be lost or damaged in transit. In some countries there are risks from political events such as wars, or natural disasters. There are also risks if sales are conducted in a foreign currency and the exchange rate changes.

Exporting can require substantial investment in working capital eg the need for customized stock for specific markets increases stocks and the long wait for payment of sales invoices on open account results in increased debtors. Before committing to exporting businesses should evaluate how much finance will be required and where they will get that finance from. The Institute of Chartered Accountants in England & Wales (ICAEW) has produced a guide to the financial aspects of exporting (International Trade: an Accountant's Guide). To access the guide and other information on importing and exporting go to: **http://www.icaew.com/en/library/subject-gateways/import-and-export**

Customers, suppliers and inward investors

Many UK businesses start exporting in response to a request or suggestion from an existing customer or supplier. They can be a potential gateway into export markets. In addition many businesses from developing countries are now established in the UK. Selling to their UK outlets can be the first step in an export plan. They can also

be helpful in understanding the culture of a country, the local traditions and issues such as bribery and corruption.

Summary

Confining a business's market to the UK restricts its potential. Exporting can be very rewarding but requires an investment of time and money. A business's first export market should be chosen with care to ensure that other countries will follow.

Sources of help

There are plenty of sources of information and advice to assist businesses with exporting.

UK Trade & Investment

UKTI has a staff of over 2,400 people in 96 countries, and a network of international trade advisers (ITAs) in the UK regions and devolved administrations. It publishes Country Business Guides and has specialist advisers for countries and sectors. It supports UK businesses to attend trade fairs overseas, organizes sector-based trade missions, exploratory missions to overseas markets and much more. **www.ukti.gov.uk/export**.

UK Export Finance

UKEF is the UK's export credit agency, helping exporters and investors by providing credit insurance policies, political risk insurance on overseas investments and guarantees on bank loans. They have advisers in each of the nine regions of England, Scotland, Wales and Northern Ireland. **www.ukexportfinance.gov.uk**

Banks

For help with financing exports and in getting paid your bank will be invaluable. All banks will have specialist teams throughout the UK. Your local branch will advise how to contact them.

Freight forwarders

A freight forwarder, or forwarding agent, is a person or company that organizes shipments for individuals or companies to get goods from a manufacturer or producer to a market, customer or final point of distribution. Forwarders contract with a carrier to move the goods. A forwarder does not move the goods but acts as an expert in supply chain management. International freight forwarders have

additional expertise in preparing and processing customs and other documentation and performing activities pertaining to international shipments.

Information typically reviewed by a freight forwarder includes the commercial invoice, export declaration, bill of lading and other documents required by the carrier or country of export or import.

British International Freight Association (BIFA): **http://www.bifa.org/content/home.aspx**

Trade credit insurance

Trade credit insurance brokers specialize in advising businesses on international risk mitigation, including insurance.

British Insurance Brokers Association (BIBA): **http://www.biba.org.uk/**

Accountants

Many smaller businesses do not have a finance professional as finance director. However, their professional advisers can help with the financial aspects of exporting such as assessing the profit potential, risk management, financing, exchange rate risks and getting paid. The tax issues from trading in overseas markets can be particularly complex. The ICAEW has a Business Advice Service (BAS) which offers a free advice session to discuss a business's issues. **www.businessadviceservice.com**

Clive Lewis is an ICAEW chartered accountant (FCA) and a chartered management accountant (ACMA). He is Head of Enterprise at The Institute of Chartered Accountants in England and Wales (ICAEW). He has conducted the annual ICAEW Enterprise Survey, now in its sixteenth year, and has represented the ICAEW at the British Bankers' Association Business Finance Roundtable and on the Department for Business, Innovation and Skills Small Business Economic Forum Working Group. He writes regular articles for the media using the feedback from surveys and ICAEW members and his experience in business. Telephone: 020 7920 8667, e-mail: **clive.lewis@icaew.com**

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Developing business internationally

8.4

The need to develop sales internationally is paramount for any company wishing to increase its sales, and with research and the right approach this is something all companies should probably consider, says Kevin Smith

In many ways British companies are very lucky in that whilst the UK is relatively small in geographic terms, there are some 64 million people that have a high standard of living and by global standards can be considered to be very wealthy consumers. Behind this of course is the whole labyrinth of construction, manufacturing and service companies and all the others necessary to make the whole country work. In short, British companies have quite a big, captive market on their own doorstep, almost no matter what the company does.

But this is of course much too simplistic a view. As the world population is now some 7.1 billion, the population of Britain only represents 0.9 per cent of potential customers around the world. Of course different products and services are of interest only to segments of the population, but the point is that in order to develop a business it is vital that virtually any company secures sales overseas.

The question that then arises is: how do companies go about doing this in the safest, most efficient, and most cost effective way for their own particular product or service? The answer, inevitably, depends on the unique circumstances of each individual business. Perhaps it is for this reason that so many companies seem afraid to take the steps to expand overseas and do not know where to start.

Developing business internationally can of course take many forms, from physically shipping large goods in a container, to selling a licence or a franchise. Some companies sell whole products, some sell components for larger products and some sell services including knowledge and expertise.

Even the way in which companies start to consider the wider markets internationally can have very different beginnings. Some of the more forward-thinking companies make a conscious decision that this is a necessary step in order to develop the company, whilst others can be pulled into it simply by reacting to enquiries from abroad that have come about because of potential buyers seeing their website or some other online exposure.

Whilst the actual solution may be different for each company, the basic thought process that should be gone through is broadly the same. All of this can start as simple desk-based research but as the field starts to narrow then much more detailed research must be carried out.

The basic points that need to be addressed include the following:

- Product/service: who are our customers and where else might our product/service be wanted?
- Markets: identifying other countries where potential sales could be made.
- Sales structure: manufacture/agent/distributor?
- Pricing and payment: currency/import duties/shipping costs/margins.
- Intellectual property rights (IPR): protecting your product.
- Selling locally: shipping/importing/certification.
- Culture: understanding different business culture is vital.

Product/service

The very simple starting point is to look at who buys your product in the UK. It does not matter if they are rich or poor individuals, big or small companies, government or anybody else. Once the profile of existing customers is fully understood then the next step is to think and research where potential customers with a similar profile can be found.

Markets

Once a broad list has been drawn up of potential countries, this needs to be refined by further research that will identify many other issues that could have a major impact on your potential sales. Depending on the product and the country this could be anything from a trade embargo to unacceptable business practices such as the expectation of bribes, to high internal transport costs because of the size of the country or distance from a suitable port or airport.

Sales structure

Most companies will not want to establish local manufacturing in a new market, at least in the initial stages, as it is of course both more expensive and carries a higher risk than simply looking to sell into the country. The next question will be whether to use an agent or a distributor. Both have advantages and disadvantages. Typically an agent would simply receive sales commission and this would be at a much lower level than the margin that would need to be given to a distributor. However, most of the back-office sales functions as well as in-country logistics and transport costs

would be left to the British company. Moreover, if local stock is required then this would need to be funded by head office. A distributor would take all of these issues away but would expect to make a much higher gross margin. Effectively they become your buyer and then on-sell the product locally.

