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3rd Edition

# Starting & Running a Business

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**Colin Barrow**

Venture capitalist and entrepreneur

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3rd edition

by Liz Barclay, Colin Barrow, Paul Barrow, Greg Brooks, Ben Carter, Frank Catalano, Stephanie Diamond, Peter Economy, Danielle Elliott Smith, Lita Epstein, Barbara Findlay Schenck, Kim Gilmour, Alex Hiam, Greg Holden, Jane Kelly, Sarah Laing, Paul Lancaster, Dan Matthews, Ruth Mortimer, Bob Nelson, Helene Panzarino, Steven Peterson, Richard Pettinger, Aliza Sherman, Shiv Singh, Bud Smith, Craig Smith, Paul Tiffany and John A. Tracy

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# Starting & Running a Business All-in-One For Dummies®

## To view this book's Cheat Sheet, simply go to www.dummies.com and search for “Starting & Running a Business All-in-One For Dummies Cheat Sheet” in the Search box.

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# Guide

# Introduction

Welcome to this latest edition of *Starting & Running a Business All-in-One For Dummies* , your launch pad to understanding the fundamentals of setting up, establishing, running and growing a successful small business. In today's challenging environment, with the banking sector still scrambling to find a foothold after the credit crunch and world stock and oil price markets see-sawing with alarming frequency, it has never been more important to be well informed on every aspect of business.

Standing out from the crowd is getting tougher, too. In 2015, a record 600,000 new businesses were started in Britain, bringing the total number of new businesses started since 2010 to 2.6 million, far more than in any other European country.

This book draws together information on the key areas of successful business – planning, funding (including new areas such as crowdfunding), staying on the right side of the law, employing staff, bookkeeping, accounting and tax, marketing promotion, social media, e-commerce and planning for growth – all in one bumper guide.

With help from this book, you can make even better business decisions and transform a simple idea into your very own business empire.

## *About This Book*

This book is the ultimate business adviser, providing expert guidance for businesses at every stage of the start-up process.

This third edition of *Starting & Running a Business All-in-One For Dummies* draws on advice from several other *For Dummies* books, which you may wish to check out for more in-depth coverage of certain topics (all published by Wiley):

- *Business Funding For Dummies* (Helene Panzarino)
- *Business Plans For Dummies* , 3rd Edition (Paul Tiffany, Steven D. Peterson and Colin Barrow)
- *Small Business Employment Law For Dummies* (Liz Barclay)
- *Small Business Marketing For Dummies* (Paul Lancaster and Barbara Findley Schenck)
- *Social Media Engagement For Dummies* (Aliza Sherman and Danielle Elliott Smith)
- *Social Media Marketing For Dummies* , 3rd Edition (Shiv Singh and Stephanie Diamond)
- *Starting a Business For Dummies* , 4th Edition (Colin Barrow)
- *Understanding Business Accounting For Dummies* , 3rd Edition (John A. Tracy and Colin Barrow)

You can find some interesting (but not essential) info in the sidebars, which are shaded boxes, and with the Technical Stuff icon. Feel free to read these if you want to dig a little deeper and to skip them if you want just the basics for now.

Note that this book is a reference book, so you don't have to read it in order (unless you want to!); simply use the table of contents and the index to help you find what you're looking for. You can dip into and out of chapters as you like.

Within this book, you may note that some web addresses break across two lines of text. If you're reading this book in print and want to visit one of these web pages, simply key in the web address exactly as it's noted in the text, pretending as though the line break doesn't exist. If you're reading this as an e-book, you've got it easy — just click the web address to be taken directly to the web page.

# Foolish Assumptions

This book brings together the elements of knowledge that are essential for understanding the world of small business. As a consequence, to keep the book down to a reasonable number of pages, we've made a few assumptions about you (we hope you don't mind!). Maybe you're:

- An entrepreneur looking for a start-up bible
- A small business owner-manager seeking a comprehensive reference guide
- A business owner with aspirations to grow

# Icons Used in This Book

When you flick through this book, you'll notice some snazzy little icons in the margin. These pick out key aspects of starting and running a business, and present you with important nuggets of information:

TIP Want to get ahead in business? Check out the text highlighted by this icon to pick up some sage advice.

REMEMBER They say elephants never forget – and nor should good business owners. This icon focuses on key information you should never be without.

WARNING Running a business isn't without its dangers – be they financial or legal – and the text beside this icon points out common pitfalls to avoid.

TECHNICAL STUFF Sometimes you'll be presented with information that's interesting but not absolutely essential to starting or growing your own business. If you see this icon next to a paragraph, you're welcome to skip by if it's not of immediate interest to you – doing so won't harm your chances in business.

# Beyond the Book

In addition to what you're reading right now, this product also comes with a free access-anywhere Cheat Sheet that provides key considerations for starting a business, factors for business success and more. To get this Cheat Sheet, simply go to `www.dummies.com` and search for 'Starting & Running a Business All-in-One For Dummies Cheat Sheet' in the Search box.

# Where to Go from Here

*Starting & Running a Business All-in-One For Dummies* , 3rd Edition, can help you succeed no matter what kind of business expertise you're looking for. If you have a great and proven business idea, you may want to plug straight into finding out how to raise finance (head over to Book 2 ). If you need more than just yourself to get your great business idea off the ground, you may want to know how to find great employees (check out Book 3 ). If you're planning to take care of your own bookkeeping and finances, you may want to find out how to successfully balance the books and take care of tax (flick through to Book 4 ). Or perhaps you've already started out and you're looking for advice on how to take your business to the next level (Book 6 gives some great advice). This book is set up so that you can dip in and out of it in a number of ways depending on your situation.

# Book 1

# Laying the Groundwork

# Contents at a Glance

# Chapter 1

# Preparing for Business

**IN THIS CHAPTER**

**Working up to opening up**

**Measuring your business's viability**

**Growing for success**

When you're starting a business, particularly your first business, you need to carry out the same level of preparation as you would for crossing the Gobi Desert or exploring the jungles of South America. You're entering hostile territory.

Your business idea may be good, it may even be great, but such ideas are two a penny. The patent office is stuffed full of great inventions that have never returned tuppence to the inventors who spent so much time and money filing them. It's how you plan, how you prepare and how you implement your plan that makes the difference between success and failure. And failure is pretty much a norm for business start-ups. Tens of thousands of small firms fail, some disastrously, every year. Most are perfectly ordinary enterprises – catastrophe isn't confined to brash Internet whiz kids entering markets a decade or so ahead of the game.

In fact, a quarter of all new businesses close their doors before their first year is over; a further quarter fail by their fourth year (for more on the reasons why, visit `www.statisticbrain.com/startup-failure-by-industry`). This chapter sets the scene to make sure that you're well prepared for the journey ahead.

## *Getting in Shape to Start Up*

You need to be in great shape to start a business. You don't have to diet or exercise, at least not in the conventional sense of those words, but you do have to be sure that you have the skills and knowledge you need for the business you have in mind, or know how to tap into sources of such expertise.

The following sections help you through a pre-opening check-up so that you can be absolutely certain that your abilities and interests are closely aligned to those that the business you have in mind requires. The sections also help you to check that a profitable market exists for your products or services. You can use these sections as a vehicle for sifting through your business ideas to see whether they're worth the devotion of time and energy that you need to start up a business.

REMEMBER You may well not have all the expertise you need to do everything yourself. In this book you can find information on the zillions of agencies and advisers who can fill in the gaps in your expertise.

## *Assessing your abilities*

Business lore claims that for every ten people who want to start their own business, only one finally does. It follows that an awful lot of dreamers exist who, while liking the idea of starting their own business, never get around to taking action. Chapter 3 of Book 1 looks in detail at how you can assess whether you're a dreamer or a doer when it comes to entrepreneurship. For now, see whether you fit into one of the following entrepreneurial categories:

- **Nature:** If one of your parents or siblings runs their own business, successfully or otherwise, you're highly likely to start up your own business. No big surprise here, as the rules and experiences of business are being discussed every day and some of it's bound to rub off. It also helps if you're a risk taker who's comfortable with uncertainty.
- **Nurture:** For every entrepreneur whose parents or siblings have a business, there are two who don't. If you can find a business idea that excites you and has the prospect of providing personal satisfaction and wealth, you can assemble all the skills and resources needed to succeed in your own business. You need to acquire good planning and organisational skills (Chapter 4 in Book 1 covers all aspects of writing a business plan) and either develop a well-rounded knowledge of basic finance, people management, operational systems, business law, marketing and selling, or get help and advice from people who have that knowledge.
- **Risk taker:** If you crave certainty in everything you do, running your own business may be something of a culture shock. By the time the demand for a product or service is an absolutely sure-fire thing, there may already be too many other businesses in the market to leave much room for you. Don't confuse risk taking with a pure gamble. You need to be able to weigh matters up and make your risk a calculated one.
- **Jack-of-all-trades:** You need to be prepared to do any business task at any time. The buck definitely stops with you when you run your own business. You can't tell a customer that his delivery is late just because a driver fails to show up. You just have to put in a few more hours and do the job yourself.

## *Discovering a real need*

You may be a great potential entrepreneur, but you still need to spell out exactly what it is you plan to do, who needs it and how it can make money. A good starting point is to look around and see whether anyone is dissatisfied with their present suppliers. Unhappy customers are fertile ground for new businesses to work in.

REMEMBER One dissatisfied customer isn't enough to start a business for. Find out if unhappiness is reasonably widespread, because that gives you a feel for how many customers may be prepared to defect. After you have an idea of the size of the potential market, you can quickly see whether your business idea is a money-making proposition.

Aside from asking around, one way to get a handle on dissatisfaction levels is to check out websites that allow consumers to register their feelings, such as www.reevoo.com, www.grumbletext.co.uk and www.resolver.co.uk. Then scour blogs where irate people can complain their hearts out. Check out websites such as http://thebloggerhub.com, www.totalblogdirectory.com and www.bloghub.com, which all operate blog-indexing services that can help you filter through the 70 million plus blogs and reach the few dozen that serve the sector you're interested in.

TIP The easiest way to fill a need that people are going to pay to have satisfied is to tap into one or more of these triggers:

- **Cost reduction and economy:** Anything that saves customers money is always an attractive proposition. Lastminute.com's appeal is that it acts as a 'warehouse' for unsold hotel rooms and airline tickets that you can have at a heavy discount.
- **Fear and security:** Products that protect customers from any danger, however obscure, are enduringly appealing. When Long-Term Capital Management (LTCM), one of America's largest hedge funds, collapsed and had to be rescued by the Federal Reserve at a cost of $2 billion, it nearly brought down the American financial system single-handedly. Two months later Ian and Susan Jenkins launched the first issue of their magazine, *EuroHedge*. At the time 35 hedge funds existed in Europe, but investors knew little about them and were rightly fearful for their investments. *EuroHedge* provided information and protection to a nervous market, and five years after its launch the Jenkinses sold the magazine for £16.5 million.
- **Greed:** Anything that offers the prospect of making exceptional returns is always a winner. *Competitors Companion* (www.competitorscompanion.com), a magazine aimed at helping anyone become a regular competition winner, was an immediate success. The proposition was simple: subscribe and you get your money back if you don't win a competition prize worth at least your subscription. The magazine provided details of every competition being run that week, details of how to enter, the factual answers to all the questions and pointers on how to answer any tie-breakers. It also provided the inspiration to ensure success with this sentence: 'You have to enter competitions in order to have a chance of winning them'.
- **Niche markets:** Big markets are usually the habitat of big business – encroach on their territory at your peril. New businesses thrive in markets that are too small even to be an appetite whetter to established firms. These market niches are often easy prey to new entrants because businesses have usually neglected, ignored or served them badly in the past.

## Checking the fit of the business

Having a great business idea and possessing the attributes and skills you require to start your own business successfully are two vital elements to get right before you launch. The final ingredient is to be sure that the business you plan to start is right for you.

Before you go too far, make an inventory of the key things that you're looking for in a business. These may include working hours that suit your lifestyle; the opportunity to meet new people; minimal paperwork; a chance to travel. Then match those up with the proposition you're considering. (Chapter 3 in Book 1 talks more about finding a good business fit.)

# Confirming Viability

An idea, however exciting, unique, revolutionary and necessary, isn't a business. It's a great starting point, and an essential one, but you have to do a good deal more work before you can sidle up to your boss and tell him exactly what you think of him.

The following sections explore the steps you need to take so that you don't have to go back to your boss in six months and plead for your old job back (and possibly eat a large piece of humble pie at the same time).

## Researching the market

However passionate you are about your business idea, you're unlikely already to have the answers to all the important questions concerning your marketplace. Before you can develop a successful business strategy, you have to understand as much as possible about your market and the competitors you're likely to face.

The main way to get to understand new business areas, or areas that are new to you at any rate, is to conduct market research. The purpose of that research is to ensure that you have sufficient information on customers, competitors and markets so that your market entry strategy or expansion plan is at least on target, if not on the bull's eye itself. In other words, you need to explore whether enough people are attracted to buy what you want to sell at a price that gives you a viable business. If you miss the target altogether, which you may well do without research, you may not have the necessary resources for a second shot.

The areas to research include:

- **Your customers:** Who may buy more of your existing goods and services and who may buy your new goods and services? How many such customers exist? What particular customer needs do you meet?
- **Your competitors:** Who are you competing with in your product/market areas? What are those firms' strengths and weaknesses?
- **Your product or service:** How can you tailor your product or service to meet customer needs and give you an edge in the market?
- **The price:** What do customers see as giving value for money, so encouraging both loyalty and referral?

  WARNING Make sure you don't set your price too low. Undercharging is one of the main reasons for early failure. Raising your price is always harder than lowering it.
- **The advertising and promotional material:** What blogs, newspapers, journals and so forth do your potential customers read, and what websites do they visit? Unglamorous as it is, analysing data on what messages actually influence people to buy, rather than just to click on a link, holds the key to identifying where and how to promote your products and services.
- **Channels of distribution:** How can you get to your customers and who do you need to distribute your products or services? You may need to use retailers, wholesalers, mail order or the

Internet. All have different costs, and if you use one or more, each wants a slice of your margin.
- **Your location:** Where do you need to be to reach your customers most easily at minimum cost? Sometimes you don't actually need to be anywhere near your market, particularly if you anticipate most of your sales coming from the Internet. If this is the case, you need to have a strategy to make sure that potential customers can find your website.

TIP Try to spend your advertising money wisely. Nationwide advertisements or blanketing the market with free CD-ROMs may create huge short-term growth, but little evidence exists that indiscriminate blunderbuss advertising works well in retaining customers. Certainly, few people using such techniques make any money.

## *Doing the numbers*

Your big idea looks as though it has a market. You've evaluated your skills and inclinations and you believe that you can run this business. The next crucial question is – can it make you money?

You absolutely must establish the financial viability of your idea before you invest money in it or approach outsiders for backing. You need to carry out a thorough appraisal of the business's financial requirements. If the numbers come out as unworkable, you can then rethink your business proposition without losing anything. If the figures look good, you can go ahead and prepare cash flow projections, a profit and loss account, and a balance sheet, and put together the all-important business plan. (Chapters 1 , 3 and 4 in Book 2 cover these procedures.)

REMEMBER You need to establish for your business:

- Day-to-day operating costs
- How long it will take to reach break-even
- How much start-up capital you need
- The likely sales volume
- The profit level you require for the business not just to survive, but also to thrive
- The selling price of your product or service

Many businesses have difficulty raising start-up capital. To compound this, one of the main reasons small businesses fail in the early stages is that they use too much start-up capital to buy fixed assets. Although some equipment is clearly essential at the start, you can postpone other purchases. You may be better off borrowing or hiring 'desirable' and labour-saving devices for a specific period. This obviously isn't as nice as having them to hand all the time, but remember that you have to maintain and perhaps update every photocopier, printer, computer and delivery van you buy, and they become part of your fixed costs. The higher your fixed costs, the longer it usually takes to reach break-even point and profitability. And time isn't usually on the side of the small, new business: it has to become profitable relatively quickly or it simply runs out of money and dies.

## Raising the money

Two fundamentally different types of money that a business can tap into are debt and equity:

- **Debt** is money borrowed, often from a bank, and that you have to repay. While you're making use of borrowed money, you also have to pay interest on the loan.
- **Equity** is the money that shareholders, including the proprietor, put in and money left in the business by way of retained profit. You don't have to give the shareholders their money back, but shareholders do expect the directors to increase the value of their shares, and if you go public they'll probably expect a stream of dividends too.

  If you don't meet the shareholders' expectations, they won't be there when you need more money – or, if they're powerful enough, they'll take steps to change the membership of the board.

Alternative financing methods include raising money from family and friends, applying for grants and awards, crowdfunding, and entering business competitions. Check out Chapters 1 and 2 in Book 2 for a review of all these sources of financing.

TIP The Financial Conduct Authority, a City watchdog, ordered all banks to publish statistics on complaints on their website from 31 August 2010. Throughout 2015, Lloyds received 85,505 complaints, Santander received 80,566, Barclays received 140,584 and HSBC received just 72,356. If your bank is high on this name-and-shame list (visit `www.the-fca.org.uk/firms/complaints-data/firm-level`, then click the link 'Downloadable table: Firm level complaints data'), get straight on to Chapters 1 and 2 in Book 2, where all aspects of raising money are covered.

## Writing up the business plan

A *business plan* is a selling document that conveys the excitement and promise of your business to potential backers and stakeholders. These potential backers can include bankers, venture capital firms, family, friends and others who may help you launch your business if they only know what you want to do. (Chapters 1 and 2 in Book 2 consider how to find and approach sources of finance.)

Getting money is expensive, time-consuming and hard work, but sometimes you can get a quick decision. One recent start-up succeeded in raising £3 million in eight days, after the founder turned down an earlier offer of £1 million made just 40 minutes after he presented his business plan. Your business plan needs to cover what you expect to achieve over the next three years. (Chapter 4 in Book 1 gives full details on how to write a winning business plan.)