Whatever structure is chosen it is imperative that knowledgeable, trustworthy, experienced partners are chosen and this is much harder to achieve than most companies would imagine. It is not a case of going through the local business directories or even getting a 'pre-qualified' list of potential partners; as this is such a vital component deciding success or failure, a much more detailed approach is necessary.

Pricing and payment

Selling overseas brings with it a long list of other issues that need to be considered and taken into account in the pricing structure of your product in the new market and it may be that once these points are factored in, the pricing is simply too high for the potential market.

First, of course, is that you will be selling in a different currency and exchange rates will vary more frequently than you will want to change your prices, so hedging the currency risk or building in a cushion might be sensible.

Second, whatever country you export to there will almost certainly be import duties but these vary considerably from one country to the next. So again, a very high import duty in a certain country may simply make it not viable.

The third factor concerns the much higher shipping costs incurred in exporting than just selling in Britain. These costs will be linked to the distance/time to the new market and also potentially to the final destination within the country, depending upon the shipping terms agreed to.

Fourth, what are realistic and achievable margins? What level of margins do the new markets consider to be standard? They may well be very different to your home market.

All of these factors bring additional costs over and above the costs involved in selling in Britain. Can you increase your prices to cover these costs so your net return is the same? Or maybe it is worth incurring these costs and accepting a lower net margin in exchange for much higher sales?

Ultimately, of course, the most important point is ensuring that payment is received, as chasing payments from abroad can be much more difficult and less certain of success. Therefore it is often best to request payment in advance or by way of letter of credit (L/C) if this is possible. Different countries will often have different standard terms of payment but this can of course be varied depending upon the USPs of your own offering – a discount for advance payment may be the way to go, at least until you have started to understand the new market and clients.

Intellectual property rights

Intellectual property rights (IPR) such as patents or copyrights can be taken almost for granted when trading in the UK or even across Europe, but they can become a more serious consideration when trading in other parts of the world. Quite possibly the IPR would need to be registered in the other countries but even if it is registered, some countries are less particular about such things than we are in Britain. Is your IPR defendable? Can you afford to do so? How high is the risk? The costs of this can be covered by an insurance policy but this is of course linked to which markets you operate in. These are all things to consider before entering a new market.

Selling locally

For those that have not done it before, shipping goods abroad and then selling them into foreign markets can be a very steep learning curve. It is very easy to get to know the standard shipping terms and options but not so easy to understand all the other aspects that may have to be complied with. Do you need any unusual paperwork when your product arrives? Any missing paperwork can result in very long delays at customs and incur extra costs or penalties. Does your product need certification? And even if it has a European certificate it will normally need local certification even though the European tests are normally more stringent. This is often not very expensive but will take some time. Some certificates only cover individual countries, some cover continents and some countries will not need one at all.

Culture

One aspect of developing a business overseas that is often ignored, or at best downplayed, is a need to understand at least the basics of the local business culture. Cultures vary greatly around the world and the differences can be very large or quite small, but whatever the case it is very important to understand these differences. Without this understanding you will always be at a great disadvantage in negotiations and in many other ways, and sales growth will be much slower and more difficult to achieve. In many parts of the world personal relationships count for much more than they do in Britain and it really is necessary to work with a local or somebody that knows and understands the culture very well.

It is worth sounding a note of caution: if not done properly there are many traps to fall into. But if you do proper research and access local knowledge these traps can be very obvious and so they can easily be avoided.

The conclusion from all the above has to be that, for virtually any business, if it is ever to grow significantly, then at some stage it must look to develop business internationally. As with any other aspect of business it is important that experienced assistance is sought if it doesn't already exist within the company. But if approached

properly the benefits of expanding activity into new markets internationally far exceeds any risks. Just remember that each new market is different and the exact approach will need to be tailored to the local circumstances.

Kevin Smith is Chairman of Aspen Waite Chartered Accountants (**www.aspenwaite.co.uk**) and CEO of AWS International Business Development (**www.awsconsult.co.uk**) and REACH Global (**www.reachglobal.net**). Aspen Waite has a proven track record of working in close partnership with clients to raise funding and drive business forward by providing total business solutions across a broad spectrum, as the wider group also provides corporate finance, independent financial advice, legal and other services. AWS also provides a range of services but focused around assisting UK-based companies to develop business internationally, with REACH Global being the latest initiative to drive this forward. Kevin has worked in some 36 countries and travelled to many more. He is a non-executive director of a number of companies, both in the UK and overseas. Telephone: 01892 667891, e-mail: **kevin.r.smith@awsconsult.co.uk**

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PART NINE
Structures for growth

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How to franchise your business

9.1

Professor Roy Seaman, CFP, QFP of Franchising Development Services (FDS) looks at how franchising can help businesses expand securely nationally and globally

An increasing number of new and well-established companies are now giving serious consideration to the benefits of expanding their operations using the franchise model. The many advantages of franchising a business, compared with opening a network of company-owned outlets, include reduced costs, faster growth and a higher rate of dedication from franchise owner–investors.

When franchising is well thought through, it can provide a perfect model for the owners of a business with genuine growth potential. It can also provide opportunities to investors who are seeking to emulate the success of the originating franchisor.

According to the latest NatWest/British Franchise Association (bfa) UK Survey, there are now 40,100 operating franchised units in the UK, which contributed £13.4 billion to the UK economy in 2012.

The bfa's Director General, Brian Smart, adds: 'Franchising has demonstrated its inherent tenacity and stability, despite a tough climate. This means many more sustainable business start-ups and jobs have been created by franchising – further helping the UK economy get back on its feet.'

The survey also revealed that, compared to the recession of the early 1990s, fewer franchise businesses are trading at a loss. In 1990 only 70 per cent of all franchise businesses were profitable, but the figure today stands at 90 per cent. Simultaneously, an ever-growing number of highly capable and competent individuals, estimated to be over 500,000, are looking to invest in owning and operating their own business under a franchise system.

Therefore, in this pro-franchising climate, any successful business owner would be well advised to check out whether franchising is suitable for their business.

To do this, business owners must first understand:

- Does it operate a proven concept that can be replicated nationwide?
- Can it be taught to others willing to invest in your franchise?

- Have any teething problems been ironed out and are all the systems and procedures in place?
- Is the business performing to replicable growth standards with a professional national-standard brand identity and corporate image?

Capital investment

Assuming the business has fulfilled these requirements, how does an individual go about franchising a business?

No short cuts should be entertained as franchising only works where a company enters with the right levels of funding, management infrastructure and motivation. Where this exists, good franchise practices can result. We know that many well-intentioned franchisors that fail have tried to take short cuts to franchising – trying to save money on professional franchise consultancy, which could have steered them away from miscalculations and injudicious moves.

During the early days of developing a franchise system, rather than a net flow of money coming into their business, the new franchisor needs to expect a net flow outwards. Support staff need to be paid and new franchise owners – also known as franchisees – must be recruited and trained. On average, franchise owners themselves cost between £5,000 and £10,000 each to recruit and will require substantial support while getting the business up and running.

The first recommendation is to engage an experienced company with a team of franchise consultants to evaluate the suitability of your company for franchising and identify the most appropriate model. Most businesses that meet the basic criteria can in fact be franchised in two or more ways. This work will also produce an outline 'franchise development business plan'. The budget for this work, which takes around two months to complete, is around £5,000.

The investment required will differ from sector to sector – for example, a pilot scheme involving the opening of a new retail outlet will usually cost much more than rolling out a franchise model for a vehicle-based operation.

Masterminding a professional infrastructure for franchising a business normally requires around £35,000 plus £15,000 for marketing, depending on the complexity of the business and the style and rate of expansion desired. A properly advised and constructed franchise development business plan will normally have between two and four franchise owners operating within 12 months from such a budget.

The commissioning of the evaluation analysis and outline franchise development business plan from a well-established franchise consultancy firm is the most important investment in the process of setting up a franchise. The study's twin goals are to analyse the business and its market and identify what modifications may be required to ensure a smooth franchise development work programme.

The work must identify the operation's systems, corporate strengths and altogether cover the 21 elements of a genuine 'business format franchise'. There will be aspects that are vital to the success of the business, which must be built into the franchise concept. There will also be elements that must be removed or amended to ensure that the franchise relationship is fair and profitable, and there will be elements

that will not affect the franchise either way – the work will recommend whether the latter be included or removed depending on the competing costs involved.

Franchise action plan

Provided that the business has genuine growth potential, good profit margins and can be taught to others, there is normally a practical and profitable way forward. Once this is ascertained, a 'franchise action plan' must be developed and implemented.

This will:

- identify the competition, both business and franchise;
- identify the ideal franchise expansion model: job, management, retail or if going global (area development or master franchising);
- analyse and define the franchise package component needs;
- ascertain the true market value of the franchise package content;
- set out a detailed franchise development business plan;
- develop the requirement of an initial training programme capable of fully preparing a franchise owner for the launch of the business;
- set out ongoing support structures such as a franchisee support telephone helpline, intranet facility, marketing support possibly including personalized websites, etc.
- identify financial support packages to assist franchise owners to meet the investment requirement and tailored insurance packages.

For a business seeking to obtain membership of the bfa – and this is certainly recommended – the construction of the franchise must be carried out with the requirements of its charter in mind.

Pre-sale documents

With the franchise package in place, the next stage is to set it down in print. There are a number of UK lawyers specializing in franchising, many of whom are affiliated members of the bfa, who will be able to produce the appropriate franchise agreements.

Additional documents must also be designed and developed, including franchise owner manuals, marketing and promotional materials. Intellectual property rights need to be secured, before the final document is produced, which is known as 'the franchise prospectus'.

Recruiting franchise owners

Once the franchise package is in place, the process of building a franchise network can start. It is at this point that having the correct strategy is absolutely crucial to

ensure the business gets off on the right footing. As Tony Urwin, FDS North Regional Director states:

> Franchisors must understand the importance of a well-managed recruitment programme. Carried out correctly, this establishes the basis of a high-quality and well-motivated franchise network. Done wrongly, it can sow the seeds of a franchisor's undoing.
>
> Frankly, the recruitment of suitable franchise owners is one of the most time-consuming aspects of any franchise development programme.
>
> A precisely-targeted marketing campaign must be developed and implemented and the results measured. Once the telephones start ringing and the inbox starts filling, each and every lead must be systematically and promptly followed up.
>
> The franchisor should take the details and answer the questions of every enquirer and – subject to initial screening – send the documentation, usually a prospectus. Returned application forms should be processed, and subsequent interviews scheduled and conducted. The marketing efforts, screening process, relationship management and data collection involved can exhaust even the most committed franchisor.

Outsource or complete in-house?

Developing a franchise is very challenging. Undertaking this development is only advisable when armed with a wealth of practical experience and the best franchise consultants that you can find and be comfortable with. It is important to engage those with a proven experience and the best track record of success.

This would seem obvious, but it is surprising how many emerging franchisors consult help only after expending a substantial investment on failing to build a workable franchise package themselves.

Accessing the franchise wisdom of more experienced parties is an insurance against having to re-tread these steps further down the line – a costly and difficult endeavour if franchise owners are already signed up, especially if the franchise agreement needs amending and is far from what it should be.

There is a whole host of weaknesses that can be easily avoided. These include: a lack of professional presentation and behaviour; weak brand profile; undercapitalization; weak infrastructure for initial and ongoing training; lack of commitment creating a genuine business format franchise; unproven systems; lack of continuity in key management; and lack of effective communication with franchise owners.

'Overall success in franchising is not based on a small number of factors, but a combination of many criteria – applied at the right time, in the right way and in the right place,' emphasizes FDS Southern Regional Director, Gary Rigby.

> Those who win in the long term do not do so by chance. They recognize the criteria that are most important, apply them and keep striving to deliver their best for both franchise owners and customers. Above all, there must be a balance of interests between franchise owners and franchisors where both parties in the partnership win unequivocally.

Franchising does provide an ideal strategy for owners of successful businesses to follow. However, there is a well-trodden pathway to follow and the key to success is to ensure that your franchise consultant knows exactly how to unlock the doors to your franchise development success.

The best advice we can provide in this chapter is for you to look at your franchise as a vehicle being built. Are you going to knock something together and hope that it will get you somewhere or are you going to engineer a Rolls-Royce that is designed to take you on your franchise journey in comfort and style?

By creating a truly majestic franchise model, you will have created something to be admired by your franchise owners and those that will look at your franchise opportunity for many years to come. Fred de Luca, the founder of Subway, has created such a vehicle and now has over 40,000 outlets worldwide. Subway's franchise vehicle is in fact now on a production line and it can quite accurately forecast that it will have 50,000 locations by 2015.

CeX, a now well-established brand here in the United Kingdom has established over 150 retail franchise locations during the recession and they are working with our company to help expand their business worldwide. This can only be achieved when you have a really strong franchise vehicle. The crux of my advice is to try to create the very best offering that you can by making concise and correct decisions in dealing only with the people who have the necessary experience to take your business where you want it to go.

Professor Roy Seaman CFE, QFP has been a tireless ambassador and highly-regarded speaker for franchising since 1981, when he founded Franchise Development Services. Roy has helped to mastermind franchise consultancy advice and guidance to hundreds of British companies and has assisted thousands of people to own a franchise.