TIP Most business plans are dull, badly written and frequently read only by the most junior of people in the financing organisations they're presented to. One venture capital firm in the United States went on record to say that in one year it received 25,000 business plans asking for finance and invested in only 40. Follow these tips to make your business plan stand out from the crowd:

- **Hit them with the benefits.** You need to spell out exactly what you do, for whom and why that matters. One such statement that has the ring of practical authority is: 'Our website makes ordering gardening products simple. It saves the average customer two hours a week browsing catalogues and £250 a year through discounts not otherwise available from garden centres. We have surveyed 200 home gardeners, who rate efficient purchasing as a key priority'.
- **Make your projections believable.** Sales projections always look like a hockey stick – a straight line curving rapidly upwards towards the end. You have to explain what drives growth, how you capture sales and what the link between activity and results is. The profit margins are key numbers in your projections, alongside sales forecasts. Financiers tend to probe these figures in depth, so show the build-up in detail.
- **Say how big the market is.** Financiers feel safer backing people in big markets. Capturing a fraction of a percentage of a massive market may be hard to achieve – but if you get it, at least the effort is worth it. Going for 10 per cent of a market measured in millions rather than billions may come to the same number, but the result isn't as interesting.
- **Introduce yourself and your team.** You need to sound like winners with a track record of great accomplishments.
- **Include non-executive directors.** Sometimes a heavyweight outsider can lend extra credibility to a business proposition. If you know or have access to someone with a successful track record in your area of business who has time on his hands, you can invite him to help. If you plan to trade as a limited company (Chapter 2 in Book 1 has details on legal structures) you can ask him to be a director, without specific executive responsibilities beyond being on hand to offer advice. But non-executive directors do need to have relevant experience or be able to open doors and do deals. Check out organisations such as Venture Investment Partners (`www.ventureip.co.uk`) and First Flight Placement's non-exec search site (`www.nonexecdirector.co.uk`) for information on tracking down the right non-executive director for your business.
- **Provide financial forecasts.** You need projected cash flows, profit and loss accounts, and balance sheets for at least three years ahead. No one believes them after Year 1, but the thinking behind them is important.
- **Demonstrate the product or service.** Financiers need to see what the customer is going to get. A mock-up is okay or, failing that, a picture or diagram. For a service, show how customers can gain from using it – that it can help with improved production scheduling and so reduce stock holding, for example.
- **Spell out the benefits to your potential investors.** Tell them that you can repay their money within *x* years, even on your most cautious projections. Or, if you're speaking to an equity investor, tell him what return he may get on his investment when you sell the business in three or five years' time.

# *Going for Growth*

Growth is as natural a feature of business life as it is of biological life. People, animals and plants all grow to a set size range and then stop. A few very small and very large specimens come to fruition, but the vast majority fit within a fairly narrow size band.

Businesses follow a similar formula: most successful new businesses, those that survive that is, reach a plateau within five to seven years. At that stage the business employs 5 to 20 people and has annual sales of between £250,000 and £1 million. Of the 5.4 million private businesses operating in the United Kingdom, it is estimated that fewer than 130,000 have a turnover in excess of £1 million a year. That doesn't represent a bad result. Viewed from the position of a one-man-band start-up, having a couple of hundred thousand pounds in sales each year is an admirable (and unusual) success.

The following sections demonstrate the great benefits of growth. (Books 5 and 6 contain more advice on how to make your business grow.)

## Gaining economies of scale

After a business starts to grow, you can spread overhead costs over a wider base. You can buy materials and services in larger quantities, which usually means better terms and lower costs. These factors generally lead to a higher profit margin, which in turn provides funds to improve the business, which in turn can lead to even lower costs. This *virtuous circle* can make a growing firm more cost-competitive than one that's cautiously marking time.

## Securing a competitive advantage

A new business can steal a march on its competitors by doing something vital that established businesses can't easily imitate. For example, a new hairdressing shop can locate where customers are, but an existing shop has to content itself with its current location, at least until its lease expires.

A growing firm can gain advantages over its slower competitors. For example, launching new products or services gives a firm more goods to sell to its existing customer base. This puts smaller competitors at a disadvantage, because they're perceived as having less to offer than the existing supplier. This type of growth strategy can, if coupled with high quality standards, lead to improved customer retention and this too can lead to higher profits – a further push on the momentum of the virtuous circle.

## Retaining key staff

The surest way to ensure that a business fails is to have a continual churn of employees coming and going. You have to invest valuable time and money in every new employee before he becomes productive, so the more staff you lose the more growth you sacrifice. Most employers believe that their staff work for money and their key staff work for more money. The facts don't really support this hypothesis. All the evidence is that employees want to have an interesting job and recognition and praise for their achievements. Chapters 5 and 6 in Book 3 explain how to get the best out of your staff.

By growing the business, you can allow key managers to realise their potential. In a bigger business you can train and promote your staff, moving them up the ladder into more challenging jobs where they can earn higher salaries on merit, so they stay with you rather than leaving for pastures new. And if employees are good at their jobs, they become more valuable the longer they stay with you. You save time and money on recruitment and you don't have to finance new managers' mistakes while they learn how to work in your business.

## *Gaining critical business mass*

Bigger isn’t always better, but a growing business has a greater presence in its market and that’s rarely a bad strategy. Large businesses are also more stable, tending to survive better in turbulent times. Bigger businesses do sometimes go bust, but smaller, ‘doing nicely’ businesses are far more likely to hit a bump in the road.

A small company often relies on a handful of customers and just one or two products or services for most or all of its profits. If its main product or service comes under competitive pressure or if a principal customer goes bust, changes suppliers or spreads orders around more thinly, the small company is in trouble. Expanding the number of customers so that you break out of the 80/20 cycle, in which 80 per cent of the business comes from 20 per cent of customers, is a sensible way to make the business safer and more predictable.

One-product businesses are the natural medium of the inventor, but they’re very vulnerable to competition, changes in fashion and technological obsolescence. Having only one product can limit the growth potential of the enterprise. A question mark hangs over such ventures until they can broaden their product base. Adding successful new products or services helps a business to grow and become a safer and more secure venture. This process is much like buying a unit trust rather than investing in a couple of shares. The individual shares are inevitably more volatile, but the spread over dozens of shares smoothes the growth path and reduces the chances of disaster significantly.

# Chapter 2

# Structuring Your Business

## IN THIS CHAPTER

**Finding the right business form**

**Protecting the crown jewels**

**Exploring options for help (and there are plenty of them)**

When you start your business, you have to make a decision more or less from the outset on the legal structure you're going to use to trade. Although that's an important decision, luckily, it's not an irrevocable one. You can change structures as your business grows – though not without some cost and paperwork.

The simplest structure is to make all the business decisions yourself and take all the risk personally. You don't have to shoulder all the responsibilities when you start a business, though most people initially do so. It may be great doing everything your way, at last, after the frustrations of working for someone else. But it can be lonely or even scary with no one with whom you can talk over the day-to-day problems and share the responsibility of decision making.

If your business requires substantial investment, or involves other people who have a more or less equal hand in the venture alongside you, then your decision about the legal structure of the business is a little more complicated.

In this chapter, you can find all the important factors to consider when deciding on the legal structure for your business. You also look at other areas of interest, from intellectual property to finding practical sources of help.

# *Going into Business*

Different legal frameworks exist for going into business and not all are equally appropriate for everyone.

Most small businesses in the UK start out as sole proprietorships; however, by the time they register for VAT (value added tax) – in other words, after they're up and running – their owners tend to seek the shelter of limited liability (see Table 2-1 .)

**TABLE 2-1 Popular Business Structures (%)**

| | *2009* | *2015* |
|---|---|---|
| Limited companies | 24.4 | 30.0 |
| Sole proprietorships | 58.2 | 62.0 |
| Partnerships | 13.5 | 8.0 |

One of the many factors you have to consider when deciding on the legal structure of your business is tax, including VAT and its implications, and you find out how to manage your tax position in Chapter 2 of Book 4.

But even more compelling reasons than tax may exist to choose one structure over another. Not all sources of finance are open to every type of business. When you know how much money you need to start up or to grow a business and what you need that money for, you're in a better position to make an informed choice about the best way to structure your business. If you need to raise large sums of money from the outset for research and development, for example, a limited company may be your only realistic option, with its access to risk capital. And if you're nervous about embroiling your finances with other people's, a partnership isn't an attractive option.

TIP

In general, the more money you require and the riskier the venture, the more likely it is that a limited company is the appropriate structure.

The good news is that you can change your legal structure at more or less any time. Even if you go the full distance and form a company and get it listed on the stock exchange, you can delist and go private. Richard Branson (Virgin) and Alan Sugar (Amstrad) have both gone down this route. That's not to say you'll find it easy to dissolve partnerships or shut down companies, but you can do it.

Both your accountant and your lawyer can help you with choosing your legal form. The types of business structures and some of their advantages and disadvantages are shown in Table 2-2 .

## TABLE 2-2 Pros and Cons of Various Organisational Structures

| ***Type of Entity*** | ***Main Advantages*** | ***Main Drawbacks*** |
|---|---|---|
| Sole proprietorship | Simple and inexpensive to create and operate. | Owner is personally liable for business debts. |
| | Profit or loss is reported on owner's personal tax return. | No access to outside capital. |
| | | Life of business is restricted to life of owner. |
| | | Limited potential for value creation. |
| General partnership | Simple and inexpensive to create and operate. | Partners are personally liable for business debts. |
| | Partners' share of profit or loss is reported on personal tax returns. | The business is dissolved when a partner dies. |
| | Potential for some value creation. | Only partners can raise outside capital. |
| Limited partnership | Non-managing partners have limited personal liability for business debts. | General partners are personally liable for business debts. |
| | General partners can raise cash without involving outside investors in the management of the business. | More expensive to create than a general partnership. |
| | Wider access to outside capital than for a sole proprietor. | Life of business is restricted to life of first partner to die. |
| | Potential for some value creation. | |
| Limited company | Owners have limited personal liability for business debts. | More expensive to create and run than partnership or sole proprietorship. |
| | Some benefits (such as pensions) can be deducted as a business expense. | Owners must meet legal requirements for stock registration, account filing and paperwork. |

| | | |
|---|---|---|
| | Owners can share out the profit and can end up paying less tax overall. | |
| | Access to full range of outside capital. | |
| | Business can live on after founder's death. | |
| | Potential for value creation. | |
| | Separate taxable entity. | |
| Co-operative | Owners have limited personal liability for business debts. | More expensive to create than a sole proprietorship. |
| | Owners' share of corporate profit or loss reported on personal tax returns. | Owners must meet legal requirements for account filing, registration and paperwork. |
| | Owners can use corporate loss to offset income from other sources. | Restricted access to outside capital. |
| | | Limited potential for value creation. |

## Settling on sole trader status

The vast majority of new businesses are essentially one-man (or one-woman) bands. As such, they're free to choose the simplest legal structure, known by terms such as *sole trader* or *sole proprietor* . This structure has the merit of being relatively formality free and having few rules about the records you have to keep. As a sole proprietor, you don't have to have your accounts audited or file financial information on your business.

REMEMBER If you're a sole trader, no legal distinction exists between you and your business. Your business is one of your personal assets, just as your house or car is. It follows that, if your business should fail, your creditors have a right not only to the assets of the business but also to your personal assets, subject only to the provisions of local bankruptcy rules (these rules often allow you to keep only a few absolutely basic essentials for yourself and family). You may be able to avoid the worst of these consequences by distancing your assets.

The capital to start and run the business must come from you, or from loans. In return for these drawbacks you can have the pleasure of being your own boss immediately, subject only to declaring your profits on your tax return and if necessary applying for a trade licence. (In practice, you'd be wise to take professional advice before starting up.)

Often people who start up on their own don't have enough money to buy into an existing operation, so the do-it-yourself approach is the only alternative.

## Forming a partnership

Unless you're the self-contained type who prefers going it alone, you have to work alongside other people to get your business going. Not just suppliers or employees or bankers and the like – everyone in business has to do that to a greater or lesser extent.

The upside of going into business with others is that you've got someone on your side to talk to when the going gets tough, and it will do from time to time. Two heads are often better than one. Also, you've got the advantage of extra physical and mental resources when they matter most, from the outset.

However, the equation isn't one-sided, unfortunately. With other people come other points of view, other agendas and the opportunity to disagree, argue and misunderstand.

### *Defining the advantages and drawbacks of a partnership*

A *partnership* is effectively a collection of sole traders or proprietors. Few restrictions apply to setting up in business with another person (or persons) in partnership, and several definite advantages exist:

- Pooling your resources means that you've more capital.
- You bring several sets of skills to the business, hopefully, instead of just one.
- If one of you is unable to work, the business can still carry on.

Partnerships are a common structure that people who started out on their own use when they want to expand.

The legal regulations governing partnerships in essence assume that competent businesspeople should know what they're doing. The law merely provides a framework of agreement, which applies 'in the absence of agreement to the contrary'.

REMEMBER In the absence of an agreement to the contrary, these rules apply to partnerships:

- All partners contribute capital equally.
- All partners share profits and losses equally.
- No partner shall have interest paid on her capital.
- No partner shall be paid a salary.
- All partners have an equal say in the management of the business.

All these provisions probably won't suit you, so you're well advised to get a partnership agreement drawn up in writing before opening for business.

Partnerships have three serious financial drawbacks that merit particular attention:

- If one partner makes a business mistake, perhaps by signing a disastrous contract without the others' knowledge or consent, every member of the partnership must shoulder the consequences. Under these circumstances, your personal assets can be taken to pay the creditors – even though the mistake was no fault of your own.
- As well as all the partners having unlimited personal liability for the debts of the partnership, they are 'jointly and severally' liable. So if one partner has no money, the other partners can be sued to pay that person's share of the debts as well as their own share.
- If a partner faces personal bankruptcy, for whatever reason, her creditors can seize her share of the partnership. As a private individual you aren't liable for your partner's private debts, but having to buy her out of the partnership at short notice rather than gaining an unwanted replacement may put you and the business in financial jeopardy.
- If one partner wants to quit the partnership, that partner will want to take the value of her part of the business with her. The remaining partner(s), in effect, has to buy out the partner who's leaving. The agreement you have on setting up the business should specify the procedure and

how to value the leaver's share, otherwise resolving the situation is costly. Several options for addressing this issue exist. Here are a few:

- The traditional route to value the leaver's share is to ask an independent accountant, but doing so is rarely cost effective. The valuation costs money and, worst of all, it's not definite and, consequently, room for argument remains.
- You can establish a formula; say, eight times the last audited pre-tax profits. This approach is simple but difficult to get right. A fast-growing business is undervalued by a formula using historic data unless the multiple (eight times or whatever) is high; a high multiple may overvalue 'hope' or goodwill, thus unreasonably profiting the leaver.

  TECHNICAL STUFF You can arrive at the multiplier by looking up the performance of a business similar to the one in question that's listed on a stock market. Such a business has a *P/E (price/earnings) ratio* published in both its accounts and the financial sections of national newspapers. You calculate the P/E ratio by dividing the share price into the amount of profit earned for each share. For example, if a business makes £100,000 profit and has 1,000 shares, the profit per share is £100. If the share price of that company is £10, its P/E ratio is 10 (100 divided by 10). So much for the science, now for the art. Because any business quoted on a stock market is big and its shares are liquid – that is, easy to buy and sell – such a business is considered more valuable than a small private company. In any event, private firms don't have a published share price. To compensate, you usually discount the P/E ratio by a third. So, using this example, a private firm in the same line of work as the one listed on a stock market would be given a P/E of approximately 7 (2⁄3 of 10).
- You can value the assets of the business and use that as a basis for dividing the spoils.

REMEMBER Even death may not release you from a partnership, and in some circumstances your estate can remain liable for the partnership's obligations. Unless you take public leave of your partnership by notifying your business contacts and legally bringing your partnership to an end, you remain liable indefinitely.

### *Looking at limited partnerships*

One option that can reduce the more painful consequences of entering a partnership is to have your involvement registered as a limited partnership. A *limited partnership* works as follows: one or more general partners must be involved with the same basic rights and responsibilities (including unlimited liability) as in any general partnership. In addition, you can have one or more limited partners who are usually passive investors. The big difference between a general partner and a limited partner is that the limited partner isn't personally liable for debts of the partnership so long as she plays no active part in the business. The most a limited partner can lose is the amount that she

- Paid or agreed to pay into the partnership as a capital contribution
- Received from the partnership after it became insolvent

The advantage of a limited partnership as a business structure is that it provides a way for business owners to raise money (from the limited partners) without having to take in new partners who are active in the business, or to form a limited company. Often, a general partnership that's been operating for years creates a limited partnership to finance expansion.

## Opting for a limited company

As the name suggests, in this form of business your liability is limited to the amount you contribute by way of share capital.

Two shareholders, one of whom must be a director, can form a limited company. You must also appoint a company secretary, who can be a shareholder, a director or an outside person such as an accountant or lawyer. You can buy a company 'off the shelf' from a registration agent and then adapt it to suit your own purposes. To do so involves changing the name, shareholders and articles of association, which takes a couple of weeks to arrange. Alternatively, you can form your own company.

A limited company has a legal identity of its own, separate from the people who own or run it. So, in the event of failure, creditors' claims are restricted to the assets of the company. The shareholders of the business aren't liable as individuals for the business debts beyond the paid-up value of their shares. This lack of liability applies even if the shareholders are working directors, unless of course the company has been trading fraudulently. In practice, the ability to limit liability is restricted these days because most lenders, including the banks, often insist on personal guarantees from the directors. Other advantages include the freedom to raise capital by selling shares.

Disadvantages include the legal requirement for the company's accounts to be filed for public inspection. Depending on the size of the company, these accounts may need to be audited and additional financial information filed.

REMEMBER When a company is first registered, it must send to Companies House ( www.companieshouse.gov.uk ), the place where all business details and accounts are kept, a copy of its memorandum and articles of association and Form 10, which contains the address of the company's registered office and details of its directors and company secretary. The directors' details are current names, any former names, date of birth, usual residential address, occupation, nationality and other directorships. For the secretary only, the name and address are required.

Companies House organises or attends a variety of seminars and exhibitions to support and advise businesses and to support new directors and secretaries. You can find details of these events on the events section of the Companies House website.

## Finding your way to franchising

Franchising can be a good first step into self-employment for those with business experience but no actual experience of running a business – often the case with those who are looking for something to do following a corporate career.

*Franchising* is a marketing technique used to improve and expand the distribution of a product or service. The franchiser supplies the product or teaches the service to you, the franchisee, who in turn sells it to the public. In return, you pay a fee and a continuing royalty, usually based on turnover. The franchiser may also require you to buy materials or ingredients from it, which gives it an additional income stream. The advantage to you is a relatively safe and quick way of getting into business for yourself, but with the support and advice of an experienced organisation close at hand.

The franchising company can expand its distribution with minimum strain on its own capital and have the services of a highly motivated team of owner-managers. Franchising isn't a path to great riches, nor is it for the truly independent spirit, because policy and profits still come from on high.

Although franchising eliminates some of the more costly and at times disastrous bumps in the learning curve of working for yourself, the system is not an easy way to riches. Ninety-one per cent of franchisees report they're trading profitably, but the number of those claiming high levels of profitability remains low, at around 4 per cent. Still, this performance compares well with the depth of the 1990 recession, when just 70 per cent of franchises traded profitably.

Some people make wild claims about how much safer a franchise is when compared to a conventional start-up. The long-established, big franchise chains are relatively safe – though a few big names have got into trouble – but the smaller and newer ones are as vulnerable as any other venture in the early, formative years.

## FACTS ABOUT FRANCHISING IN THE UK IN 2015

The following statistics are from the National Westminster Bank and the British Franchise Association annual franchise survey 2015 ( www.thebfa.org/about-franchising/franchising-industry-research ):

- The industry annual turnover is £15.1 billion (25 years ago, the figure was just £5 billion).
- Some 44,200 franchise outlets exist.
- The number of people employed in franchising is 621,000.
- Ninety-seven per cent of units are profitable (including new businesses).
- Twenty-nine per cent of franchisees own more than one outlet.
- One in five new franchisees in the last two years was under 30 years old.

### *Looking at franchise types*

Franchises can be clustered under these three main headings:

- **Business franchises:** These businesses typically have premises and employees. They require a higher level of investment, typically in the range of £20,000–£120,000, in stock, equipment and premises. Large numbers of business franchises are available in such areas as retailing, food services and business services such as high-street printing shops.
- **Investment franchises:** Here, you're talking about initial investments of over £120,000. Hotels and some of the larger and more-established fast-food outlets come into the top range of this category at around £750,000. The essence of this type of franchise is that the franchisee is unlikely to work in the business day to day. People operating investment franchises typically

operate several similar franchises in nearby areas.

- **Job franchises:** These franchises are where you're buying the rights to operate what's essentially a one-person business, such as plumbing, building services or a recruitment business. These franchises require a financial investment in the £7,000–£20,000 range and can be described as 'buying a job'. However, with backup in the way of training, customer leads, advertising and so on from the franchiser, these kind of franchises are suitable for someone with little capital but who has a specific area of expertise or is willing to be trained in it, such as cleaning or vehicle repair and maintenance services.

### *Defining a franchise*

A franchise agreement is just like any business contract, in that it sets out what each party is expected to do and what can happen if she doesn't.

The main ingredients of the franchise agreement are

- Permission to use a business name and so be associated with that bigger enterprise
- The right for the franchiser to set and enforce business and product standards, such as the use of ingredients, cooking processes, opening times, staff uniforms and so forth
- An obligation for the franchiser to provide help, training and guidance in all aspects of operating the business
- A definition of how the franchisee is to pay for the rights to operate the franchise; for example, royalties on sales, initial purchase fee, marketing levy, mark-up on goods and services provided, and so forth

The British Franchise Association (BFA) expects its members to follow its code of practice, and you can find out more on its website: `www.thebfa.org`.

### *Evaluating a franchise opportunity*

Although membership of the BFA and adhering to a code of practice are helpful, they're not a guarantee of success for your franchise. You should be looking for a shortlist of as many as six opportunities, acquiring as much advice as you can get from franchisers, from franchisees, from your bank and from other professional advisers.

Before deciding on a particular franchise, you must consult your legal and financial advisers, as well as ask the franchiser searching questions such as the following:

- Has the franchiser operated at least one unit for a year or so as a pilot unit in the UK? They must have done so before selling franchises to third parties. Otherwise, how can the franchiser really know all the problems, and so put you on the right track?
- What training and support is included in the *franchise package* , the name given to the start-up kit provided by the franchiser? This package should extend to support staff over the launch period and give you access to backup advice.
- How substantial is the franchise company? Ask to see the balance sheet (take it to your accountant if you can't understand it). Inquire into the track record of the directors (including their other directorships).

Sometimes a major clearing bank offers financial support to buy a particular franchise, which is an encouraging sign that the company is in good financial health. At least you know that the concept is tried and tested and, to some extent, the business is reputable. However, as with everything to do with starting up a business, the buck stops with you.

If you are at an early stage of looking at franchising as a business option, you can look at a website that pulls them together by industry type, has a brief profile of each and has an indication of the minimum investment required. This may help you narrow down the field a little before you start on a more detailed investigation. A site like Franchise Direct might help you ( www.franchisedirect.co.uk/topfranchises/ ).

You can meet franchisers and hear their pitch at one of the dozen or so franchise exhibitions held around the country each year. The BFA Diary page ( www.thebfa.org/events/seminars ) gives details of dates and venues.

## *Popping into a pop-up*

Temporary businesses have been around a long time, in one form or another – charity shops taking short-term leases on vacant high-street sites and car parks springing up on bomb sites awaiting planning consent are two of the most high-profile examples. But recently, these ventures have acquired their own brand name – *pop-ups* . Now, pop-ups house artists looking for temporary space to exhibit work, put on stage shows or create studio spaces. You can find pop-up gardens and parks, pop-up cinemas and theatre shows, and pop-up cafes and restaurants. London is probably the best market for pop-ups, with great media, a large tourist market and property in a constant state of flux – indeed, at the last count 74 pop-up restaurants existed in London, including one established by a Michelin-starred chef.

A number of websites are dedicated to the pop-up phenomenon, including www.londonpopups.com , www.popupspaceblog.com , http://popupcity.net , www.spareplace.com and www.theplacestation.org.uk . You can even find websites that focus on specific business needs, such as the following that offer insurance: www.popupspace.com and www.hencilla.co.uk . For national funding for pop-ups, www.fundingcentral.org.uk is a good starting point; search 'pop-up' and you find loads of sources of funds.

For a good look at the subject, read *Pop Up Business For Dummies* by Dan Thompson (Wiley).

# *Safeguarding Your Business Assets*

Nothing in business escapes the legal eye of the law, and protecting your assets from predators is no exception. You have patent and copyright issues to consider, for example.

A number of vital aspects of your business distinguish it from similar firms operating in or near to your area of operations. Having invested time, energy and money in acquiring these distinguishing factors, you need to take steps to preserve any benefits they provide you with. Intellectual property, often known as IP, is the generic title covering the area of law that allows people to own their creativity and innovation in the same way that they can own physical property. The owner of intellectual property can control and be rewarded for its use, and this control encourages further innovation and creativity.

TIP The following four organisations can help direct you to most sources of help and advice across the entire intellectual property field. They also have helpful literature and explanatory leaflets and guidance notes on applying for intellectual property protection:

- Intellectual Property Office ( www.ipo.gov.uk )
- European Patent Office ( www.epo.org )
- United States Patent and Trade Mark Office ( www.uspto.gov )
- World Intellectual Property Organization ( www.wipo.int )

The most common types of intellectual property are discussed in the following sections.

WARNING Protecting your intellectual property in the UK may not be of much help in a global world. This lack of protection can be a problem, particularly when it comes to patents where disclosure is a part of the application process. Your details and those of your idea will be included in the government's searchable patents journal when it publishes your application. Both are available to the public on its website and can be found using most standard search engines. The Intellectual Property Office provides guidance on getting worldwide protection for your IP at www.ipo.gov.uk/types/patent/p-manage/p-abroad/p-worldwide.htm .

## *Naming your business*

The main consideration in choosing a business name is its commercial usefulness. You want one that lets people know as much as possible about what your company does. So choose a name that conveys the right image and message.

You also want to make sure that you choose a name that does not restrict you in the future as you expand your business, perhaps into different international markets and different products. For example, a name like the London Sandwich Company may work very well to start off with, but if the business were to start selling ready-cooked meals in Glasgow, for instance, this name may not work quite so well.

Whichever business name you choose, it has to be legally acceptable and abide by the rules of the Business Names Act 1985. Detailed information on this subject is available from the Business Names section at the Companies House website. Go to www.companieshouse.gov.uk and click on 'Guidance' and then 'Incorporation and names'.

## *Looking at logos*

You don't have to have a logo for your business, but it can build greater customer awareness. A *logo* may be a word, typeface, colour or shape. The McDonald's name is a logo because of its distinct and stylistic writing.

REMEMBER Choose your logo carefully. It should be easily recognisable, fairly simple in design and able to be reproduced on everything associated with your business. As far as the law is concerned, a logo is a form of trademark (see 'Registering a trademark ', later in this chapter).

## Protecting patents

*Patents* can be regarded as contracts between inventors and the state. The state agrees with the inventor that if she's prepared to publish details of her invention in a set form and if it appears that she's made a real advance, the state then grants her a monopoly on the invention for 20 years. The inventor can use the monopoly period to manufacture and sell the innovation; competitors can read the published specifications and glean ideas for their research, or they can approach the inventor and offer to help to develop the idea under licence.

If you want to apply for a patent, you mustn't disclose your idea in non-confidential circumstances. If you do, your invention is already 'published' in the eyes of the law, and this fact can invalidate your application. Ideally, you write down the confidentiality of the disclosure you make in a confidentiality agreement, which the person to whom you're making the disclosure signs. The other way is to get your patent application on file before you start talking to anyone about your idea. You can talk to a chartered patent agent in complete confidence because they work under strict rules of confidentiality.

The process of filing an application and publishing and granting the patent takes two and a half years. The associated costs can be high: subject matter searches cost upwards of £500, validity searches from £1,000 and infringement searches from £1,500. The relevant forms and details of how to patent are available from the Intellectual Property Office at `www.ipo.gov.uk`, and you can find more information in Henri Charmasson's and John Buchaca's *Patents, Copyrights & Trademarks For Dummies* (Wiley).

## Registering a trademark

A *trademark* is the symbol by which the goods of a particular manufacturer or trader can be identified. It can be a word, a signature, a monogram, a picture, a logo or a combination of these.

To qualify for registration, the trademark must be distinctive, must not be deceptive and must not be capable of confusion with marks already registered. Excluded are national flags, royal crests and insignia of the armed forces. A trademark can only apply to tangible goods, not services (although pressure is mounting for this ruling to be changed). To register a trademark, you or your agent should first conduct preliminary searches at the Trade Marks section of the Intellectual Property Office (`www.gov.uk/topic/intellectual-property/trade-marks`) to check that no conflicting marks are already in existence. You then apply for registration on the official trademark form and pay a fee (currently £200, or £170 if you apply online). Registration is initially for ten years. After this time, you can renew for further periods of ten years at a time, with no upper time limit.

A professionally drafted patent application in the UK typically costs between £3,000 and £6,000.

Even a very simple case costs at least £2,000 to file. Also you should be aware that after you file a patent, you have to be prepared to defend in law around the world when it is infringed, which may prove far more expensive than the original filing. Some countries such as China and Russia are notorious at not recognizing patents and ripping off inventors.

TIP Check out http://virtuosolegal.com/legal-practice-areas/ip-infringement-explained/ for more on defending your IP.

If you've been using an unregistered trademark for some time and it can be construed that customers closely associate it with your product, the trademark has acquired a 'reputation' that gives it some protection legally, but registration makes it much simpler for the owner to have recourse against anyone who infringes the trademark.

## Detailing your design

You can register the shape, design or decorative features of a commercial product if it's new, original, never published before or – if already known – never before applied to the product you have in mind. Protection is intended to apply to industrial articles to be produced in quantities of more than 50.

REMEMBER Design registration only applies to features that appeal to the eye – not to the way the article functions.

To register a design in the UK, you apply to the Intellectual Property Office (www.gov.uk/apply-register-design) and send a specimen or photograph of the design plus a registration fee (currently £60 plus £40 for each additional design). To protect your design outside the UK, you generally have to make separate applications for registration in each country in which you want protection.

## Controlling a copyright

*Copyright* gives protection against the unlicensed copying of original artistic and creative works – articles, books, paintings, films, plays, songs, music and even engineering drawings. To claim copyright, the item in question should carry the symbol © with the author's name and date. No other action is required to take out copyright, if that copyright is relevant to your business. For further information, you can access the Copyright service through the Intellectual Property Office website (www.gov.uk/topic/intellectual-property/copyright).

Copyright doesn't last forever. Its duration depends on the type of copyright involved and can be anything from 25 to 70 years after the creator's death.

## Assisting inventors

Each year over 7,000 hopeful inventors in the UK file patents to protect their intellectual property from poachers. With a success rate of getting patented ideas to market of lower than 2 per cent, inventors need all the help they can get. Check out these organisations that can smooth out the path:

- **Institute of Patentees and Inventors ( www.invent.org.uk ):** The Institute has among its 1,000 members not only inventors but also patent agents, marketers and others who can provide expert advice to its membership on the complex issues relating to invention and innovation. These issues cover intellectual property rights and topics as diverse as originality searching, manufacturing practices, pricing practices, presentation techniques, funding and other subjects relating to the exploitation of an invention. The Institute also produces a journal titled *Future and the Inventor* at least once per annum and issues it to members. The journal contains information pertinent to inventors and details the forthcoming activities of the Institute. Annual membership is £70 with a joining fee of £15.
- **International Federation of Inventors' Associations (IFIA; www.ifia.com ):** This is a not-for-profit, non-governmental organisation created by seven European inventor associations in 1968. Its current membership comes from more than 88 countries. IFIA has web links to its 100 member organisations and to 345 other organisations of probable use to inventors, as well as details of reference books, guides, surveys, studies, conferences, seminars, workshops, expert group meetings, lectures, competitions and awards for inventions.
- **NESTA ( www.nesta.org.uk ):** NESTA is the National Endowment for Science, Technology and the Arts – an independent body with a mission to make the UK more innovative. It helps and invests in early-stage companies, informs policy and delivers practical programmes that inspire others to solve the big challenges of the future. NESTA aims to bring the best ideas, new flows of capital and talented people together, and encourage them to develop further.

# Getting Help

After you've made the decision to ignore all your doubters, to strike out on your own, raise loads of money, create a global brand and build an incredibly talented team, you may find that, much to your surprise, your superhero status doesn't mean that you have *all* the answers to *all* the questions *all* the time. But you know what? That's perfectly okay. If you're anything like most can-do people who decide to take the entrepreneurial plunge, you're your own harshest critic, and you demand the impossible of yourself.

*Help* is the hardest four-letter word to use when you're used to doing everything yourself, helping others first and putting your own needs aside, but getting ill, doing a so-so job versus a great job or, in the worst case scenario, losing it all because you were too proud to ask for help, is not a good plan. If you knew all the answers, not only would you be superhuman (and probably very annoying), but you'd also never learn anything.

Although your position can be a very lonely one at times, you absolutely don't have to do it all on your own. Whatever stage your business is at, however long you've been an entrepreneur and wherever you're located, help is at hand, and it comes in many forms.

## Accessing national and regional support

The United Kingdom is in the grip of high-growth SME (small- and medium-sized enterprise) fever – unemployment is the lowest it's been for decades, investments of all kind are up, SME exports are finally starting to pick up and British business is truly great. This means that all manner of government-backed, as well as privately funded, support organisations, growth schemes and business development programmes (including funding schemes) are queuing up to help you with your high-growth business. So much so that, at times, it may be a bit difficult to navigate the support landscape, but persevere (this book helps!). Aid is there for the taking, and once you get the hang of how it works, you can transform your business.

Some of the best – and arguably, sometimes the worst – help for your business is available from government-backed services, which are often free or very good value. These services are often paid for by your taxes, so you may as well make use of them. Many of them are national in scope, but some are for specific regions, communities, age groups or sectors, so you need to read the fine print.

TIP A good website that gives you an overview of the support landscape is www.gov.uk/browse/business . After you see what's available, you can choose the help that's right for you and your business.

WARNING If aid or advice is offered for free, it's important to check the credentials of the people giving the advice. Sometimes you get what you pay for. You need to apply the same process you'd use if you were paying for the help.

### *Using national government support*

The UK government is very aware that providing support to UK SMEs helps to strengthen the broader UK economy, and also puts a positive spin on whichever party is in office at the time of strong economic growth.

The national government has been operating all sorts of one-to-one, group advice, and training programmes and schemes for decades. In addition to meeting with advisers, attending workshops and taking part in exhibitions, trade missions and networking events, you may find times when actual financial support is also on offer.

Depending on the state of the economy, the government has been known to bolster non-financial support with pots of money in the form of grants, loans or co-funded equity to help fill the SME funding gaps. This money puts some much-needed cash back into the system to create jobs, boost exports and revive derelict areas.

You can expect to find government-backed support in some or all of these areas at one time or another:

- Deciding which business category is right for you
- Understanding your role and responsibilities as a director
- Determining whether you have the right skill set and personal characteristics to run a business
- Delivering business-improvement schemes and incentives
- Offering workshops and training schemes
- Locating sources of funding, including debt and equity

- Sponsoring grants, loans and equity co-funding
- Providing online and offline resources for all areas of your business

TIP Exactly what help is on offer varies from year to year, so you need to keep checking, and a good one-stop shop to use as a launch pad is the BIS (Department for Business Innovation & Skills) website at www.gov.uk/government/organisations/department-for-business-innovation-skills ). You can click through to all the different services and schemes, and go directly to the specific landing pages. The government's business finance website at www.gov.uk/business-finance-support-finder is also a very good source of information.

### *Benefitting from regional schemes*

In addition to support delivered on a national level, a number of programmes are designed for and delivered in specific regions that may have distinctive requirements for specialist support. These include:

- **Regional Growth Fund (RGF) ( www.gov.uk/understanding-the-regional-growth-fund ):** Launched in 2010, the Regional Growth Fund focuses on businesses and projects in all areas of the UK that create economic growth and sustainable employment. Investments are made alongside private sector investments. It supports businesses across all sectors and has invested £2.85 billion to help businesses grow since its inception.
- **Local Enterprise Partnerships (LEPS) and Enterprise Zones ( www.gov.uk/government/policies/local-enterprise-partnerships-leps-and-enterprise-zones ):** The LEPS are partnerships between local authorities and businesses. They help support economic growth through enterprise partnerships and Enterprise Zones. The UK has 39 local LEPS and 24 Enterprise Zones, and these provide a mix of support, advice and training as well as some limited funding. Enterprise Zones can take advantage of tax incentives and simplified local planning regulations and business property rates, which can be of significant value to a business.
- **England – National Enterprise Network (NEN) ( www.nationalenterprisenetwork.org ):** A national network of enterprise support organisations, in which members offer independent advice and support on starting or growing a business. Many of these organisations also have local loan funds or grant funds targeted at local businesses, especially for those in the start-up phase. These networks can be found in over 100 locations around the country, and their website has a handy interactive map to help you find your nearest member.
- **Scotland – Scottish Enterprise ( www.scottish-enterprise.com ):** Scotland's main economic and innovation investment agency, Scottish Enterprise helps innovative and ambitious businesses grow. You can get help in attracting investment, developing your organisation, promoting new products and services, exporting and more. Many of the services are organised via a network of Business Gateway offices across Scotland. You can find more information at www.bgateway.com/about/our-services .
- **Wales – Business Wales ( www.businesswales.gov.wales ):** Business Wales provides support for people starting, running or growing a business, and includes information, advice and guidance by phone, online or face-to-face at Business Wales Centres.

# Choosing small business associations

In addition to the government-backed or subsidised business support services, you can tap into a number of commercial or semi-commercial organisations that operate on a membership model. These organisations offer information and help with a range of topics including training, lobbying, networking, purchasing and similar services tailored to a specific industry, business size or geographical group. Although they may not offer direct funding programmes, you can tap into their membership network of finance and investment consultants and advisers and get help with creating an effective funding proposition for your business.

Business support networks are ready, willing and waiting to help you be the best you can be, and to shout from the mountain tops about your success in their case studies, reports and press releases. No question is too dumb; no inquiry too trivial. As the saying goes, 'if you don't ask, you don't get'.

The next sections talk about some of the more established and well-known of these organisations.