For further information about franchising, visit **www.fdsfranchise.com**, **www.TheFranchiseMagazine.net**. Telephone: 01603 620301, e-mail: **enquiries@fdsltd.com**.

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Licence to grow

9.2

Mark Anderson discusses IP licensing as a route to growth

Intellectual property (IP) can be a company's most valuable asset. Astute management of IP can be more important to a company's long-term success than the management of conventional assets such as buildings and stock-in-trade, or even (dare one say it aloud) employees. It can also be a waste of money and resources. IP only has value if it is protected and managed in support of a clear business strategy. IP licensing (in-licensing or out-licensing) can make a valuable contribution to a company's growth strategy.

Bill Gates famously started his business by licensing, rather than assigning, the copyright in MS-DOS to IBM. This enabled him to grow his business by licensing the same software elsewhere.

The Nutrasweet Company, as it is now called, had a two-pronged IP strategy for protecting their artificial sweetener, aspartame. Initially, they protected the product with patents, but patents only last for 17 or 20 years. By the time the patents expired in 1992, they had developed a trade mark licensing programme. The company maintained its market-leading position by licensing diet drink manufacturers to use the name *Nutrasweet*®, which was trusted by consumers. More recently, other sweeteners, with their own brand names, eg *Splenda*®, have taken some market share. Take a look at the small print on the label, next time you buy a can or bottle of Diet Coke®. Some contain *Nutrasweet*®, and others contain *Splenda*®. In both cases, the trade mark is being licensed to add value to the ultimate product.

IP can benefit growing companies

You don't need to be a large company such as Microsoft or Nutrasweet in order to benefit from IP. Last year, my firm helped a micro-business – a carpentry company that designs and makes five-bar gates for wildlife parks. The company supplied gates for one project, and later discovered that the customer had commissioned someone else to make gates to the same design for a second project. By asserting copyright and design rights, we were able to get him compensation from the customer. Our client managed to maintain a business relationship with the customer and received further orders for carpentry products.

In all of these examples, the management of IP – copyright, design rights, trade secrets, patents and trademarks – has been an important part of a larger business strategy.

IP is not for everyone

However, IP management is not for everyone. Business managers do not need to become experts in the intricacies of patents and other IP – that takes years for even the brightest patent attorneys to learn – but they do need to be able to engage with a certain amount of legal detail. This is necessary in order to take good strategic decisions about the IP, to give clear instructions to IP professionals, and to negotiate advantageous terms in IP agreements.

Even more fundamentally, the business needs to be one that can take advantage of IP assets. Some small businesses are based on a very simple business model: make or buy-in goods at one price, and sell them at a higher price. The business may be managed by a single individual who spends their time in day-to-day trading activities, and who is not well-equipped for sophisticated business planning. In such cases, investing in IP may be an unprofitable diversion from the core activities of the business. The author has encountered too many small businesses that think IP licensing is a quick, cheap way of expanding their business beyond its natural limits, or of shoring up a failing business. Some franchise propositions, aggressively marketed in the back pages of national newspapers, have fallen into this category.

You don't need to be a technology business to benefit from IP

Other businesses are better equipped to take advantage of the opportunities that IP may bring. A common misconception is that you need to be in a 'technology' business in order for IP to be valuable. If you are in a technology business, almost certainly IP will be important, but the reverse is not true.

Let's take some practical examples. Franchising was mentioned earlier. The most successful franchises are heavily dependent on IP protection and licensing. Typically, the franchisee obtains a trade mark licence, allowing him to use the franchise brand. He usually obtains a know-how licence, which gives him controlled access to a bible of confidential information about how to run the franchise. There may be a copyright licence in respect of artwork and marketing materials. Less frequently for high-street franchises, there may also be a patent licence, to allow use of patented technology.

A more technology-focused example is software licensing. One of our clients develops computer games, which it licenses to large gaming and betting companies for use on their websites. Another of our clients in-licenses third-party software, bundles it with its own software, and licenses the bundled package on to customers.

Skills required for managing IP transactions

What are the skills that are required for successful IP licensing? For present purposes, we are referring to the business skills required of a commercial manager, and

not to the more specialist skills of a contract lawyer or patent attorney. You will certainly need professional advice on IP transactions, but you cannot just leave the entire project to the advisers. Ultimately, a commercial manager should take the business decisions, lead commercial negotiations and take commercial responsibility for the deal.

A good starting point is to have a basic understanding of what intellectual property is, and how it can be traded – usually by an *assignment* (outright transfer of ownership) or *licence* (permission to use, with ownership remaining with the licensor). An alternative business model is not to trade the IP, but instead to maintain it as an in-house resource, and as the basis for legal action against infringers if required. Simple guides to IP can be found on the UK Intellectual Property Office website, and the author of this chapter runs courses on IP subjects for non-lawyers.

It is useful for the commercial manager to become familiar with licensing practice in the relevant industry sector on issues such as whether to grant exclusive or non-exclusive licences, how to calculate royalties, and what royalty rate to charge. Many commercial managers pick up this information as they go along, but there are some useful courses, such as the licensing courses run by PraxisUnico for the UK university sector.

Finally, it is important for the commercial manager to know their way around a typical licence agreement. Experienced licensing professionals see the same points being raised time and time again in negotiations, and there are usually standard arguments on each side of the negotiation. For some types of transaction, eg sale of goods, the commercial negotiations tend to focus on a few key issues, including specification, delivery, price and payment terms.

IP licence agreements have equivalent issues to these, but also have a larger number of secondary issues that are commercially important and cannot just be left to the lawyers to decide. For example, should the licensee be allowed to include a 'royalty stacking' clause that allows him to reduce the royalties paid to you if he also has to pay royalties to a third party? Should the licensor give warranties of non-infringement of third-party rights? Should the licensee lose his licence if he fails to bring products to market by a defined date? These are just a few examples of the types of issue that are typically negotiated in a detailed licence agreement.

Some issues that business managers face

When deciding whether to in-license or out-license IP, a business manager may need to address the following issues:

- **Why?** Will protection and/or management of IP be a good investment in support of my business strategy? Can I run my business without investing in IP?
- **What?** Have I thought through the pros and cons of investing in different types of IP (eg patents or trademarks)? Have I researched the IP landscape to see what IP my competitors have?
- **How?** Do I have the skills and resources (in-house or external) to protect and manage the IP and to negotiate IP licence agreements?

- **Costs.** Do I have a budget for legal and, if appropriate, IP filing fees? What will I do if a dispute arises under the licence agreement, or I face competition from unlicensed competition? Will I have to take or defend legal action, or can I get my licensor or licensee to bear these costs?

Plan your deal terms before you negotiate

Finally, a heartfelt plea from an IP licensing lawyer: don't work out what deal terms you want in the middle of licensing negotiations. Establish in advance what terms you aspire to achieve, and your 'walk away' positions. This author has seen too many negotiations where deal positions are worked out 'on the hoof', in response to seeing how the other party reacts to commercial proposals. Leaving aside the question of whether this approach is likely to achieve the best deal, it can be very inefficient as a process and lead to an escalation of legal costs.