## The British Chambers of Commerce

The British Chambers of Commerce (BCC) is a membership-based organisation that caters for all shapes and sizes of business, at all stages and in all sectors. The BCC ( `www.britishchambers.org.uk` ) is a national network of accredited chambers that are managed and developed locally, and monitored at national level to ensure they meet quality standards and deliver results to members.

The BCC currently has 92,000 members in 52 accredited UK chambers, with additional members overseas.

Business resources, trading information, training courses, export introductions and networking all come with your membership, and the offerings often are tailored to your individual needs. The BCC offers fantastic savings on overheads to SMEs on a budget. Through its partnerships and affiliate offers, your business may save money on accommodation, print services, employment services and so on.

Through its chambers in other countries and links to UK exporting associations and expertise, the BCC is a terrific resource for SMEs that are first-time exporters, as well as for seasoned pros. The BCC can point you in the direction of the currently available export finance products, and help you successfully navigate the application process.

In addition to outbound services, the BCC also carries out surveys and consultations, and produces reports on the things that really matter to business owners and managers at the coal face. The BCC is a voice for business, influencing thought leaders, opinion makers and government policy.

## The Federation of Small Businesses

On its website at `www.fsb.org.uk` , the Federation of Small Businesses (FSB) describes itself as 'the UK's largest campaigning pressure group, promoting and protecting the interests of the self-employed and owners of small firms'. With hundreds of thousands of members across the UK, the FSB has been around since 1974 and offers a number of business services via its network of members for start-ups and growth businesses. Its business support services are run by experienced business owners and include business planning and environmental, legal and finance information.

TIP One of the potentially valuable services the FSB offers is a legal benefits package. Any business seeking funding requires a range of legal services and advice, and the FSB provides access to legal advice 24 hours a day, 365 days a year.

The FSB offers advice and information on employment documentation and specially priced insurance policies for members. It also offers its own loan service, which can be accessed at www.fsb.org.uk/benefits/finance/fsb-cash-advance.

Membership starts in the low hundreds of pounds and can rise to just under £1,000, depending on the size of your organisation and your membership category.

### *A few more strings to your bow*

Literally hundreds of organisations, associations, clubs and groups exist to help you start and grow your business. A few that may be able to meet some of your specific needs include the following:

- **British Franchise Association (BFA) (www.thebfa.org):** A voluntary self-regulatory organisation for the franchise industry, the BFA offers membership on a subscription basis with a number of categories and fee levels. It aims to promote the growth of franchising in the UK, and to provide members with a code of ethical standards by which to run their business. It started from humble beginnings in 1977 and now has thousands of members, and links to international franchising groups. It has useful information on the finance options available to franchisees, and includes consultants and advisers within its membership.
- **Business Association of Women Entrepreneurs (BAWE) (www.bawe-uk.org):** Run by women, BAWE is a long-standing peer group for women who want to generate revenue, grow their businesses, maximise their networking and learning opportunities, and challenge the male-dominated world of senior positions. Membership has tiers and starts at £80 and goes up to £260 per year.
- **Institute of Directors (IOD) (www.iod.com):** The IOD refers to itself as a 'professional institute that offers a wealth of insight and inspiration', but to the user it feels like a formal club headquartered in a prestigious central London location. With satellite offices around the country and in Europe, the IOD provides terrific networking opportunities and very useful business research and information. The business library holds useful information on the financial performance of businesses in a variety of sectors, publications that explain financial ratios, margins and calculations and other information you can use when formulating your business and financial plans. It also offers members specially priced director training courses and a topical monthly business publication. It charges annual membership fees in the hundreds of pounds, as well as an election fee upon joining.
- **Prowess Charter for Women in Business (www.charter.prowess.org.uk):** This organisation delivers female-friendly business advice and support through a network of members around the UK. It also hosts networking events, organises training and produces useful business guides, including a finance guide, tailored for women-led businesses. Membership is £175 per year for businesses with up to ten employees.
- **Social Enterprise UK (www.socialenterprise.org.uk):** The trade body for businesses with a

social or environmental focus, Social Enterprise UK helps with lobbying, networking, running events, training and development, and research for social- and environmental-minded businesses and their owners/managers. Through their networks and partnerships, you find information and events focused on raising finance for social enterprises. Membership categories and fees vary according to the type and size of your organisation.

- **Start-ups.co.uk (** www.startups.co.uk/financial-planning **):** This website is a free resource site that covers many finance and funding topics for start-up and scale-up businesses. The site has articles, practical guides, and hints and tips around raising finance. Topics include how to create a financial forecast, how to calculate your break-even, VAT and your small business, and so on.

## Entering incubators or accelerators

At first glance, the terms *incubator* and *accelerator* seem to be at odds with each other. An *incubator* conjures up thoughts of slow nurturing, and an *accelerator* has a kind of 'hurry up and get it done' feeling to it, which, in terms of minimising the risk surrounding an investment, are complete opposites. When it comes to the funds they bring to your early-stage business, both types of organisations are, in fact, on the same team. Both incubator and accelerators want you to get your business idea and product or service to market as quickly as possible, and both are prepared to put some money – as well as support, advice, mentoring, networking and infrastructure – on the table to help you get there.

The most common sector to benefit from taking part in incubator or accelerator programmes is technology, but that's changing – there are now food, health and fashion counterparts in the UK. In the United States, where this model of support has been around for longer, success stories from companies such as Airbnb (a website that connects vacationers with lodging) have made incubators and accelerators very popular among fledgling businesses seeking finance and support for their high-growth businesses. Accelerators are covered in more detail in Chapter 2 of Book 2. You can also find out more about incubators by contacting the UKSPA, the United Kingdom Science Park Association ( www.ukspa.org.uk ).

With more than 100 incubators and accelerators across Europe (and dozens in the UK) providing a springboard for innovative businesses in need of expert advice and funding, it's important that you get the right one for your business and that you're prepared to put in the time to get the best results.

The following sections look at what you need to think about when you're entering an incubator or accelerator.

### Finding the right type of incubator or accelerator

Whatever they call themselves – *incubators* , *accelerators* , *innovation hubs* , *hatcheries* – increasing numbers of closed-group, often niche-industry hothouses now exist in the market, each with its own set of aims and objectives.

Some are set up by corporate venture arms of big businesses looking to find the next big thing; some are initiated by private entrepreneurs or capital groups looking to get rich quicker by investing in and nurturing new or unexploited talent and ideas. They all want to encourage new business, more jobs and more investment, so they throw their support behind fledgling ventures.

Whatever the aim, the bottom line is that entrepreneurs get funding and expert help and advice in exchange for a share in their business, and there seems to be a growing appetite for this particular brand of meal ticket.

This desire to get on board is particularly evident in innovative or technology-based businesses that have the kernel of an idea and need to develop it, or that have developed the idea or product but have nowhere to turn for capital to get started. For these business owners, incubators and accelerators are an oasis in a very dry business support landscape.

Hundreds of incubators around the world graduate classes of thousands each year. Some graduates fly high when they step out of their cocoons, and others wither and die when the artificial life support is unplugged. No one’s really sure how many have gone which way, but incubators certainly seem to be gaining in popularity.

### *Applying to an incubator or accelerator*

The process of getting into an incubator or accelerator usually starts with an application that asks fairly standard questions about your business and its aims. Often, you also need to submit a basic business plan, or an extended executive summary (see Chapter 4 in Book 1), and sometimes a video saying why you should be accepted.

# Chapter 3

# Can You Do the Business?

**IN THIS CHAPTER**

**Figuring out what you want from a business**

**Checking out various ventures**

**Taking a skills inventory to identify any gaps**

Governments are keen to foster entrepreneurship: new businesses create jobs for individuals and increased prosperity for nations, which are both primary goals for any government. If those new firms don't throw people out of work when recessions start to bite, supporting them becomes doubly attractive.

But people – you included – don't start businesses or grow existing ones simply to please politicians or to give their neighbours employment. They have many reasons for considering self-employment. The idea of escaping the daily grind of working for someone else and being in charge of their own destiny attracts most people. But despite the many potential benefits, they face real challenges and problems, and self-employment isn't a realistic option for everyone.

The questions you need to ask yourself are: Can I do it? Am I really the entrepreneurial type? What are my motivations and aims? How do I find the right business for me? This chapter can help you discover the answers.

## *Deciding What You Want from a Business*

See whether you relate to any of the most common reasons people give for starting up in business:

- Being able to make your own decisions
- Having a business to leave to your children
- Creating employment for the family
- Being able to capitalise on specialist skills
- Earning your own money when you want
- Having flexible working hours
- Wanting to take a calculated risk
- Getting more in control of your destiny
- Having the satisfaction of creating something truly your own
- Being your own boss
- Working without having to rely on other people

The two central themes connecting all these reasons seem to revolve around gaining personal satisfaction – making work as much fun as any other aspect of life – and creating wealth – essential if an enterprise is going to last any length of time. Even when your personality fits and your goals are realistic, however, you have to make sure that the business you're starting is a good fit for your abilities. The following sections explore these reasons in more detail.

## *Gaining personal satisfaction (or, entrepreneurs just wanna have fun)*

No one particularly enjoys being told what to do and where and when to do it. Working for someone else's organisation brings all those disadvantages. When you work for yourself, the only person to blame if your job is boring, repetitive or takes up time that you should perhaps spend with family and friends is yourself.

Another source of personal satisfaction comes from the ability to 'do things my way'. Employees are constantly puzzled and often irritated by the decisions their bosses impose on them. All too often managers in big firms say that they'd never spend their own money in the way the powers that be encourage or instruct them to do. Managers and subordinates alike feel constrained by company policy, which seems to set out arbitrary standards for dealing with customers and employees in the same way.

WARNING The high failure rate for new businesses suggests that the glamour of starting up on their own seduces some people who may be more successful and more contented in some other line of endeavour.

Running your own firm allows you to do things in a way that you think the market and your employees believe to be right at the time.

## *Making money*

Apart from winning the lottery, starting your own business is the only possible way to achieve full financial independence. But it isn't risk-free. In truth, most people who work for themselves don't become mega-rich. However, many do and many more become far wealthier than they would probably have become working for someone else. You can also earn money working at your own pace when you want to and even help your family to make some money too.

REMEMBER Running your own business means taking more risks than you do if you're working for someone else. If the business fails, you stand to lose far more than your job. If, like most owner-managers, you opt for *sole trader status* – someone working usually on his own without forming a limited company (find more on business categories in Chapter 2 of Book 1) – you can end up personally liable for any business debts you incur. This can mean having to sell your home and other assets to meet your obligations. In these circumstances, not only will all your hard work have been to no avail, but you can end up worse off than when you started. Also, winding up a business is far from fun or personally satisfying.

These warnings aren't intended to discourage you, just to apply a reality check. The truth is that running your own business is hard work that often doesn't pay well at first. You have to be okay with those facts to have a chance of success.

## *Saving the planet*

Not everyone has making money as his sole aim when setting up in business. According to the government's 2015 figures, around 70,000 'social entrepreneurs' run businesses aiming to achieve sustainable social change, and trade with a social or environmental purpose.

They contribute £24 billion to the national economy and assist local communities by creating jobs, nearly a million at the last count. They also demonstrate value by providing ethical products and services using sustainable resources, and reinvesting a share of the profits back into society.

Ethical businesses have some unique advantages. For example, according to those running such firms, they can relatively easily attract and retain intelligent people. Over 70 per cent of students say that a potential employer's track record is an important factor in job choice. Customers also like ethical firms. According to a recent European Union survey on sustainable consumption, 86 per cent of those polled in the UK, Spain, Germany, Greece and Italy said that they felt very strongly about wanting things to be produced and marketed responsibly. They also blamed brands for not providing more environmentally and socially friendly products.

TIP

If you want to explore the prospects for starting a social enterprise, contact the School for Social Entrepreneurs (website: www.sse.org.uk ; tel: 020 7089 9120), which can help with specific and tailored support. If you need funds to start a social enterprise, contact Bridges Ventures (website: www.bridgesventures.com ; tel: 020 3780 8000), a venture capital firm with a social mission. Its founding principle is that all the funds it invests go to businesses with a clear social purpose, as well as aiming to achieve financial returns for investors.

# *Exploring Different Types of Business*

At one level all businesses are the same – they sell something to people who want to buy from them, while trying to make a profit. At another level, many very different types of business and ways of doing business exist, even within what superficially can appear to be very similar fields.

## *Selling to other businesses*

Business-to-business (B2B) enterprises, such as those selling market research, database management, corporate clothing, management consultancy, telemarketing or graphic design, involve one businessperson selling to another. The attractions are that you're dealing with other people who have a definite need and usually buy in relative large quantities and at regular intervals. For example, an individual may buy envelopes in packs of a dozen a few times a year, but a business buys scores, perhaps even thousands, and puts in an order every month. Corporate customers are harder to win, but are often worth more when you have them. Businesses usually invest more time in evaluating suppliers, so they are reluctant to change except for compelling reasons. An excessive price hike, a quality failure or a late delivery, for example, are reasons that might trigger a supplier review.

TIP Some downsides exist too. Business customers expect credit, perhaps taking between 60 and 90 days to pay up. If they go bust, they may owe money and take suppliers down with them. You may have to attend exhibitions to make your presence known, a costly and time-consuming process, or advertise in trade directories. Check out these websites to find out more about these topics: www.expodatabase.com and www.ukbusinessmate.co.uk .

## Opening all hours

Conventional shops, restaurants and the like have long opening hours and have to meet the expectations of increasingly savvy consumers, whose access to the Internet has made them aware of competitive prices as well as high specifications and standards of service. The upside of any form of retailing is that you're almost always paid up front. But just because you get the cash in your hand doesn't mean that you don't have to meet exacting standards. Customers are protected in their dealings in a myriad of ways, and if you fall short of their legal entitlement you can end up with a bigger bill than a simple cash refund. In conventional retailing, you also have to rent premises and stock them with products. Both factors can add significantly to your level of business risk.

Increasingly, new retail business start-ups are Internet-based. The website is in effect the shop window, and the stock of products being sold may even be in a warehouse owned by a third party. This keeps up-front costs down, but it also means you need to keep abreast of fast-changing technologies – the Internet, servers and computer hardware and software. (We look at these in more depth in Chapters 6 and 7 of Book 5.)

## Making products

One of the attractions of manufacturing is that you can have a greater degree of control over the quality, cost and specification of the end product than a retailer or wholesaler. But with those advantages come some hefty penalties. Factories, equipment, stocks of raw materials and employees are costly overheads. You have to incur these expenses well before you're certain of any orders – an unlikely way into business for someone without previous manufacturing experience and a deep wallet. Such owners also bear some significant risks towards their employees. The UK manufacturing sector reports 70,000 work-related accidents to the Health and Safety Executive each year. This figure includes over 20,000 major injuries such as fractures and amputations as well as around 16 fatalities. (For details, see www.hse.gov.uk/statistics/industry/manufacturing/manufacturing.pdf .)

A more likely route to manufacturing for a new business is subcontracting, where you work for a manufacturer on part of a product. The most common examples of subcontractors are plumbers, electricians and carpenters in building work, metal and plastic casing production and the like in civil engineering, and a range of activities in the information technology sector.

## Servicing customers

Service industries now dominate the British economy and account for around 70 per cent of gross domestic product (the value of the goods and services that the country produces). Services include financial intermediaries, hairdressing, real estate, computer services, research and development, education, health and social work, refuse disposal, recreational, cultural and sporting activities, and an extensive range of other activities where no physical goods play a major part in any transaction. In truth, however, most manufactured goods include a service element, though the business functions are often separated. For example, manufacturing businesses produce cars but are quite separate from the garage chains that repair those vehicles. But some manufacturers go further – Dell manufactures computers and also carries out delivery and many other service functions.

Service businesses require a high degree of personal involvement and as such call for founders who see their people skills as pivotal. In a nutshell, if you don’t enjoy understanding the intimate details of what makes customers tick and then going out of your way to meet their needs, running a service business may be of little appeal.

# Assessing Yourself

Business isn’t just about ideas and market opportunities. Business is about people too, and at the outset it’s mostly about *you* . You need to make sure that you have the temperament to run your own business and the expertise and understanding required for the type of business you have in mind.

The test at the end of this section requires no revision or preparation. You may find out the truth about yourself and whether or not running a business is a great career option or a potential disaster for you.

## Discovering your entrepreneurial attributes

Business founders are frequently characterised as people who are bursting with new ideas, highly enthusiastic, hyperactive and insatiably curious. But the more you try to create a clear picture of the typical small business founder, the fuzzier that picture becomes. In reality, the most reliable indicator that a person is likely to start a business is that he has a parent or sibling who runs a business – such people are highly likely to start businesses themselves. That being said, commentators generally accept some fairly broad characteristics as desirable, if not mandatory. Check whether you recognise yourself in the following list of entrepreneurial traits:

- **Accepting of uncertainty:** An essential characteristic of someone starting a business is a willingness to make decisions and to take risks. This doesn’t mean gambling on hunches. It means carefully calculating the odds and deciding which risks to take and when to take them.

  Managers in big business tend to seek to minimise risk by delaying decisions until they know every possible fact. They feel that working without all the facts isn’t prudent or desirable. Entrepreneurs, on the other hand, know that by the time the fog of uncertainty has completely lifted, too many people are able to spot the opportunity clearly. In fact, an entrepreneur is usually only interested in decisions that involve accepting a degree of uncertainty.
- **Driven to succeed:** Business founders need to be results-oriented. Successful people set themselves goals and get pleasure out of trying to achieve them as quickly as possible and then move on to the next goal. This restlessness is very characteristic.

- **Hardworking:** Don't confuse hard work with long hours. At times an owner-manager has to put in 18-hour days, but that shouldn't be the norm. Even if you do work long hours, as long as you enjoy them, that's fine. Enthusiasts can be very productive. Workaholics, on the other hand, have a negative, addictive, driven quality where outputs (results) are less important than inputs. This type of hard work is counterproductive. Real hard work means sticking at a task, however difficult, until you complete it. It means hitting deadlines even when you're dead-beat. It means doing some things you don't much enjoy so you can work your way through to the activities that you enjoy most.
- **Healthy:** Apart from being able to put in long days, successful small business owners need to be on the spot to manage the firm every day. Owners are the essential lubricant that keeps the wheels of small business turning. They have to plug any gaps when other people are ill or because they can't afford to employ anyone else for that particular job. They can't afford the luxury of sick leave. Even taking a week or so for a holiday is something of a luxury in the early years of a business's life.
- **Innovative:** Most people recognise innovation as the most distinctive trait of business founders. They tend to tackle the unknown; they do things in new and difficult ways; they weave old ideas into new patterns. But they go beyond innovation itself and carry their concept to market rather than remain in an ivory tower.
- **Self-disciplined:** Owner-managers need strong personal discipline to keep themselves and the business on the schedule the plan calls for. This is the drumbeat that sets the timing for everything in the company. Get that wrong and you send incorrect signals to every part of the business, both inside and out.

  WARNING A common pitfall for novice businesspeople is failing to recognise the difference between cash and profit. Cash can make people feel wealthy, and if it results in a relaxed attitude to corporate status symbols such as cars and luxury office fittings, failure may be just around the corner.

- **Totally committed:** You must have complete faith in your business idea. That's the only way in which you can convince all the doubters you're bound to meet along the route. But blind faith isn't enough. You have to back your commitment up with a sound business strategy.
- **Well rounded:** Small business founders are rarely geniuses. Some people in their business nearly always have more competence in one field than they can ever aspire to. But the founders have a wide range of ability and a willingness to turn their hand to anything that has to be done to make the venture succeed. They can usually make the product, market it and count the money, but above all they have the self-confidence that lets them move comfortably through uncharted waters.

## Working out a business idea that's right for you

Take some time to do a simple exercise that can help you decide what type of business is a good match with your abilities. Take a sheet of paper and draw up two columns. In the left-hand column, list all your hobbies, interests and skills. In the right-hand column, translate those interests into possible business ideas. Table 3-1 shows an example of such a list.

**TABLE 3-1 Matching a Business Idea to Your Skills**

| *Interest/Skills* | *Business Ideas* |
|---|---|
| Cars | Car dealer; repair garage; home tuning service; valet and cleaning/taxi |
| Cooking | Restaurant; home catering service; providing produce for home freezers |
| Gardening | Supplying produce to flower or vegetable shops; running a nursery or garden centre; landscape design; running a gardening service |
| Using a computer | Typing authors' manuscripts from home; typing back-up service for busy local companies; running a secretarial agency; web design; bookkeeping service; selling online |

Having done this exercise, balance the possibilities against the criteria that are important to you in starting a business.

## *Figuring out what you're willing to invest*

We're not just talking about money here. How much are you willing to invest of your time, your interest and your education, as well as your (and your investors') money?

### *Spending time*

How much time are you willing to devote to your business? That may sound a basic enough question, but different businesses done in different ways can have quite different time profiles. One business starter we know started a French bakery in London. He was determined to make his own croissants and did so for the first three months. But making his own bread meant starting work at 4 a.m. Because he didn't close until city workers passed his door on their way home, by the time he had cleaned up and taken stock, he was working a 15-hour day. But he still had the books to do, orders to place and plans to prepare. He eventually settled for a 10-hour day, which meant that he had to buy in ready-baked croissants.

### *Furthering your education*

You may have identified a market opportunity that requires skills over and above those that you currently have. There may, for example, be a gap in the market for Teaching English as a Foreign Language (TEFL), but to do so requires a month of intensive study plus a £1,000 course fee. Doing the TEFL certificate may involve you in more skill upgrading than you want to commit to, at the outset at least. So either you need to find customers who don't require you to have that qualification, or you need to think about a less educationally challenging business.

### *Keeping things interesting*

If you want to start a restaurant and have never worked in catering, get a job in one. That's the best way to find out whether you'll like a particular type of work. You may find that a restaurant looks very different from behind the chair as opposed to on it. Some businesses are inherently repetitive, with activities that follow a predictable pattern. If that suits you, fine, but if not, you may need to consider a business venture with a range of tasks.

## *Weighting your preferences*

After you have an idea of some of the businesses you may want to start, you can rank those businesses according to how closely they match what you want from starting a business. Go through the standards you want your business to meet and assign a weight between 1 and 5 to each, on a range from 'not important at all' to 'absolutely must have'. Next, list your possible business opportunities and measure them against the graded criteria.

Table 3-2 shows a sample ranking for Jane Clark, an imaginary ex-secretary with school-aged children who needs work because her husband has been made redundant and is looking for another job. Jane isn't in a position to raise much capital, and wants her working hours to coincide with her children's school day. She wants to run her own show and to enjoy what she does.

## TABLE 3-2 Weighing Up the Factors

| *Criteria* | *Weighting Factor* |
|---|---|
| Minimal capital required | 5 |
| Possibility to work hours that suit lifestyle | 5 |
| No need to learn new skills | 4 |
| Minimal paperwork | 3 |
| Work satisfaction | 2 |
| Opportunity to meet interesting people | 1 |

Because minimal capital was an important criterion for Jane she gave it a weight of 5, whereas meeting interesting people, being less important to her, was only weighted 1. Jane gave each of her three business ideas a rating in points (out of five) against these criteria. A secretarial agency needed capital to start, so she gave it only 1 point. Back-up typing needed hardly any money and she allocated 5 points to it. Her worked-out chart is shown in Table 3-3 .

## TABLE 3-3 Scoring Alternatives

| | | *Secretarial Agency* | | *Back-up Typing* | | *Authors' Manuscripts* | |
|---|---|---|---|---|---|---|---|
| *Criteria* | *Weighting factor* | *Points* | *Score* | *Points* | *Score* | *Points* | *Score* |
| Minimal capital | 5 × | 1 | 5 | 5 | 25 | 4 | 20 |
| Flexible hours | 5 × | 1 | 5 | 3 | 15 | 5 | 25 |
| No new skills | 4 × | 2 | 8 | 5 | 20 | 5 | 20 |
| Work satisfaction | 3 × | 4 | 12 | 1 | 3 | 3 | 9 |
| Minimal paperwork | 2 × | 0 | 0 | 4 | 8 | 5 | 10 |
| Meeting people | 1 × | 4 | 4 | 3 | 3 | 4 | 4 |
| **Total Score** | | | **34** | | **74** | | **88** |

The weighting factor and the rating point multiplied together give a score for each business idea. The highest score indicates the business that best meets Jane's criteria. In this case, typing authors' manuscripts scored over back-up typing, because Jane could do it exactly when it suited her.

# Chapter 4

# Preparing the Business Plan

**IN THIS CHAPTER**

**Understanding why you need a business plan**

**Creating your business plan**

**Utilising software**

**Preparing to pitch**

Perhaps the most important step in launching any new venture or expanding an existing one is the construction of a *business plan* . If the hundreds of millions of results that come from putting those words into Google are anything to go by, plenty of interest in the subject exists, and rightly so. Such a plan must include your goals for the enterprise, both short and long term; a description of the products or services you offer and the market opportunities you anticipate; and finally, an explanation of the resources and means that you need to achieve your goals in the face of likely competition.

Preparing a comprehensive business plan along these lines takes time and effort – the Cranfield School of Management estimates anywhere between 200 and 400 hours, depending on the nature of your business and how much data you've already gathered. Nevertheless, such an effort is essential if you're to both crystallise and focus your ideas, and test your resolve about starting or expanding your business.

The core thinking behind business plans and their eventual implementation is strategic analysis. The strategic analysis refines or confirms your view of what's really unique about your proposition. Or to put it another way, 'Why on earth would anyone want to pay enough for this to make me rich?'

After completion, your business plan serves as a blueprint to follow that, like any map, improves users' chances of reaching their destination.

## *Finding a Reason to Write a Business Plan*

A number of important benefits arise from preparing a business plan. All these benefits add up to one compelling reason: businesses that plan make more money than those that don't – and they survive for longer too.

REMEMBER The research on planning generally shows a positive relationship between planning and business performance. A 2015 study of research on the subject concluded that planning is 'vital for ensuring good corporate performance' and said that only those firms that practice some form of planning will survive. Businesses that follow a well-thought-out plan generally out-perform businesses with no plans or informal plans in every relevant category. Businesses that continue to update their plans throughout their life enjoy significantly more success than businesses that don't.

The following sections cover the key reasons for writing up your business plan.

## Building confidence

Completing a business plan makes you feel confident in your ability to set up and operate the venture because you've put together a plan to make it happen. It may even compensate for lack of capital and experience, provided of course that you've other factors in your favour, such as a sound idea and a sizeable market opportunity for your product or service.

## Testing your ideas

A systematic approach to planning enables you to make your mistakes on paper, rather than in the marketplace. One potential entrepreneur made the discovery while gathering data for his business plan that the local competitor he thought was a one-man band was in fact the pilot operation for a proposed national chain of franchised outlets. This discovery had a profound effect on his market-entry strategy!

Another entrepreneur found out that, at the price she proposed charging, she would never recover her overheads or break even. Indeed, *overheads* and *break even* were themselves alien terms before she embarked on preparing a business plan. This naive perspective on costs is by no means unusual. (This whole area is covered in Chapter 3 of Book 2.)

## Showing how much money you need

Your business plan details how much money you need, what you need it for, and when and for how long you need it.

Under-capitalisation and early cash-flow problems are two important reasons why new business activities fail, but you can reduce these risks of failure if you have a soundly prepared business plan. You can also experiment with a range of alternative viable strategies and so concentrate on options that make the most economic use of scarce financial resources.

To say that your business plan is the passport to sources of finance is an exaggeration. It does, however, help you to display your entrepreneurial flair and managerial talent to the full and to communicate your ideas to others in a way that's easier for them to understand so that they appreciate the reasoning behind your ideas. These outside parties can be bankers, potential investors, partners or advisory agencies. As soon as they know what you're trying to do, they're better able to help you.

## Providing planning experience

Preparing a business plan gives you an insight into the planning process. This process – not simply the plan that comes out of it – is itself important to the long-term health of a business. Businesses are dynamic, as are the commercial and competitive environments in which they operate. No one expects every event recorded on a business plan to occur as predicted, but the understanding and knowledge created by the process of business planning help prepare the business for any changes it may face, and so enable it to adjust quickly.

## *Satisfying financiers' concerns*

If you need finance, you should examine what financiers expect from you in order to succeed in raising those funds. (For more on approaching finance, see Chapter 1 of Book 2, Chapter 3 of Book 4 and Chapter 5 of Book 6.)

The media often claims that no shortage of money exists for new and growing businesses, and that the only scarce commodities are good ideas and people with the ability to exploit them. A potential entrepreneur may find this claim hard to believe. One major venture capital firm alone receives several thousand business plans a year (*venture capitalists* put up risk capital to invest in other businesses on behalf of institutions such as pension funds). It examines only 500 or so in any detail, pursues fewer than 25 to the negotiating stage and invests in only 6 of those.

To a great extent, the decision of whether to proceed beyond an initial reading of the plan depends on the quality of the business plan used in supporting the investment proposal. The business plan is your ticket of admission, giving you your first, and often only, chance to impress prospective sources of finance with the quality of your proposal.

To have any chance at all of getting financial support, your business plan must be the best that you can write and it must be professionally packaged. The plans that succeed meet all the following requirements.

### *Presenting evidence of market orientation and focus*

You need to demonstrate that you recognise the needs of potential customers, rather than simply being infatuated with an innovative idea. Financiers usually cold-shoulder business plans that occupy more space with product descriptions and technical explanations than with explaining how products are going to be sold and to whom. They rightly suspect that these companies are more of an ego trip than an enterprise.

But market orientation isn't enough in itself. Financiers want to sense that entrepreneurs know the one or two things their business can do best and that they're prepared to concentrate on exploiting these opportunities.

### *Demonstrating customer acceptance*

Financiers like to know that your new product or service is going to sell and is being used, even if only on a trial or demonstration basis. For example, the founder of Solicitec, a company that started out selling software to solicitors to enable them to process relatively standard documents such as wills, had little trouble getting support for his house-conveyancing package after a leading building society had tried and approved his product for its panel of solicitors. Solicitec went on to rebrand itself as Visualfiles in 2004, a term that better defined its real value to customers, and was then sold in 2006 to LexisNexis Butterworths. By that time the business had 450 clients and employed 150 people.

If you're only at the prototype stage, financiers have no immediate indication that, when made, your product is going to appeal to the market. They have to assess your chances of succeeding without any concrete evidence. Under these circumstances, you have to show that the problem your innovation seeks to solve is a substantial one that a large number of people are prepared to pay for.

As well as evidence of customer acceptance, you need to demonstrate that you know how and to whom your new product or service may be sold, and that you've a financially viable means of doing so.

### *Owning a proprietary position*

Exclusive rights to a product through patents, copyright, trademark protection or a licence help to reduce the apparent riskiness of a venture in financiers' eyes, because these things can limit competition, for a while at least.

However well protected legally a product is, marketability and marketing know-how generally outweigh 'patentability' in the success equation. A salutary observation made by an American professor of entrepreneurship revealed that less than 0.5 per cent of the best ideas contained in the *US Patent Gazette* in the last five years have returned a dime to the inventors.

### *Making believable forecasts*

Entrepreneurs are naturally ebullient when explaining the future prospects for their businesses. They frequently believe that the sky's the limit when it comes to growth, and that money (or rather the lack of it) is the only thing standing between them and their success.

When you're looking for venture capital, the providers of that capital are looking for rapid growth in your business. However, remember that financiers deal with thousands of investment proposals each year, and they already have money tied up in hundreds of business sectors. Therefore, they have a perception of what the accepted financial results and marketing approaches currently are for any sector. Any new company's business plan showing projections that are outside the ranges perceived as acceptable within an industry is going to raise questions in the investor's mind.

Make your growth forecasts believable – support them with hard facts where possible. If they're on the low side, approach the more cautious lending banker, rather than a venture capitalist. The former often sees a modest forecast as a virtue, lending credibility to the business proposal as a whole.

# *Writing Up Your Business Plan*

In the following sections, you find some guidelines to make sure that your plan attracts attention and succeeds in the face of fierce competition. More than 1,500 businesses start up in the UK each day, and many of those are looking for money or other resources that they're hoping their business plan can secure for them. Making your business plan the best it can be gives it a chance to stand out.

## *Defining your readership*

Clearly, a business plan is more effective if you write it with your readers in mind. Doing so involves research into the particular interests, foibles and idiosyncrasies of those readers. Bankers are more interested in hearing about certainties and steady growth, and venture capitalists are also interested in dreams of great things to come. *Business angels* , who put their own money at risk, like to know how their particular skills and talents can be deployed in the business.

You can benefit from carrying out your reader research before the final editing of your business plan, because you should incorporate something of this knowledge into the way you present it. You may find that you have to create slightly different versions of the business plan for different audiences. This differentiation makes readers feel that you're addressing the proposal to them rather than them just being the recipient of a 'Dear Sir or Madam' type of missive. However, the fundamentals of the plan remain constant.

## Creating the plan

The following sections help you prepare the plan itself.

### Deciding on content

No universal business plan format exists. That being said, experience has proved that certain styles are more successful than others. Following these guidelines results in an effective business plan that covers most requirements. Not every subheading may be relevant to you, but the general format is robust.

REMEMBER The following list contains the elements of an effective business plan, one that covers most requirements. You may not need all these sections, and you may need others to cover special requirements.

- The **cover** should show the name of your business, its website, Facebook/Twitter and any other relevant social media pages, physical address, phone number(s) (including a mobile), fax number(s), email address, contact name and the date on which this version of the plan was prepared. It should confirm that this document is the current view on the business's position and financing needs.
- The **title page** , immediately behind the front cover, should repeat the cover information and also give the founder's name, address and phone number. A home phone number can be helpful, particularly for investors, who often work irregular hours.
- The **executive summary** is ideally one page, but certainly no longer than two, and contains the highlights of your plan. Writing this summary is a difficult task, but it's the single most important part of your business plan. Done well, it can favourably dispose the reader from the outset. If you do the executive summary badly, or not at all, your plan may not get beyond the investor's mail room. This one page (or two pages) must explain
  - The current position of the company, including a summary of past trading results
  - A description of the products or services, together with details of any rights or patents and your competitive advantage
  - The reasons that customers need this product or service, together with some indication of market size and growth
  - A summary of forecasts of sales and profits, together with short- and long-term aims and the strategies that you'll employ
  - How much money you need to fund the growth and how and when the provider of that finance can benefit

TIP Write the executive summary only after you complete the business plan itself.

- The **table of contents** , with page numbers, is the map that guides readers through the business plan. If that map is obscure, muddled or even missing, you're likely to end up with lost or irritated readers who are in no mind to back your proposal. You should list and number each main section and give it a page number. Elements within each section should also be numbered: 1, 1.1, 1.2 and so on.
- Details of the **business and its management** should include a brief history of the business and its performance to date, if any, and details of key staff and their work experience, current mission, legal entity, capital structure and professional advisers. It's worth remembering that people invest in people just as much as they do the business, so if you've got a great team, shout out about it!
- The description of **products and services** , their applications, competitive advantage and proprietary position must include details of the state of readiness of new products and services, and development cost estimates.
- The **marketing** section should provide a brief overview of the market by major segment, showing size and growth. Explain the current and proposed marketing strategy for each major segment, covering price, promotion, distribution channels, selling methods, location requirements and the need for acquisitions, mergers or joint ventures, if any.
- Information on **management and staffing** should give details of current key staff and any recruitment needs. Include information on staff retention strategies, reward systems and training plans.
- The **operations** section describes how you make your products and services and fulfil orders, how you assure quality standards and how you can meet output.
- The summary of the key **financial data** includes ratios, together with a description of the key controls used to monitor and review performance.
- Include **financing requirements** needed to achieve the planned goals, together with how long you need the money for. Also demonstrate how the business would proceed using only internal funding. The difference between these two positions is what the extra money helps to deliver.
- **E-commerce** isn't just about selling goods and services online, though that's important. It covers a range of activities that you can carry out online to make your business more efficient. These solutions extend across the supply chain, from ordering your raw materials right through to after-sales service. It can incorporate market intelligence gathering, customer relationship management and a whole range of back-office procedures. Your business plan should show how you plan to tackle this area.
- Include **major milestones** with dates; for example, 'get prototype for testing by 20 December', 'file patents by 10 January' or 'locate suitable premises (by such and such a date)'.
- **Risk assessment** features high on your reader's list of concerns, so you should anticipate as many as you can, together with your solution. For example: 'Our strategy is highly dependent on finding a warehouse with a cold store for stock. But if we can't find one by the start date, we will use space in the public cold store 10 miles away. This isn't as convenient but it will do'.
- Detail an **exit route** for venture capitalists and business angels. Typically, they're looking to liquidate their investments within three to seven years, so your business plan should show them

how much money they can make and how quickly.

If you think that you need long-term investment (see Chapter 1 of Book 2 and Chapter 5 of Book 6 for more about equity financing), you need to say something about who may buy the business and when you may be able to launch it on a stock market.

- **Appendices** include CVs of the key team members; technical data; patents, copyrights and designs; details of professional advisers; audited accounts; consultants' reports; abstracts of market surveys; details of orders on hand; and so on.

TIP Appendices should be bound separately to the main business plan document. Doing it this way enables the reviewer to read both the business plan and the appropriate appendices alongside each other as opposed to going backwards and forwards each time.

### *Writing and editing*

The first draft of the business plan may have several authors and it can be written ignoring the niceties of grammar and style. The first draft is a good one to talk over with your legal adviser to keep you on the straight and narrow, and with a friendly banker or venture capitalist. This discussion can give you an insider's view of the strengths and weaknesses of your proposal.

When you've revised the first draft, then comes the task of editing. Here grammar, spelling and a consistent style do matter. The end result must be a crisp, correct, clear and complete plan no more than 20 pages long. If you're not an expert writer, you may need help with editing. Your local librarian or college may be able to put you in touch with a local editor. You can also use websites such as People Per Hour (`www.peopleperhour.com`) and Upwork (`www.upwork.com`) to help you find editors.