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As well as advising clients, Mark runs training courses on IP licensing and other commercial law subjects, and is the principal author of several textbooks on IP subjects, including *Technology Transfer* (3rd edn, Bloomsbury Publishing, 2010). He also runs a popular blog on the subject of IP contracts at **www.ipdraughts.wordpress.com**.

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Acquisitions that work

9.3

Strategic acquisitions can be an unbeatable route to growth, says Dr Mike Sweeting, Director of International Development at BCMS 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: Buyer/seller overlap

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 a business ready for sale 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: Growth

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. Some 63 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 adviser 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 fewer companies during the notional twelve months. They have usually only looked at companies 'for sale'. They have not thoroughly investigated their alternatives.

Use advisers who 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: Strategic focus

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 it 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 the up- and down-sides 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, consider what you want each acquisition to deliver, specifically, 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

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 (PE) 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 thought entirely strategically. It is *potential* they were 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 MBOs/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 an 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

The people! I am afraid that we are now on ground where no statistics help 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 tekkie 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 cashflow 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 that I 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 diversify;
- good acquisitions give you 'critical mass'.

Dr Mike Sweeting (a Fellow of both the Institute of Sales & Marketing Management and the Institute of Directors) is the Director of International Development at BCMS International, and was previously MD of Acquisitions International. In between, he spent several years developing 'thought leadership' with the legal and accounting professions. His current work is entirely cross-border and cross-cultural, taking the BCMS brand to new countries by whatever is the most appropriate of the strategic growth methods discussed above. E-mail: **mike.sweeting@bcmscorporate.com**, website: **www.bcmscorporate.com**

He likes rock climbing, poetry, military history and shooting – some of the things he finds as stimulating as getting a deal done!

PART TEN
Growth capital

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Raising finance

10.1

Think broadly enough, before you start, to capture all possible sources of finance, says Bill Corr, Innovation Specialist at Scottish Enterprise

By now it is fairly well accepted that the single biggest challenge to start-up and growing businesses, of whatever sector, is raising finance. Long gone are the days of being reasonably able to raise funds from a single, local source. Perhaps at this point I ought to introduce myself as it will make it clearer as to why there are so many Scottish references. As an Innovation Specialist with Scottish Enterprise (SE) I help support companies of all sizes and sectors to access funds for R&D and innovation activities. This can be from single owner/employee technology start-ups to large multinationals. Clearly multinationals are less likely to struggle to raise finance; however, support from government or other sources can often be a deciding factor on whether the company will either invest locally in R&D or manufacturing or invest in a lower-cost geography.

From this starting point it is clear that companies must now, more than ever, fully understand all aspects of the type of help that can be sought to support their business objectives. Much of this support will come from quite unusual sources which I will come to later. When working with companies my main piece of advice is to look at the issue of raising funds in a far more holistic fashion than they might otherwise have in the past. A strategic approach will ensure that the company will scope the areas of potential support *prior* to projects and activity beginning, as much of the support will take time to access, is often paid retrospectively and some years in the future! Starting a project before the grant/loan is approved will often result in a company not being able to access some grant mechanisms. So we have to start with a plan.

Given the complexity and importance of the planning stage it may be simpler if I simply limit the scope to that of small and medium-sized enterprises (SMEs), although much of the advice will also be relevant to large companies.

Normally I get involved with a company when they have expressed an interest in an innovation or R&D project, and as I often work with innovators there is usually *not* a plan of any form other than the type of technical activity they'd like to engage in! Often this is the time to get the company accountant involved. Once the technical scope of a project is known I can then begin to understand the type of support they require in the short- to medium-term and then also give advice as to the longer-term considerations.

So where might you access support? Clearly this depends on the type of project, technology and geographical location. Once a draft plan is prepared I would normally look at pockets of activity to see if there is support in the first instance that can be accessed for free. Universities are a great source of free support, and in Scotland the Scottish Funding Council offer £5,000 (with a matching in-kind contribution from the company) Innovation Vouchers through Interface to your university of choice.

Scottish Enterprise also supports a group of universities (Glasgow, Strathclyde and Aberdeen) through the Encompass programme. However, there are others such as Sporting Chance through Stirling University all offering the same £5,000 support. Universities also actively seek real-life technical and business issues for student projects; this benefits the company and the student, so it is imperative that companies develop a good working relationship with their local university. In a recent project with one of my client companies who design and supply laboratory fume cupboards the technical director was absolutely delighted with the quality of not only the Strathclyde University department of Design Manufacturing and Engineering Management (DMEM) students but also the standard of the design work, all for some bus fares and fish and chips! Technical Director Steven McKay of McQuilkin & Co stated:

> We're now entering our third year with DMEM projects and our experience so far has been a very rewarding one. The students always adopt a very professional approach to our projects and deliver to a level where the outcomes have been incorporated into our product range. We look forward to a long relationship with DMEM.

Technical resource can also be an issue. In some areas technically qualified and experienced staff can be difficult, and expensive, to source. To that end there are a number of mechanisms, such as Knowledge Transfer Partnerships (UK-wide) and Talent Scotland, which help source and support graduates into business. These can be extremely cost-effective ways of resourcing a project for a limited period without the need to fully commit to a new member of staff; however, the evidence suggests that a high proportion of graduates do go on to become full-time members of staff.

State aid

As I mentioned in the introduction, traditional routes to funding have changed dramatically over the past few years and companies now find that most projects are funded from a number of different sources. These sources can range from loans, grants and equity, and can be found at local level such as local authorities, but also at national level through Scottish and UK governments and the European Union. I also mentioned that there are also some unusual sources: HMRC can also be of great support to many companies and I will go into that in more detail later.

Scotland

Through the Scottish government, Scottish Enterprise (SE), the Business Gateway and local authorities there are a number of different products, programmes and support

which can help companies of all sizes to grow and develop. There are many 'products' which remain stable in any given period such as Regional Selective Assistance, grants for R&D, innovation, sustainability, organizational development, capital expenditure, equity support via SE's Scottish Investment bank, international activities, market development, strategy and business improvement to name but a few.

There may be support with a particular technical, sectoral or geographical focus such as renewables or biomedical sciences. For example, in recent years there have been calls for projects in marine renewables through programmes such as POWERS (offshore wind) and WATERS (wave and tidal energy). These mechanisms are 'competitive calls' and as such it is important that companies ensure they are fully appraised about what is happening in their business sector and geography at any given time.