## CHECKING ON READABILITY

Many business plans are difficult to read. Two things make life hard for readers: long sentences and long words. Back in 1952, Robert Gunning, a business language expert, devised a formula called the Fog Index to measure just how tough a memo, letter or report is to read. Following are the four steps:

1. Find the average number of words per sentence. Use a sample at least 100 words long. Divide the total number of words by the number of sentences to give you the average sentence length.
2. Count the number of words of three syllables or more per 100 words. Don't count words that are capitalised; combinations of short, easy words like *bookkeeper* ; or verbs that are made up of three syllables by adding –ed or –es, like *created* or *trespasses* .
3. Add the two factors above and multiply by 0.4. This calculation gives you the Fog Index. It corresponds roughly with the number of years of schooling a person would require to read a passage with ease and understanding.
4. Check the results against this scale:
    - 4 and below, very easy: perhaps childish
    - 5 or 6, fairly easy: tabloid press, hard-selling letters
    - 7 or 8, standard: *Daily Mail* , most business letters and business plans
    - 9–11, fairly difficult: *The Times* , *Daily Telegraph* , good product literature

- 12–15, difficult: *The Economist* , technical literature
- 16 or above, very difficult: *New Scientist* – don't use in business plans

You can find a neat tool to calculate the Fog Index at http://gunning-fog-index.com . Just copy and paste the text you want checked into the box. Microsoft Word has its own readability statistics tool listed as an option when you select the spelling and grammar checker. As a guide you should aim for a Fog Index score of 7 or 8.

### Laying out and packaging

Your business plan should be visually appealing. Dense text, poor layout and clutter all serve to put your reader off. Create a favourable impression from the outset and you'll have the reader on-side. Here are the most important guidelines to make your written business plan stand out from the crowd:

- **Layout:** The reasoning behind good layout is to entice the reader to read your words and take the action you want – back your proposition. Give your text room to breathe by leaving plenty of white space around it. You can achieve this look by having wide margins and double line-spacing. Also use headings to break up the text and different font sizes and styles to differentiate between sections of your business plan.
- **Font:** Don't be tempted to use a fancy font in the body of the business plan. Stick to *serif* fonts, those with slight 'tails' on the letters that lead the eye from letter to letter. Times Roman, Book Antiqua and Century are good examples of texts that cause less eye strain. Sans-serif fonts like Arial, Calibri and Helvetica can cause eye fatigue, so save these fonts for headings, bullets or short paragraphs outside the main body of your text. Never use a font smaller than 10 point, unless your readership is mostly under 30. For over-70s, the recommended size to cause the least pain is 14 point. However, most business plan writers settle on 12 point as the preferred size.
- **Images and charts:** Pictures, images, charts, tables, graphs and pictures are powerful ways to convey large amounts of information quickly and efficiently. A picture, so the saying goes, is worth a thousand words – which is excellent because they usually only need the space of 200! Using images and charts is also a great way to break up the text and retain the reader's attention.

  TIP The University of Leicester has a useful guide to the role of text, tables, graphs and charts in presenting numerical data; visit www2.le.ac.uk/offices/ld/resources/numeracy/numerical-data .
- **Packaging:** Appropriate packaging enhances every product and a business plan is no exception. Most experts prefer a simple spiral binding with a clear plastic cover front and back. This presentation makes it easy for the reader to move from section to section, and it ensures that the document survives the frequent handling that every successful business plan is likely to get.

## Maintaining confidentiality

Finding an investor or a bank to lend to your business may take weeks or months. During that time, potential investors diligently gather information about the business so that they don't have surprises later about income, expenses or undisclosed liabilities. The business plan is only the starting point for their investigations.

If you and the prospective financiers are strangers to one another, you may be reluctant to turn over sensitive business information until you're confident that they're serious. (This issue isn't as sensitive with banks as it is with business angels and venture capital providers.) To allay these fears, consider asking for a confidentiality letter or agreement.

A confidentiality letter suffices in most circumstances. But if substantial amounts of intellectual property are involved, you may prefer to have a lawyer draft a longer, more formal confidentiality agreement, also known as a *non-disclosure agreement* (NDA). The confidentiality letter should be limited to their agreement to treat the information as strictly confidential and to use the information only to investigate lending or investing in the business, and to the other terms set out in the letter.

TIP The Intellectual Property Office provides a guide that can help you put together an NDA; see www.ipo.gov.uk/nda.pdf.

## Doing due diligence

Don't be surprised if the investor wants to find out about your personal financial status, job or business history. Investors are interested in your financial stability, your reputation for integrity and your general business savvy because they will, in effect, extend credit to you until you deliver them the interest or return they're expecting on their money. That's what the *due diligence* process is all about.

Usually, the due diligence process, which involves a thorough examination of both the business and its owners, takes several weeks if not longer. But that depends on how much money your plan calls for and from whom you're trying to raise it. (Raising finance is covered in Chapter 1 of Book 2 and Chapter 5 of Book 6.)

Accountants and lawyers usually subject your track record and the business plan to detailed scrutiny. You're then required to warrant that you've provided *all* relevant information, under pain of financial penalties. The cost of this due diligence process, rarely less than a big five-figure sum and often running into six, is borne by the firm raising the money, but is paid out of the money raised, if that's any consolation.

# Using Business Planning Software

You may consider taking some of the sweat out of writing your business plan by using one of the myriad software programmes on the market. You need to take care in using such systems, because the result can be a bland plan that pleases no one and achieves nothing worthwhile.

WARNING Don't buy a package with several hundred business plans covering every type of business imaginable. The chances are that the person who wrote the plans knows far less than you do about your business sector and can add little or no value to your proposition. Worse still, at least an even chance exists that the reader of your plan has seen the fruits of these packaged plans before and may be less than enthusiastic to see yet another one.

You may well find it beneficial to use the test shown in Figure 4-1 as an uncomplicated form of self-assessment, before becoming bogged down in number-crunching software.

By answering the questions below you will get some idea of how well your business plan is progressing. Score 1, 2, or 3 following the key below for each of the questions. Mark the options closest to your instincts, and be honest. Then add up your scores and refer to the results at the end of the questionnaire to see how you scored and to check the potential of your plan.
Whatever your score, remember that this type of self-assessment test is broad brush. It is designed only to give an indication of whether you have the basic attitude, instincts, and capabilities to make a success of launching a home-based business.
If your score is low, the chances are that you do not. If it is high, the opposite is true.

**1 = Made a start** **2 = Some data only** **3 = Comprehensive**

**Title page** ☐1 ☐2 ☐3

Name of business contact details, date of business plan, contents

**Executive summary** ☐1 ☐2 ☐3

Your details; summary of key strategies; why you are better or different; summary of profit projections; summary of financial needs

**The business and its management** ☐1 ☐2 ☐3

You and your team's relevant experience; business goals and objectives; legal structure of the business

**The marketing strategy** ☐1 ☐2 ☐3

Market segment analysis; pricing strategy; promotion plans; product mix and range; e-commerce strategy; location; selling strategy

**Management and staffing** ☐1 ☐2 ☐3

Staff numbers; roles and responsibilities; recruitment needs

**Operations** ☐1 ☐2 ☐3

What facilities and equipment are needed; what services will be brought in?

**Legal issues** ☐1 ☐2 ☐3

What intellectual protection do you have as a barrier to entry; what other legal issues affect your business?

**Financial forecasts** ☐1 ☐2 ☐3

Summary of financial projections; monthly cash flows; profit and loss accounts; balance sheets; break-even analysis

**Financing requirements** ☐1 ☐2 ☐3

How much money do you need; what is it needed for; how much money can you provide; how much do you need to raise from outside; what security is available?

***Results:***

**9 points or less:**
*You still have a lot more information to gather or decisions to make. No serious plan can be drawn up at this stage.*
**Between 10 and 20 points:**
*You have made progress, but still have a few gaps to fill. Concentrate your efforts on completing your plan.*
**More than 20 points:**
*Your plan is now complete and ready for final editing.*



**FIGURE 4-1:** Assessing the content of your business plan.

The following sections help you understand what software can and can't do, and where to start finding software to suit your needs.

## *Recognising the limits of software*

Good business planning software provides a useful structure to drop your plan into and may provide a few helpful spreadsheets and templates for financial projections and market analysis. It also provides a valuable repository for your work in progress as you assemble the evidence to convince yourself and others that your business can succeed.

What software doesn't do is write a convincing business proposition by itself. The maxim 'garbage in, garbage out' applies to business planning software just as it does to everything to do with computers.

The other danger is that you end up with spreadsheet solutions – numbers just pumped into the financials – without any evidence of the underlying logic to support them.

TIP Use business planning software as an aid and not a crutch. Go beyond that and you may end up worse off than if you'd started with a blank sheet of paper.

### Reviewing packages

This list tells you how to access business planning software packages and resources that have been used to good effect:

- **Lloyds Bank** offers Sage Business Planning free to anyone opening an account with them. See `http://businesshelp.lloydstsbbusiness.com/starting/business-plan`.
- **NatWest** bank's Business Planner is easy-to-use software that takes the hassle out of planning (it claims to offer a business plan in 60 seconds!). PC and Mac versions are available. On the website, you can also find tips on writing plans. Visit `https://app.natwestplanner.co.uk/signup` where you can find links to its business planning tools. You have to register to get access to them.
- **Bradley University, Illinois** , provides a range of business planning resources at `www.bradley.edu/academic/colleges/fcba/centers/turner/business/planning`.

## Presenting Your Plan

Anyone backing a business does so primarily because she believes in the management of the business. She knows from experience that things rarely go according to plan, so she must be confident that the team involved can respond effectively to changing conditions. You can be sure that any financier you're presenting to has read dozens of similar plans and is well rehearsed. She may even have taken the trouble to find out something about your business and financial history.

While the written plan has to be thorough, you need to be equally well prepared to present and defend your proposition in person. That involves thinking through how you'll come across when you make your pitch and how you'll react to the inevitable questions and criticism. Think about how people fare in the BBC's *Dragon's Den* programme, and be prepared.

### Starring in show time

What does any actor do before stepping onto a stage? Rehearse, rehearse, rehearse. As you rehearse, keep in mind the following guidance for how to really connect with your audience:

- **Be prepared.** You need to have every aspect of your business plan in your head and know your way around the plan forwards, backwards and sideways!

- **Create empathy between yourself and your listeners.** While you may not be able to change your personality, you can take a few tips on presentation skills. Eye contact, tone of speech, enthusiasm and body language all have a part to play in making a presentation successful (see the nearby sidebar 'Words, tone and body language ').
- **Dress to impress.** Wearing a suit is never likely to upset anyone. Shorts and sandals just set the wrong tone. Serious money calls for serious people and even the Internet world is growing up.
- **Explain your strategy in a business-like manner.** Demonstrate your grasp of the competitive market forces at work.
- **Provide the latest information** on sales, profits, product development, market tests or other evidence-based milestones. This information may be too current to include in your written plan, so here's the opportunity to add strength to your proposition.
- **Use visual aids.** If possible, bring and demonstrate your product or service. A video or computer-generated model or diagram can help bring your proposition to life.
- **Allow plenty of time for questions.** Listen to comments and criticisms carefully and make your replies to questions brief and to the point (avoid a defensive attitude when you respond). If your potential investors want more information, they can ask. This approach allows time for the many different questions that must be asked now or later, before an investment can proceed.
- TIP **Don't bluff.** If you are asked a question and you don't know the answer, be open and say something like 'That's a really good question and I don't have the answer to that to hand right now. Let me just make a note of that and I will get back to you with the information you need'. You can't be expected to know everything. Of course if you don't know the basics about your business, then you are in trouble.

## WORDS, TONE AND BODY LANGUAGE

Researchers have shown the value of each of the following in transmitting a message:

- **Words – 7 per cent:** Controlling the words is pretty easy when you prepare what you're saying carefully.
- **Tone – 35 per cent:** You must work hard to sound professional, interested, open to criticism and friendly, without being over-familiar.
- **Non-verbal or body language – 58 per cent:** Subconsciously, your body reveals what you really mean and think. So if you sit with your arms and legs crossed, you indicate a hostile attitude towards the other person and/or the message. If you sit with your arms folded with your thumbs up, you show a superior attitude. Leaning forward indicates interest or intimidation. People who rest their chin on one hand and have a finger in or near their mouth need reassurance. Those who rub their chins are thinking or making a decision and so aren't listening. You've limited control over your body language, but it really matters!

Check out *Voice and Speaking Skills For Dummies* by Judy Apps (Wiley), which is crammed full with useful information on everything you need to find your voice and communicate with confidence.

## Handling feedback

Don’t be surprised or disheartened if your business plan doesn’t get the reception you hope for. Even the most successful businesses can face a rocky start:

- Anita Roddick’s Body Shop proposition was turned down flat. It was only when a local garage owner, Ian McGlinn, advanced her £4,000 in return for 25 per cent of her company that she got the money to open a second shop; that deal netted him a couple of hundred million and her considerably more.
- Tim Waterstone’s business plan was turned down by bank after bank for being too ambitious. They wanted him to open a bookshop, but he’d set his sights on a chain. Eventually, he got backing and went on to build his chain, change the shape of book retailing in the UK and sell his business to his former employers, WH Smith, for £47 million.

Business plans are turned down for hundreds of reasons. Venture capitalists turn down 95 propositions for every 100 they receive. Why? Because they’re just not convinced that the plan has been well thought through and/or properly researched, and that the person or team are up to the task.

TIP These measures help you to take account of feedback and minimise the chances of ultimate rejection:

- Listen carefully to criticisms when you’re presenting your business plan. If you can tell at the time that you’re going to be turned down, ask two questions:
  - Why?
  - What can I do to improve my proposition?
- Go back over your business plan and see whether you can change anything to make the financial proposition look less risky. Cash pouring out in the early weeks and months on staff, offices and promotion without any significant sales revenue coming in is a big turn-off for financiers.
- Consider whether you’re pitching your proposition to the right audience. Risky technology-based ventures are more likely to appeal to venture capitalist and corporate venture firms. Bankers are more interested in putting up cash for tangible assets such as property and elements of working capital (including stock in trade), and financing quality customers taking credit. These funding options are covered in Chapter 1 of Book 2 and Chapter 5 of Book 6.

## Making an elevator pitch

You never know when the chance to present your business plan may occur – maybe even in a lift between floors (hence the term *elevator pitch* ). You need to know your business thoroughly, and it’s as well to have a 5-, 10- and 20-minute presentation ready to run at a moment’s notice.

One entrepreneur was given a chance to make a presentation of her business plan to the most powerful and influential person in her industry. This person could make or break new businesses, and frequently did. The opportunity was a ten-minute ride in a chauffeur-driven car between the Dorchester hotel and Harrods. She had no room to demonstrate the product, set up flip charts or

PowerPoint presentations, or involve the team. She had just enough space and time to convey a handful of powerful facts with passion, conviction and authority. Fortunately, the entrepreneur concerned had rehearsed her impromptu presentation and was completely prepared to seize the opportunity presented. Thanks to this successful pitch, she secured the rights to a product range crucial to the success of her business. Barely a decade after taking that fateful car ride, she had built and sold her business for £20 million.

# Chapter 5

# Establishing Your Starting Position

**IN THIS CHAPTER**

**Evaluating your company's situation**

**Identifying company strengths and weaknesses**

**Analysing your situation with a SWOT grid**

When you look into a mirror, you expect to see an image of yourself. When you listen to your voice on an answering machine, you expect to hear yourself. When you look at photos or home videos, you expect to recognise yourself. But how many times have you said

*That doesn't look like me.*

or

*Is that what I really sound like?*

An honest self-portrait – whether it's seeing and hearing yourself clearly or making objective statements about your own strengths and weaknesses – is tough to put together. Strengths and weaknesses have to be measured relative to the situations at hand, and a strength in one circumstance may prove to be a weakness in another. Leadership and snap decision making, for example, may serve you extremely well in an emergency. But the same temperament may be a liability when you're part of a team that's involved in delicate give-and-take negotiations.

You're going to face similar problems in seeing clearly and objectively when you take on the task of measuring your company's internal strengths and weaknesses. You may be surprised by how many businesses fail miserably at the job of objective self-analysis – companies that cling to a distorted image of the resources that they command and the capabilities that they bring to the marketplace.

In this chapter, we help you get a handle on your company's strengths and weaknesses in relation to the opportunities and threats that you face. First, we look at ways that you can spot potential strengths and weaknesses by making a list of your capabilities and resources. Next, we show you how the critical success factors in your industry come into play to determine which of those capabilities and resources are strengths and which aren't. Then we help you pull all the pieces of the puzzle together – your company's strengths, weaknesses, opportunities and threats – to create a complete picture.

## *Introducing SWOT Analysis*

You can examine your company's situation by using a tried-and-tested approach known as SWOT

– an acronym for *strengths* , *weaknesses* , *opportunities* and *threats* .

Your company’s strengths and weaknesses can’t be measured in a vacuum, of course. Your situation depends not only on your own capabilities and resources, but also on the opportunities and threats that arise from things beyond your control. Depending on the situations that you face, opportunities and threats appear, disappear and change all the time, and your company’s strengths and weaknesses change with them.

A thorough SWOT analysis is something that you complete more than once. In fact, you’ll probably carry out a SWOT review on a regular basis, depending on how fast your business environment, the industry and your own company change.

# Identifying Strengths and Weaknesses

Your company’s *strengths* are the capabilities, resources and skills that you can draw upon to carry out strategies, implement plans and achieve the goals that you’ve set for yourself. Your company’s *weaknesses* are any lack of skills or a deficiency in your capabilities and resources relative to the competition that may stop you from acting on strategies and plans or accomplishing your goals.

TIP To capture your own first impressions of your company, complete the Company Strengths and Weaknesses Questionnaire (see Figure 5-1 ). On the right side of the questionnaire, assess your capabilities and resources in each area. On the left side, rate the importance of these elements to your industry.

**Company Strengths and Weaknesses Questionnaire**

| *Importance to Industry* | | | *Business Area* | *Your Capabilities and Resources* | | | |
|---|---|---|---|---|---|---|---|
| *Low* | *Moderate* | *High* | | *Poor* | *Fair* | *Good* | *Excellent* |
| ❑ | ❑ | ❑ | Management | ❑ | ❑ | ❑ | ❑ |
| ❑ | ❑ | ❑ | Organisation | ❑ | ❑ | ❑ | ❑ |
| ❑ | ❑ | ❑ | Customer base | ❑ | ❑ | ❑ | ❑ |
| ❑ | ❑ | ❑ | Research & development | ❑ | ❑ | ❑ | ❑ |
| ❑ | ❑ | ❑ | Operations | ❑ | ❑ | ❑ | ❑ |
| ❑ | ❑ | ❑ | Marketing & sales | ❑ | ❑ | ❑ | ❑ |
| ❑ | ❑ | ❑ | Distribution & delivery | ❑ | ❑ | ❑ | ❑ |
| ❑ | ❑ | ❑ | Financial condition | ❑ | ❑ | ❑ | ❑ |



**FIGURE 5-1:** Company Strengths and Weaknesses Questionnaire.

You build on the outcomes of the questionnaire (Figure 5-1 ) in the upcoming sections to create a full picture of your company’s strengths and weaknesses.

## WHEN A STRENGTH BECOMES A WEAKNESS

For 30 years, Marks and Spencer hired its managers and supervisors from a talent pool that consisted almost exclusively of young men and women under 26 years of age who had graduated from its own Management Training Programme. M&S saw this hiring policy as being a major corporate strength, creating a remarkable sense of unity and consistency in its outlook and its internal culture. The company didn't need seminars and workshops to develop a common sense of values and vision; M&S values were built in from the beginning.

But that apparent strength was challenged in the late 1980s, when M&S's dominance and the stability of the entire retail sector were thrown up for grabs. Big food companies – Tesco, Sainsbury's and the others – encroached on M&S's traditional advantage in the quality pre-prepared food market sector, and no one at M&S seemed to have the slightest idea what that was going to mean. Many forward-thinking, out-of-the-mould managers had already been driven out of the straitjacket management line-up. Everyone in the organisation came from the same background and thought in much the same way. Nobody understood the speed or magnitude of the competitive threat – or the changes that were about to engulf the company.

What started as an important company strength turned into a serious weakness as M&S faced a battle for survival. The company began an aggressive campaign to hire managers with different backgrounds and diverse experience. It also moved to recruit its very top management from outside of its founding family members and time-serving employees in an all-out effort to prepare for a future in which fast-moving change and fierce competition became the name of the game.

# Frames of reference

After you complete the questionnaire shown in Figure 5-1 , you'll have an initial list of your company's strengths and weaknesses. In order to be objective, however, you need to go beyond first impressions and look at your business assets from more than one point of view. Different frames of reference offer the advantage of smoothing out biases that are bound to creep into a single viewpoint. They also offer the best chance of making your list as complete as it can be.

- **Internal view.** Draw on the management experience inside your company (use your own experience, or that of your friends and former co-workers if you're self-employed) to come up with a consensus on your business strengths and weaknesses. You may want to use the same people to get a sense of what's happened in the recent past as well. A little corporate history can show you how your company's strengths and weaknesses have changed over time – and how easily the organisation shifts gears.
- **External view.** Beware of becoming too self-absorbed in this analysis. It's important to step back and look around, using your competitors as yardsticks, if you can. All of your competitors do business in the same industry and marketplace that you do, and they're strong or weak in all the key areas that you're interested in. If your list is going to mean anything when the time comes to apply it to your own business situation, your strengths and weaknesses have to be measured against those of your competitors. (Flip to Chapter 6 in Book 1 for more information on the competition.)
- **Outside view.** Perhaps you identify company strengths that are assets only because your competitors haven't reacted yet, or maybe you ignore real weaknesses because everybody else has them, too. Every once in a while, you need an objective outside assessment of what's happening in your business. That's where consultants can actually be of some use. If you can't afford that kind of advice, make sure that you at least monitor the business press to get an outside view of what the experts are saying about your industry's key players. The organisations listed in Chapter 2 of Book 1 can generally help firms to set up an objective appraisal of the strengths and weaknesses of their business.

TIP If you don’t have a management team that can conduct a situation analysis, bring together one of the informal groups that you rely on for some of your other planning tasks. Ask the group members to spend a little time analysing strengths and weaknesses. Make sure that the group looks at your company’s situation from various perspectives, using the different frames of reference in the preceding list.

## *Capabilities and resources*

In putting together a list of your company’s capabilities and resources, cast your net as widely as possible. Look at your capabilities and resources in a systematic way, reviewing all the business areas introduced in the Company Strengths and Weaknesses Questionnaire (refer to Figure 5-1 ). In each area, try to identify as many capabilities and resources as possible by using different frames of reference. At the same time, assess how relevant each capability or resource is in helping you to carry out your plans and to achieve your business goals. You’re going to use this master list as raw material when the time comes to identify your company’s strengths and weaknesses. The following sections focus on the top two areas from Figure 5-1 .

### *Management: Setting direction from the top*

Your company’s management team brings together skills, talent and commitment. You want team members to find their direction from your company’s mission, vision and values statements, as well as from the business goals and objectives that you plan to achieve. Top-notch managers and owners are particularly important in industries that face increasing competition or fast-changing technologies. It’s hard to think of an industry that doesn’t fit into one of these two categories.

TIP Management is there to determine what your company’s going to do. Senior managers are officially charged with setting the direction and strategy for your company, but all managers indirectly set a tone that encourages certain activities and discourages others. Office products leader 3M, for example, gives its managers the freedom to be entrepreneurs in their own right, allowing the company to recognise and invest in new business opportunities with the speed and flexibility of much smaller rivals. The Body Shop, on the other hand, is recognised for its environmentally aware management. The company attracts highly qualified men and women who want to work in a business environment that values both personal and corporate social responsibility.

Following are some key questions to ask about the management and/or ownership of your company:

- How long have managers been around at various levels in your company? (Alternatively, what variety of experiences do you have as an owner?)
- Does your company plan to hire from the outside or promote from within?
- What’s the general tone set by you or your company’s management?
- Do you have a management development programme in place? (Alternatively, how do you plan to develop your own skills, if you’re a sole proprietor?)

- What backgrounds do you or your managers have?
- How is management performance measured in your company?
- How would you rate the general quality of your own skills or those of your management team?

### *Organisation: Bringing people together*

The people who make up your company and its workforce represent a key resource, both in terms of who they are and how they're organised. Although human resources are important to all companies, they're especially critical to companies in service industries – in which people are a big part of the product.

Your organisation starts with who your employees are, and that depends first on how well you select and train them. Beyond that, the work environment and your company's incentive systems determine who goes on to become a dedicated, hard-working employee and who gets frustrated and finally gives up. The setup of your organisation (how it's structured and how it adapts) can be just as important as your employees are when it comes to creating a company team – even a small one – that performs at the highest levels, year in and year out.

Pharmaceutical companies, for example, hire hundreds of new sales people annually. Are these companies really growing that fast? Of course not. But the industry routinely loses up to 60 per cent of new employees by the end of the third year, after investing heavily in their training. Why? The industry discovered one problem was in its selection process: too many new sales people were unsuited to the stresses and strains of hitting challenging sales goals and making upwards of 20 field calls a day, with hundreds of miles of driving thrown in. After all, the typical industry new sales person was a young university graduate. So the industry revised its hiring practices – candidate advertising, interviewing and psychometric testing – and has already started to see major improvements in both sales performance and longevity.

Following are some key questions about your organisation to consider:

- What words best describe the overall structure of your organisation?
- How many reporting levels do you have between a front-line employee and your CEO?
- How often does your company reorganise?
- What are your employees' general attitudes to their jobs and responsibilities?
- How long does the average employee stay with your company?
- How does your absenteeism level compare with industry benchmarks?
- How does your employee retention level compare with your that of your competitors?
- Does your company have ways to measure and track employees' attitudes and morale?
- What does your company do to maintain morale and positive job performance?

## *Critical success factors*

It's important to decide whether your capabilities and resources represent company strengths that you can leverage or weaknesses that you must correct as you plan for the future. To do that, you have to be clear about exactly what's important to your industry and the marketplace. The *critical success factors* are those capabilities and resources that absolutely have to be in place if you want your company to succeed over the long haul.

You may have already prepared a list of critical success factors. (If you haven't, take a look at

*Business Plans For Dummies* , written by Paul Tiffany, Steven Peterson and Colin Barrow and published by Wiley.) Along with a critical success factor list, you need a set of your company's capabilities and resources. You can use the two lists to construct a grid, which in turn allows you to compare your capabilities and resources with those that your industry thinks are important. In a perfect world, the lists would be identical, but that's seldom the case. The completed grid helps you identify your company's current strengths and weaknesses (see Figure 5-2 ).

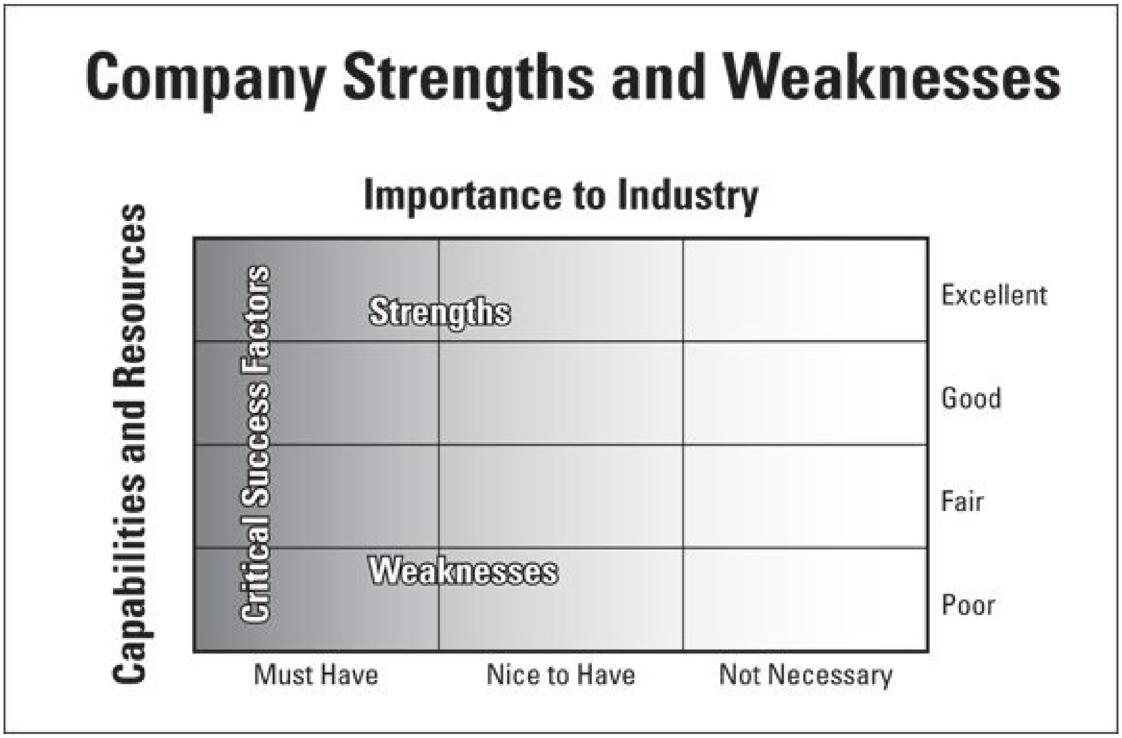




**FIGURE 5-2:** Compare your capabilities and resources with those that are thought to be critical success factors in your industry.

TIP To complete a grid similar to the one in Figure 5-2 , remember the following:

- The capabilities and resources that you place up and down the left side of the grid are in your industry's 'must have' category. They represent critical success factors.
- The capabilities and resources that you place in the top-left corner of the grid are critical success factors in which your company is good or excellent. They represent your company's strengths.
- The capabilities and resources that you place in the bottom-left corner of the grid are critical success factors in which your company is only fair or even poor. They represent your company's weaknesses.

WARNING It's easy to find some value in the capabilities that your company already excels in, and it's just as easy to underestimate the importance of things that your company doesn't do as well. Try to be as objective as you can here. It's hard to admit that you're devoting valuable resources to things that don't really matter, and it's equally hard to admit that you may be neglecting key business areas.

REMEMBER Keep in mind the following points as you review your company's CSFs, strengths and weaknesses:

- Different people have different ideas about what your company's strengths and weaknesses really are.
- By combining different viewpoints, both inside and outside your company, you get a more balanced picture.
- Be sure to assess your capabilities and resources in every area, from management to marketing to R&D to delivery.
- Strengths are strengths only if your capabilities and resources line up with the critical success factors in your industry.

# Analysing Your Situation in 3-D

You must be prepared to take advantage of your company's strengths and minimise your weaknesses, which means that you have to know how to recognise opportunities when they arise and prepare for threats before they overtake you. Timing is everything here, and it represents a third major dimension that you have to think about.

Chapter 6 of Book 1 discusses where major opportunities and serious threats come from. These dragons can come from almost any source and from all directions. They often change the rules of the game and can even alter critical success factors that you assumed would always be part of your industry. Many opportunities and threats are the direct result of change; others come directly from your competitors and the uncertainty that they introduce.

## Taking a glance at your competitors

It's a good idea to create strengths-and-weaknesses grids for two or three of your most intense competitors. (Turn to Chapter 6 in Book 1 for a look at exactly who your competitors are and what information you have about them.) You won't know as much about your competitors as you know about yourself, of course, so the grids aren't going to be as complete as they may be about your own company. But what you *do* know is going to tell you a great deal.

Comparing the strengths and weaknesses of competitors with your own can help you see where competitive opportunities and threats to your business may come from. Opportunities often arise when your company has a strength that you can exploit in a critical area in which your competition is weak. And you can sometimes anticipate a threat when the situation is reversed – when a competitor takes advantage of a key strength by making a move in an area where you're not as strong. Because the competitive landscape is always changing, plan to monitor these grids on a regular basis.

## Completing your SWOT analysis

A SWOT analysis (an analysis of your strengths, weaknesses, opportunities and threats) allows you to construct a strategic balance sheet for your company. In the analysis, you bring together all the internal factors, including your company's strengths and weaknesses. You then weigh these factors against the external forces that you've identified, such as the opportunities and threats that your company faces due to competitive forces or trends in your business environment. How these factors balance out determines what your company needs to do and when it needs to do it. Follow these steps to complete the SWOT analysis grid:

1. **Divide all the strengths that you've identified into two groups, based on whether they're associated with potential opportunities in your industry or with latent threats.**
2. **Divide all the weaknesses the same way – one group associated with opportunities, the other with threats.**
3. **Construct a grid with four quadrants.**
4. **Place your company's strengths and weaknesses, paired with industry opportunities or threats, in one of the four boxes (see Figure 5-3 ).**

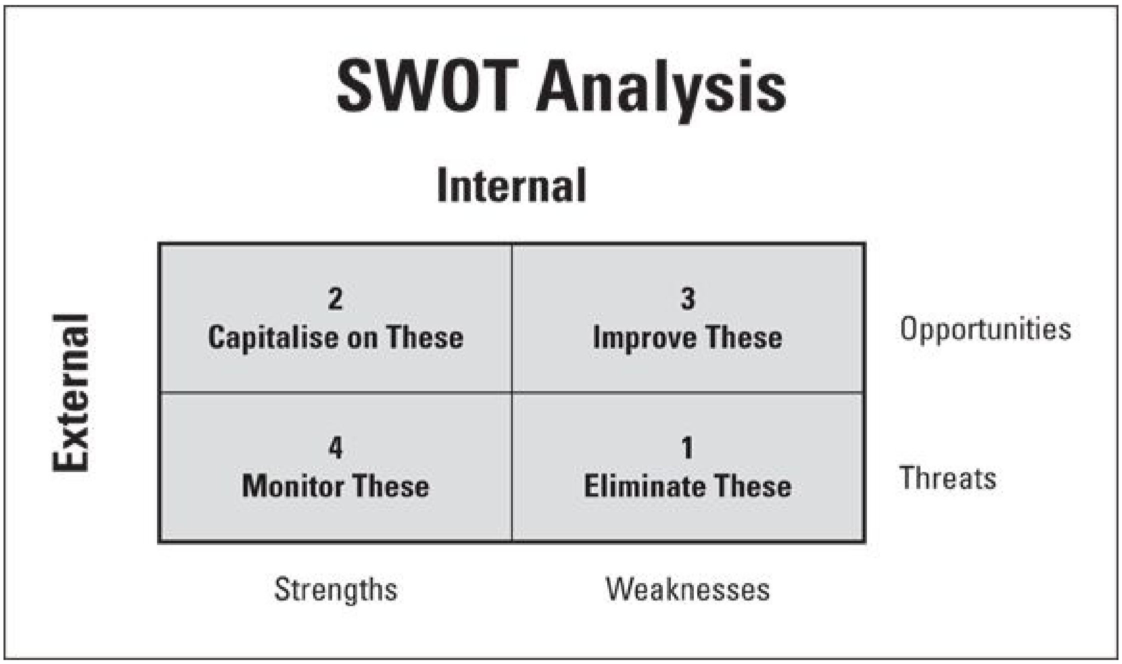


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**FIGURE 5-3:** The SWOT grid balances your company's internal strengths and weaknesses against external opportunities and threats.

The SWOT analysis provides a bit of useful strategic guidance. Most of it is common sense. First, fix what's broken. Next, make the most of the business opportunities that you see out there. Only then do you have the luxury of tending to other business issues and areas. Be sure to address each of the following steps in your business plan:

1. **Eliminate any company weaknesses that you identify in areas in which you face serious threats from your competitors or unfavourable trends in a changing business environment.**
2. **Capitalise on any business opportunities that you discover where your company has real strengths.**
3. **Work on improving any weaknesses that you identify in areas that may**

**contain potential business opportunities.**

4. **Monitor business areas in which you’re strong today so that you won’t be surprised by any latent threats that may appear.**

REMEMBER Change is the only constant in your business, your industry and your marketplace. Constant change means that you can’t complete your SWOT analysis only once; you have to revise the grid regularly as your company grows and as the environment around you changes. Think of your SWOT analysis as being a continuous process – something that you do repeatedly as an important part of your business-planning cycle. Keep in mind the following:

- To identify potential opportunities and threats, take a close look at the strengths and weaknesses of your competitors.
- A SWOT grid places your strengths and weaknesses in the context of opportunities and threats, and thereby tells you what to do.
- The SWOT strategy is to eliminate weaknesses in areas where threats loom and also to capitalise on strengths in areas where you see opportunities.

# Chapter 6

# Researching Your Customers and Competitors

**IN THIS CHAPTER**

**Targeting and reaching prospective customers**

**Understanding why customers buy**

**Looking at your product**

**Getting a handle on your competitors**

**Evaluating your market share**

**Working out what market research is worth to you**

Every marketer mulls over the same questions: Who are my customers? How did they hear about me? Why do they buy from me? How can I reach more people like them? Who am I going to be competing against? How much is it worth to find the answers?

Successful businesses use the answers to these questions to influence every product design, pricing, distribution and communication decision they make. This chapter focuses on the person with an interest in your product or service and an open wallet and the person who is also after a slice of the action.

Whether your business is starting up, running at full pace or in need of a turnaround, you can use the information in this chapter to get in tune with the customers who can make or break your bottom line:

- If your business is doing well, use this chapter to create a profile of your best customers so that you can attract more just like them.
- If your business feels busy but your sales and profits are weak, this chapter can help you differentiate between the customers who are costing you time and money and the ones who are making you money – so you can direct your marketing efforts at the moneymakers.
- If your sales have hit a frustrating plateau – or worse, if they're sliding downhill – you need to get and keep more customers, full stop. That means knowing everything you can about who is buying products or services like the ones you're selling, who your competitors are that they're buying them from and what it will take to make those potential customers buy from you (instead of from your competitors).