United Kingdom

Although the structure for regional development agencies in England and Wales has changed over the last few years there are still a number of UK support mechanisms. These mechanisms are usually transient or 'competitive calls' and therefore it is vitally important that companies ensure they are fully aware of pending 'calls' primarily as they are time-bound and often the timing can be tight, especially if the grant calls for the formation of a collaboration. In recent years there have been calls from organizations such as Department of Energy & Climate Change (DECC), Technology Strategy Board (TSB), UK Trade and Investment (UKTI), the Carbon Trust, the Department for Business, Innovation and Skills (BIS), WRAP, Manufacturing Advisory Service and many others. They usually follow a particular theme, such as the recent TSB Vessel Efficiency call, for which one of my client micro-companies, Witt Energy Solutions Ltd, was able to form a collaboration with the companies A&P (Falmouth), Supacat (Devon) and Exeter and Plymouth universities.

There are also many local initiatives in England and Wales, such as NAREC in the north east and Wave Hub in the south west, so it is important that companies fully understand all local initiatives.

European Union

The EU is another source of funding for development projects, of which ERDF, Framework 7 (FP7 – soon to become Horizon 2020), and Eureka Eurostars are only three amongst many. EU funding is a rather specialized area and it would be advisable for companies to gain specialist advice wherever possible.

Venture Capital

Funding for projects is likely to come from a variety of sources: loans, grants and equity. Sourcing funds from venture capital (VC) is another excellent method of raising funds and has certainly come to the fore recently as a result of the TV programme *Dragons' Den* as it has raised the public's awareness of such funding. This is another

method by which companies can release equity into the business, which in turn can often then be used to leverage grant and loan funds from other sources. In fact Scottish Enterprise has several funds via the Scottish Investment Bank which work closely with co-investment partners. There are also new VC players, and 'crowdfunding' is now seen as a viable source of raising equity capital.

HMRC

In my introduction I mentioned 'quite unusual sources'. The HMRC is an excellent source of support 'before, during and after' many development projects. Firstly, R&D tax credits can support R&D/innovation activity and can be claimed together with normal state aid, although there can be caveats.

Getting external equity funding can also be an issue; however, if a company registers with the HMRC Seed Enterprise Investment Scheme (SEIS) there can be tax incentives which will ultimately lessen the risk for the external investors involved. I previously mentioned a client, Witt Energy Solutions Ltd, that has also successfully registered for SEIS. The company MD, Mairi Wickett, stated that it had been a most important part of their overall investment strategy, enabling them to raise two rounds of equity finance and leverage it with an investment fund in the south west of England. The most recent introduction to the HMRC portfolio has been Patent Box; this will allow companies to potentially reduce their corporation tax liabilities for products that are, or contain, technology which has been granted a UK patent.

However, the HMRC also have other mechanisms of support, such as Enhanced Capital Allowances, so it is well worth getting to know your local HMRC representative. On a personal note I have found the HMRC R&D tax credit team extremely helpful in supporting projects and helping companies understand R&D tax credits.

Conclusion

The areas of support covered are by no means exhaustive and I have only been able to scratch the surface. My advice would be that companies should attempt to understand all funding mechanisms which relate to their particular business, sector and development strategy. Contrary to myth there are a large number of funding options open to companies. It may not always be easy to find a way through the application processes but ultimately it will be worthwhile, and raising finance from all possible sources should form an important part of any new product/market development strategy, business model expansion or diversification. Companies should understand fully the support landscape and give themselves sufficient time to apply. As I often tell my clients '... you can't be too early, but you can be too late!'

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Structuring the funding package

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 of Aspen waite Accountants

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 from a bank.

This perception is often caused by the unimaginative approach of many banks and sadly, many of the banks' small business advisers 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 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 the wrong financing package can at the very least hamper growth.

In recent years, obtaining debt funding from banks has been 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 shareholder's 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.

Crowd finance

A revolution in finance started in 2011 that is changing the face of raising finance for SMEs in Britain. The revolution is 'crowd finance' or 'crowd funding' and since 2011 it has been growing very rapidly, filling the vacuum left by banks unable or unwilling to finance growing companies. The fact that many companies still need to raise debt or equity fits perfectly with the fact that there are many individuals that are looking for a better return on their investments than the very low levels of interest paid on savings. Using the wide reach of the internet there are now very many variations on this theme where websites have been established to encourage individuals to fund companies (and indeed other individuals).

These websites encourage companies to pitch for funds on the one side and encourage individuals to lend or invest into specific companies that they feel comfortable with on the other side. This process provides the companies with competitively priced funds and provides the individuals with a much better return. All of the websites advise the individuals to spread their investments amongst many companies in order to guard against failure. The sponsors of the website handle all the administration and the like as part of their duties in exchange for charging a fee for when the funds are raised.

Most sites will only charge a fee once the funding has been raised and the standard rule is that 100 per cent is raised or it does not go ahead. This seems to ensure that companies only seek realistic amounts (and in the case of equity, on realistic terms). Typical amounts raised go from as low as £10,000 up to £100,000 or even £150,000 and more. Quality control is tight in order to ensure only credible businesses are offered to investors.

Crowd finance is already entering the mainstream as a viable alternative to 'traditional' sources of funding and this is reflected in the fact that the UK government is pumping money into the sector to encourage funding to be made available and the fact that the providers are now becoming FCA-regulated businesses.

It is the banks' reticence in recent years to finance anything without being massively over-secured, and the large increase in rates and charges when they are prepared to provide finance, which has let this genie out of the bottle – but now the genie is out it will not be returning. This type of funding is already providing strong competition to the banks and the other more traditional finance detailed here. This can of course only be good for SMEs.

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 mid-way 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. This is at last beginning to ease a little.

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, forfeiting, 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 onto 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 principle 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.

Kevin Smith is Chairman of Aspen Waite Chartered Accountants (**www.aspenwaite.co.uk**) and CEO of AWS International Business Development (**www.awsconsult.co.uk**) and REACH Global (**www.reachglobal.net**). Aspen Waite has a proven track record of working in close partnership with clients to raise funding and drive business forward by providing total business solutions across a broad spectrum, not just accounting, as the wider group also provides corporate finance, independent financial advice, legal and other services. AWS also provides a range of services but focused around assisting UK based companies to develop business internationally with REACH Global being the latest initiative to drive this forward. Kevin has worked in some 36 countries and travelled to many more. He is a non-executive director of a number of companies, both in the UK and overseas.
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Pensions to fund growth

10.3

Andrew Stallard and Matt Higham at Worldwide Financial Planning discuss the options for using a pension fund as an alternative source of finance

While owners may have confidence in their business and are hopeful of a successful future, the same can't always be said for lenders, many of whom may be unwilling to take the smallest risks.

Struggling to finance expansions, more and more start-ups and established firms are looking to alternative forms of finance; one innovative method involves using business owners' pension funds to release money in exchange for certain business assets being held in the pension as an investment asset. Often existing funds are in tired old insurance company funds and owners feel a lot more engaged in their retirement planning if the pension is involved in the business.

There are many advantages to you and your business, and pension contributions can be used in a number of ways:

- They may be used to reduce liability to 40 per cent tax or recover the personal allowance if income is above £100,000.
- They may allow child benefit to be claimed if income is above £60,000.
- Contributions may reduce company corporation tax liability.
- In the case of business failure the pension may be the only tangible asset left.
- Bonus payments from the company to individual pensions save on employer NI contribution; this can be shared with the employee or used to reduce cost of bonus to the company.
- Commercial property can be purchased using a pension fund and 50 per cent mortgage funding can also be obtained by the pension fund.
- Some schemes will allow the pension fund to lend to the company to purchase commercial vehicles or machinery.
- Pension contributions can also be made on behalf of non-working spouses; this means a £3,600 pension contribution only costs £2,880.

Quite often this can be done in conjunction with banks, which will become more amenable to a large business loan if the owner shows they're willing to put some of their own capital at risk. Let's look at three situations.

1. **Growth has meant expansion and the need for larger commercial premises.** Business owners are able to purchase some or all of their business premises using their pension funds. The pension fund then becomes the landlord and the rent paid is in effect a pension contribution. If you own the premises already you can buy the property from yourself and release the capital back to you.

   This way allows you and your business to generate cashflow.
2. **A commercial loan from the pension.** This is a reasonably straightforward process of a business owner's pension fund loaning money to the business, and being repaid with interest.

   The loan cannot exceed 50 per cent of the pension fund's value, and must be paid back at an interest rate of at least one per cent higher than the Bank of England base rate. It can only be done via a Small Self-Administered Scheme (SSAS) with the approval of the scheme trustees, and not from a Self-Invested Personal Pension (SIPP).
3. **Intellectual property sale and lease.** Non-tangible assets such as intellectual property are a permitted asset class for pension-led funding.

   The business owner's SIPP or SSAS can purchase the intellectual property (IP) – such as domain names, patents, trademarks and copyrights – from their company, and lease it back to the business with the payments filling the hole left in the pension fund.

   The purchase can exceed 50 per cent of the pension fund, but never be 100 per cent of the fund. Around 70 per cent is about as high as you're likely to get.

What are the benefits and risks?

There are a number of benefits of using your pension fund to raise funds and unlike taking a loan from the banks, you are not going to be hit with punitive charges, hounded, declared bankrupt and potentially lose your home if you default.

If you take the route of selling a firm's IP to your pension, then the pension pot will grow as the business grows as the value of the intellectual property increases.

When it comes to retirement, this property can be sold back to the business at a profit, or can continue to provide an income as the business continues after the owner has retired.

As the business becomes more profitable owners can repay the money to their pension sooner by increasing the amount they spend on the lease. These payments gain 100 per cent relief from corporation tax.

There is always the risk that the business may not be as profitable as planned and if the business fails then it's your pension pot that will take the hit.

In the worst case scenario, and if the business has sold its IP to the pension, then all might not be lost, as this property may still retain an element of value even if the business goes under.

Is it appropriate for your business?

Any firm that facilitates a pension-led funding arrangement, not to mention the provider of the owner's pension pot, will require a large amount of information before approving an application. Those choosing to go direct to their pension provider will need to do so via their independent financial adviser (IFA).

No adviser or provider is going to agree to pension-led finance if the reason for the loan is to prop up a failing company, nor will it approve a loan or IP purchase if the owner does not have a large enough pension pot.

In all cases of raising finance for your business an in-depth business case for the loan has to be presented, along with a detailed assessment of company accounts, track record, business plan and funding structure carried out by a corporate finance and pension specialist.

When it comes to IP, an independent valuer is appointed to assess how much could be levied from the pension pot from its sale.

The input of independent financial Advisers becomes particularly important if the business owner is the member of a final salary scheme where 'caution should be exercised' given the potentially generous nature of such pensions at time of retirement. Similar caution should also be taken with pension pots that come with guaranteed annuity rates, spouse benefits and transfer penalties.

How much does it cost?

The costs will vary depending on how much an owner's financial adviser charges for their services which could include reviewing the business, carrying out due diligence, valuation of IP, checking compliance, and a final audit. Generally charges are broadly similar to the interest costs of taking out a typical business loan.

Although you pay interest on loans taken from an owner's pension pot, the money is being paid back to the owner themselves so it doesn't cost anything extra.

Independent financial advice allows you and your business more options to fund your business growth and whilst using your pension may not be for everyone your adviser will be able to consider it in light of all your circumstances and aspirations so that you put into place the most appropriate financing at that time.

Future strategy

If you decide that your priority is growth then you need to plan carefully if you are to succeed. Growth has its risks, but the right strategy can deliver stability, security and long-term profits. Once you've assessed the current strengths, weaknesses, opportunities and threats to your business and how well it's equipped to handle them, you can move on to the next stage – building a strategy for growth. The options that may be considered could be increasing market share, diversification, partnerships, joint ventures, mergers and acquisitions.

Each form of growth strategy has implications and although growing your business can be exciting, it can also be a nerve-racking time. Sometimes when you are on the rollercoaster of growth it is difficult to give your expansion plans the time and thought that is really needed. In these circumstances, as you will more than likely have experienced in other areas of your business, delegation and outsourcing specialist areas will in most cases be more effective than taking it all on your own back.

When looking at strategic options your financial adviser will be able to consider what financial products are available to either support your strengths and opportunities but also to look at protecting the downside that could come when looking at your weaknesses and strategic threats.

Your financial adviser will use their specialist skills and experience in determining how to support your objectives and will consider both your personal and business aspirations and help guide you to the most appropriate sources of finance and protection. Using your pension as an option for raising finance for your business has been discussed but when considering your other growth strategies there may be other options more suitable to your individual needs.

Your extended team of accountant, solicitor and business consultant should include independent financial advice from a suitably qualified and experienced adviser. Give your expansion plans the best chance of success and allow yourself peace of mind by doing some careful planning beforehand with their support – they may have solutions to issues that are not normally at the top of your mind!

Contact *Andrew Stallard* or *Matt Higham* at Worldwide Financial Planning for a free consultation about using your pension for funding business growth. Telephone: 0845 230 9876, e-mail: **info@wwfp.net** or take a look at our website **www.wwfp.net**.

Worldwide Financial Planning is a whole-of-market independent financial adviser advising you on all aspects of financial planning, including commercial finance, mortgages, inheritance tax, investment, equity release, long-term care and pensions.

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Flotations

10.4

Richard Evans at Strand Hanson weighs up the benefits of listing for growth companies

It is a simple fact that growth companies need capital in order to grow.

Start-up companies usually depend on investment from founders and their family and friends. As they grow, further capital is added from retained profits or by borrowing from a bank. But bank debt may be difficult to obtain unless the business has tangible assets to offer as security.

But what growth companies really need to expand is equity investment. Such risk capital can be obtained from the private equity industry or by obtaining a listing on the stock market. The AIM market has made a significant contribution to sustaining small and growing companies since it was established in 1995 and represents the first entry point to a stock market listing for most companies.

TABLE 10.4.1 Pros and cons of listing

How can a listing help?	What can go wrong?
increased public profile and prestige	your business is always for sale
freedom to manage	failure to demonstrate sound corporate governance
a licence to print money	it becomes an expensive backwater
a debt-free way to grow	lack of investor engagement can deny future funding

Profile and prestige

A key benefit of a stock market listing is that it offers increased public profile and prestige. Quoted companies feature every day in the business pages of national newspapers or as investment tips in the money pages. Their raised profile also serves to increase their credibility with stakeholders such as customers, suppliers and employees

due to the prestige of being listed. For a growth company operating in a competitive business environment public profile can be as important as capital for fuelling growth. These advantages come at a cost of increased public accountability, but provided a listed company is prepared to apply the necessary resources to engage in effective investor relations then it can use the stock market as a platform for rapid and sustained growth.

Debt-free source of capital

Whereas private equity-backed businesses are burdened with substantial debt, listed company capital structures are usually equity-based. Servicing debt can claim a lot of the cashflow generated by a company to meet inflexible recurring payments to capital providers. Equity-financed companies offer their management complete discretion as to how much to return to investors in the form of dividends and how much to retain in the business to fund its growth.

A licence to print money

The fact that a listed company's shares can be freely traded allows it to become its own bank by issuing shares, either to the stock market for money, or to vendors to pay for acquisitions of businesses or assets. Listed shares can be easily used to pay staff through current or future share ownership. Staff who own shares or who hold share options can check the value of their interests simply by looking in a national newspaper each day, which can provide a powerful sense of ownership and motivation to deliver the success of their company.

Freedom to manage

The management of private equity-backed companies is usually directly influenced by their investors, often to the extent of having a representative or two sitting as non-executive directors on the company's board. A listed company often never meets the majority of its shareholders, which leaves the management of quoted companies entirely responsible for the strategic direction and operation of their business with little direct interference from shareholders.

How to unlock the benefits of a quotation

Only those businesses that are prepared to embrace the changes necessary for a life as a public company will be able to experience the full benefits of a listing. In this respect there are a few simple rules that should always be borne in mind.

Explain your growth story to everyone

Growth company investors look for businesses with a clearly defined strategy and with a market position that can be defended from competitive threats. But it is only those companies that are prepared to take the time and make the effort to articulate and explain these things clearly to the stock market that will benefit from a quotation as they compete with a thousand other public companies for investor interest.

Under-promise and over-deliver

Investors are risk-averse and do not like surprises. In telling the story it is essential to explain all material risks and possibilities. It is human nature to emphasize opportunities and upsides whilst minimizing the impact of possible threats and downside risks. When the market has already been conditioned to understand what could go wrong, when bad news arises (which it always will), investors will respond more rationally by focusing on management's remedial actions rather than reacting in shock to the bad news. Therefore, it is best to give a rounded view and not make promises of future performance that do not allow the possibility of things going wrong.

Demonstrate the strength of the management team

Private equity active investors often benefit the companies they back by strengthening the management team and mitigating any weaknesses it may have on a day-to-day basis. Therefore, listed companies need to instil confidence in the market by demonstrating that they have a strong and diverse management team in place. Those public companies that are not overshadowed by one dominant leader will usually be more attractive to investors over time, particularly if there is clearly visible strength in depth in the team.

What can possibly go wrong with my listing?

Whilst a listing can be a solution to the problem of financing growth, the stock market will always set challenges for public companies that not all are able to rise above.

Going public means always being for sale

Being listed on the stock market literally makes a company public property. Anyone can buy the company's shares, but they will not share the founders' personal passion for the business they have built. Instead, such shares become just another portfolio investment waiting to be sold one day. Even if the management is doing well, the company can be sold to whoever offers investors the right price, particularly if the management hold only a minority position on the share register.

Being a public company is hard work

The arms-length relationship with shareholders means that listed companies have to adopt more transparent and formalized corporate governance arrangements in order to ensure that they can demonstrate to an often unknown investor base that the company is being run effectively and in the interests of all shareholders. The requirements of good corporate governance can be onerous, but being required to adopt such disciplines can help management to adopt a more challenging approach to their own decisions and so help to avoid making bad business choices.

However, those companies that fail to convince investors that the company has adopted and complies with all the best practices can be overlooked in favour of other public companies. When this happens, shareholder support for the management evaporates, making the company vulnerable to an unsolicited takeover approach or unable to raise more capital.

Maintaining a listing costs money

Public companies that fail to engage actively with the investing community because they think it distracts from the 'real job of doing the business' will find themselves falling out of favour with the stock market. The quotation will still cost a six-figure sum each year to support with listing fees and annual professional adviser costs but will only return a stagnant share price and an inability to raise capital in future.

Then it can be difficult to overcome the investment community's negative perception, particularly when there are over a thousand alternative companies that are potential destinations for their money. The road back to shareholder acceptance can be long and arduous involving a heightened level of communications, confidence building and, above all else, exceptional performance delivery.

Delivering sustained growth only keeps you in the game

Investors back growth companies because they expect them to be dynamic. Smaller companies are able to sustain high valuations without paying out substantial dividends because shareholders understand that it is much easier for a smaller business to double its profits than for a FTSE 100 global company. But maintaining a competitive rate of growth against the market can be challenging for even the best management team.

The economy is not always favourable and in a downturn it is smaller companies that can suffer the most. Earnings can evaporate and with them the investors' interest. It can be a genuine challenge for a listed company's management team to sustain growth, both organically and through well-chosen acquisitions.

Is it worth listing now?

The past five years have seen some of the most difficult conditions for growth companies in living memory. Many may be sceptical of taking the risk of incurring

significant cost to obtain a quotation when the economic outlook is uncertain. It is true that the stock market has offered a rollercoaster ride for share prices with the market responding strongly and then falling back twice during the intervening period. However, the past year has been very positive for IPOs and share prices and it would not be unreasonable to expect this momentum to be maintained for the next year or so due to the stimulus the economy has received in anticipation of the next general election.

Therefore, for those companies prepared to come to the stock market with their eyes open to both the opportunities and the threats, a listing can still be a gateway to sustained growth.

Conclusion

In summary, the stock market is best used by companies that:

- can benefit from the increased public profile that such a listing offers;
- understand the need to invest time in explaining their business to the market;
- know to under-promise and over-deliver expectations; and
- have existing strength and depth in their senior management team.

Richard Evans is Chief Operating Officer at Strand Hanson, a leading firm of nominated advisers to the AIM market with significant expertise across the natural resources sector. He has 30 years' experience working with both public and private growth businesses as adviser and as a regulator. He is Deputy Chairman of the QCA's Corporate Finance Expert Group. Further details: **www.strandhanson.co.uk**

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