REMEMBER Business leaders don't work for themselves; they work for their customers.

## *Anatomy of a Customer*

Understanding who's who among your clientele is called *market segmentation* – the process of breaking down your customers into segments that share distinct similarities.

If people are going to actually use or consume your product or service themselves (a B2C relationship, to use the marketing buzz term), then getting a handle on them is reasonably straightforward. Here are some common market segmentation terms and what they mean:

- **Geographics:** Segmenting customers by their physical locations to determine the regions, counties, countries, postcodes and census districts where current and, therefore, likely prospective customers live.
- **Demographics:** Segmenting customers into groups based on factors such as age, sex, race, religion, education, marital status, income and household size.
- **Psychographics:** Segmenting customers by lifestyle characteristics, behavioural and purchasing patterns, beliefs, values, and attitudes about themselves, their families and society.
- **Geodemographics:** A combination of geographics, demographics *and* psychographics. Geodemographics, also called *cluster marketing* or *lifestyle marketing* , is based on the age-old idea that birds of a feather flock together – that people who live in the same area tend to have similar backgrounds and consuming patterns. Geodemographics helps you target your marketing efforts by pinpointing neighbourhoods or geographic areas where residents share the age, income, lifestyle characteristics and buying patterns of your prospective customers.

But what about a B2B business (a company that sells primarily to other businesses or organisations)? If you are segmenting business markets, you could divide the market by

- **Industry sector:** What they do, public or private, size and location.
- **Buying patterns:** How they place their orders – size and frequency.
- **Behaviour:** Loyalty and attitude to risk.
- **Operations:** What technologies they use and how your products fit in with these technologies.

TIP Although much of what follows works for both B2C and B2B companies, just be aware that you are looking at segmentation through slightly different eyes. In B2C you are targeting both the buyer and consumer in the same person. In B2B there are usually both a buyer and a consumer who are different people. That means in B2B, you have to get to both the buyer and the consumer and work out how the two are different and interact. When you read terms like *people* , be prepared to change the word to *business* to see how it may apply to a B2B company.

The following sections look at your customers in more detail, starting with how you can collect customer data.

## Collecting customer information

People with the profile of your current customers are apt to become customers as well. That's why target marketing starts with customer knowledge. Small businesses fall into two groups: those with customer databases and those that serve customers whose names and addresses they never capture.

A medical clinic or auto repair shop falls into the first group. A sandwich shop or convenience store likely falls into the second group, although even those who don't automatically collect customer names and information can use loyalty schemes or competitions to collect valuable customer data.

The more you know about current customers, the better prepared you are to target and reach more people just like them. Start by doing some research.

### *Do-it-yourself fact-finding*

You can get a good start on conducting customer research without ever walking out the front door of your business. Start by focusing on information that you can collect through customer communications and contacts:

- **Collect addresses from shipping labels and invoices in order to group customers by location and purchase type.**
- **Monitor the origin of incoming phone calls.** When prospects call your business, find out where they're from and how they found you.

  WARNING Keep questions conversational and brief. Remember that customers are calling to *receive* information, not to become research subjects.

  - Use the caller identification feature on your phone to collect the incoming phone number prefix and area code, which enables you to track the geographic origin of customer calls.
  - Your phone service provider may be able to furnish you with lists of incoming call area codes or dialling prefixes for your reference.
- **Track responses to ads and direct mailers.** Include a call to action that inspires a reaction. When prospects respond, collect their addresses and other information to build not just a database but also an enquiry profile.
- **Study web reports to discover more about visitors to your website.** Work with the firm that hosts and manages your site to discuss available reports and how to mine the information you collect. Also, enter your web address into Google Analytics (www.google.com/analytics) to access data about site visitors, including their geographic origin, language and other facts.

  WARNING Be aware, though, that some Internet providers hide the geographic origin of users under the label 'undefined', and others bundle all traffic, which means you may see a good many site visitors from a distant location not relevant to your business.

Beyond studying tell-tale signs for the geographic origins of your business, put your small business advantage to use and actually talk with your customers, using these approaches:

- **Survey your customers.** Use online survey services available through sites such as www.surveymonkey.com, which allows you to choose from a range of templates and collect responses for up to ten questions from 100 people for free. Or you can create and email a survey to customers on your own or use contest forms to collect information.

TIP If your business attracts foot traffic, consider surveying customers in person. Whether you survey all customers or limit your effort to every *n* th customer (every tenth one, for example), keep the question period short, keep track of responses and time interviews so that your findings reflect responses from customers during various days and weeks.

When surveying customers and collecting data, keep these cautions in mind:

- Establish and share your company's privacy policy to assure customers that you respect and protect the information you collect.

  If you collect information online, visit the website of the Information Commissioner's Office (ICO) at http://ico.org.uk for guidance on data protection.
- Don't risk treating long-standing customers like strangers to your business. Instead of asking, 'Is this your first visit?', try to get at the answer indirectly, asking questions such as, 'Have you been here since we moved the reception area?' or 'Have you stayed with us since we started our wine reception?'

  TIP Savvy restaurateurs don't have to ask at all. They know that if a customer asks for directions to the bathroom, that person is likely a first-time patron. On the other hand, a waiter who overhears a customer recommending a certain menu item to a tablemate can make a safe guess that the patron is a repeat guest.
- Realise that although informal studies aren't statistically valid, they can provide interesting insights that help you better understand an informally assembled cross-section of your clientele.

- **Observe your customers.** Without asking a single question, you can find out a lot from observing customer behaviour. What kinds of cars do your customers drive? How long do they spend during each visit to your business? Do they arrive by themselves or with others? Do those who arrive alone account for more sales or fewer sales than those who arrive accompanied by others? Where do they pause or stop in your business? Your observations help you define your customer profile while also leading to product decisions, for example:
  - A small theme park may find that most visitors stay for two hours and 15 minutes, which is long enough to want something to eat or drink. This can lead to the decision to open a café or restaurant.
  - A retailer may realise that women who shop with other women spend more time and money, which may lead to a promotion that offers lunch for two after shopping on certain days of the week.
  - A hotel may decide to post a restaurant display at a hallway entry where guests frequently pause.

### *Calling in the pros*

Doing it yourself doesn't mean doing it all on your own. As you're conducting customer research, here are places where an investment in professional advice pays off:

- **Questionnaires:** Work out what you want to find out and create a list of questions. Then consider asking a trained market researcher to review your question wording, sequence and format. After your questions are set, you can distribute the survey on your own or with professional help. Whatever you decide, get someone with design expertise to prepare a questionnaire that makes a good visual impression on your business's behalf. Include a letter or introductory paragraph explaining why you're conducting research and how you're going to protect the privacy of answers.
- **Phone or in-person surveys:** Professional researchers pose questions that don't skew the results. When you ask the questions yourself, if you're not careful you may let your biases, preconceptions and business pressures leak through and sway responses. Plus, customers are more apt to be candid with third parties. (If you need proof, think of all the things people are willing to say behind someone's back that they'd never say to the person's face. The same principle applies in customer research.)
- **Online surveys:** Professional online survey tools are free unless you want to reach particularly large survey groups, in which case reasonably priced packages are available. If only a portion of your clientele is active online, be sure to accompany online surveys with off-line surveys in order to capture the opinions of those who don't use the Internet.
- **Focus groups:** If you're assembling a group of favourite clients to talk casually about a new product idea, you're fine to go it alone. But to get opinions from outsiders or insight into sensitive topics such as customer service or pricing, use a professional facilitator who is experienced in managing group dynamics so that a single dominant participant doesn't steer the group outcome.

To obtain outside assistance, contact research firms, advertising agencies, marketing firms and public relations companies. Explain what you want to accomplish and ask whether the company can do the research for you or direct you toward the right resources.

TIP Another good starting point is the British Library Business & IP Centre in London or one of its satellite centres in Birmingham, Leeds, Liverpool, Manchester, Newcastle or Sheffield, who can undertake market research for you.

## *Geographics: Locating your market areas*

Not all businesses are geographically constrained. Most Internet businesses aren't; most restaurants are. If geography matters to your business, though, it can be an essential ingredient in arriving at your customer profile.

To target your market geographically, you need to ask, 'Where am I most likely to find potential customers, and where am I most able to inspire enough sales to offset my marketing investment?' To help you answer these questions, here's some advice:

- **Start with the addresses of your existing customers.** Wherever you have a concentration of customers, you likely have a concentration of *potential* customers. Unless you already have sky-high market share, those are the areas where you should direct your advertising efforts.

- **Follow your enquiries.** Enquiries are customers waiting to happen. They're consumers whose interest you've aroused and whose radar you're on. Your first objective should be to convert inquiry interest into buying action. Further, by finding out where enquiries are coming from, you may discover new geographic areas to target with future marketing efforts.
- **Locate new customer prospects in your local market area.** Identify people who match the profile of your current customers but who don't yet buy from you. By discovering where these prospects live, you also discover areas for potential market expansion. You can locate these prospects in several ways:
  - Contact the media outlets that serve your business sector. Ask for information regarding geographic areas with a concentration of people who fit your customer profile. Advertising representatives are often willing to share information as a way to convince you of their ability to carry your marketing message to the right prospects.
  - Contact your industry association. Enquire about industry market analyses that detail geographic areas with concentrated interest in your offerings. If you can export your offering beyond your regional marketplace, you may discover national or international market opportunities that you otherwise wouldn't have considered.
  - Visit your local library. It can provide access to books, databases and publications to help you research companies, markets and sectors.

Each time you discover a geographic area with easy access to your business and with a concentration of residents who fit your buyer profile, add the region to your list of prospective geographic target markets.

## *Demographics: Collecting customer data*

After you determine *where* your customers are, the next step is to define *who* they are so that you can target your marketing decisions directly towards the people who fit your customer profile.

TIP Trying to market to everyone is a budget-breaking proposition. Instead, narrow your customer definition by using demographic facts to zero in on exactly whom you serve by following these steps:

1. **Use your own general impressions to define your customers in broad terms based on how you describe their age, education level, ethnicity, income, marital status, profession, sex and household size.**

   Answer these questions about your customers:

   - Are they mostly male or female?
   - Are they mostly children, teenagers, young adults, early retirees or senior citizens?

- Are they students, graduates or PhDs?
- What do they do – are they housewives, teachers, young professionals or doctors?
- Are they mostly single, couples with no children at home, parents, grandparents or recent empty-nesters?
- How would you describe their ethnicity and the languages they speak?
- Based on your observations, how would you define their income levels?

2. **Break your market into subgroups, perhaps categorised by the kinds of products the customers usually purchase or the time of year they typically do business with you.**

   A restaurant that analyses its weekday lunchtime clientele and patrons of its dinner business may discover that the two timeframes draw customers with dramatically different demographic profiles. For example, perhaps the lunchtime clientele is comprised mostly of business people from the nearby area, whereas the dinner traffic is largely tourist families. This finding may lead to the development of two different and highly targeted promotions: a *50 minutes or it's free* lunch offer aimed at the nearby business community and promoted through the Chamber of Commerce newsletter and other low-cost, local business publications; and a *Kids under 7 eat free* offer aimed at tourists and promoted through hotel receptions and local visitor publications.

3. **Verify your answers by asking your customers.**

   Incorporate questions during enquiry and sales contacts by following the advice in the 'Do-it-yourself fact-finding ' section, earlier in this chapter.

WARNING As you collect demographic information about your customers, realise that people who fit the same factual description may vary widely in their purchasing patterns. That's why you need to make sure that you also understand customer lifestyles and buying behaviours (covered in the next section on psychographics).

## Psychographics: Customer buying behaviour

Knowing where and who your customers are allows you to select the right communication vehicles to carry your marketing messages. As you decide what to say and how to present your message, you also want to find out as much as you can about the attitudes, beliefs, purchasing patterns and behaviours of your customers. This information helps you create marketing messages that interest your prospects and motivate them to buy from you.

### Defining who isn't a prospect for your product

Sometimes, the easiest way to start your customer profiling is to think about who *isn't* likely to buy from your business:

- A manufacturer of swings and climbing frames knows that most customers aren't young professional couples living in flats. It needs to talk to families whose homes have back gardens.
- A landscape and nursery business knows that it won't find many customers in city centre apartments.
- A manufacturer of architectural siding may decide that its buyer isn't the end user – or homeowner – at all. Rather, the customer is the architect who specifies the product in the initial building design.

TIP Don't be afraid to target the audience for your marketing messages. You can still sell to anyone who enters your business or website, but your marketing investment should target only those who best fit your customer description.

### *Identifying the purchasing tendencies that customers have in common*

Based on your personal impressions and also on information that you find through conversations and surveys (see the earlier section 'Collecting customer information '), make a list of common traits shared by your best customers by answering the following questions:

- Do they buy on impulse or after careful consideration?
- Are they price-conscious or more concerned about the quality and prestige of the purchase?
- Are they loyal shoppers who buy from you on a frequent basis or are they one-time buyers?
- Do they buy from your business exclusively or do they also buy from your competitors?
- Do they reach you through a certain channel – for example, your office, shop or website – or do they contact you via referrals from other businesses or professionals?

For example, a retailer in a tourist area may organise customers into the following subgroups:

- **Geographic origin:** Local residents, regional, national and international visitors.
- **Activity interest:** Golfers, skiers, campers and business travellers/convention guests.

REMEMBER By creating customer subgroups, you'll see patterns emerge. Certain customer groups account for higher sales volume, more frequent purchases, purchases of certain types of products, purchases during certain seasons or hours, purchases through your website rather than in person and so on. When you know the tendencies of various segments, you know what to offer each target group.

## *Determining Which Customers Buy What*

REMEMBER Marketing is a matter of resource allocation. No budget – not even those of mega-brands like General Motors or McDonald's – is big enough to do it all. At some point, every marketer has to decide to spend their budget on the markets and products that have the best chance of delivering results and providing a good return on the marketing investment.

## *Viewing your sales by market segment*

The best marketers aim promotions precisely at target audiences that they believe have the interest and ability to purchase the featured product. Take these steps as you match segments of your market with the categories of your product line that they're most likely to want to purchase:

1. **Break down your sales by product categories to gain a clear picture of the types of products you sell, the sales volume each category produces and the type of customer each attracts.**
2. **Use your findings to determine which product categories offer the best potential growth opportunities and to clarify which segments of your clientele are most likely to respond to marketing messages.**
3. **Weight your marketing expenditures and develop your marketing messages and media plans to achieve your targeted sales goals through promotions that appeal to clearly defined customer segments.**

A furniture manufacturer may divide its products into office, dining and children's lines – each meeting the demands of a different market segment and even employing a different distribution and retailing strategy. The manufacturer would follow three separate marketing-communications strategies, placing primary emphasis (and budget allocation) on promoting the line most able to deliver top sales volume over the upcoming period.

An accounting firm may sort its clientele both by type of service purchased and by client profile. For example, it may target individual clients for tax returns in the month prior to the submission deadline.

After you're clear about which segments of your customer base are most likely to purchase which products, you have the information you need to develop and communicate compelling promotions and offers. You may also discover clues to new-customer development. For example, studying sales patterns may lead to the finding that certain products or services provide a good point of customer entry to your business, arming you with valuable knowledge you can use in new-customer promotions. Consider the example in Table 6-1 .

**TABLE 6-1 Market Segmentation Analysis Example: Mountain Valley Hotel**

| | *Home Town* | *Rest of Home County* | *Neighbouring Counties* | *Other National/International* |
|---|---|---|---|---|
| **Total Sales** | | | | |
| £712,000 | £56,960 | £462,800 | £128,160 | £64,080 |
| | 8% | 65% | 18% | 9% |
| **Sales by Length of Stay** | | | | |
| 1-night stay | £48,416 | £83,304 | £19,224 | £3,204 |
| 2-night stay | £2,848 | £231,400 | £70,488 | £32,448 |
| 3–5-night stay | None | £101,816 | £32,040 | £28,428 |

| | | | | |
|---|---|---|---|---|
| 6+ night stay | £5,696 | £46,280 | £6,408 | None |
| **Sales by Season** | | | | |
| Summer | £5,696 | £277,680 | £96,120 | £54,468 |
| Autumn | £11,962 | £55,536 | £12,816 | £6,408 |
| Winter | £4,557 | £37,024 | £6,408 | None |
| Christmas | £22,783 | £23,140 | None | None |
| Spring | £11,962 | £69,420 | £12,816 | £3,204 |

With detailed market knowledge, you can make market-sensitive decisions that lead to promotions tailored specifically to consumer patterns and demands. The following examples show how the hotel featured in Table 6-1 can use its findings to make marketing decisions:

- **Local market guests** primarily stay for a single night and mostly during the Christmas holidays, making them good targets for local year-end promotions. Additionally, 10 per cent of local guests stay for six nights or longer, probably while undergoing household renovations or lifestyle changes. This long-stay business tends to occur during non-summer periods when hotel occupancy is low, so the hotel may want to consider special offers to attract more of this low-season business.
- **Half of countywide guests** spend two nights per stay, although nearly a third spend three to six nights, which proves that the hotel is capable of drawing countywide guests for longer stays. This information may lead to an add-a-day promotion.
- **National and international guests** account for approximately one-quarter of the hotel's business. Because these guests are a far-flung group, the cost of trying to reach them in their home market areas via advertising would be prohibitive. Instead, the hotel managers may research how these guests found out about the hotel. If they booked following advice from travel agents, tour group operators or websites, the managers could cultivate those sources for more bookings. Or, if the guests made their decisions while driving through town, the hotel may benefit from well-placed outdoor ads and greater participation in travel apps and review sites that influence traveller behaviour.

Conduct a similar analysis for your own business:

- How do your products break down into product lines? (Find more information about this important topic in the later section 'Seeing Your Product through Your Customers' Eyes '.)
- What kind of customer is the most prevalent buyer for each line?

Then put your knowledge to work. If one of your product lines attracts customers who are highly discerning and prestige-oriented, think twice about a strategy that relies on discount vouchers, for example.

## *Matching customers with distribution channels*

*Distribution* is the means by which you get your product to the customer. A good distribution system blends knowledge about your customer (see the earlier section 'Anatomy of a Customer ') with knowledge of how that person ended up with your product (that's what distribution is about). This route can often be a surprisingly complex one.

To demonstrate, take a look at how visitors may arrive at a local museum. Imagine that 50,000 visitors walk through the turnstiles every year. Suppose that 10,000 of those visitors are school groups, 5,000 are tour groups, 5,000 pre-purchased tickets through local B&Bs and hotels, 5,000 pre-purchased tickets through the websites of the museum and the regional tourist board, 5,000 have tickets distributed by partner businesses as part of special promotional programmes, and 20,000 are museum members or independent visitors.

Based on these numbers, the museum is distributing its tickets through the following channels:

- Educators (possibly influenced by curriculum directors)
- Tour companies (possibly influenced by regional or local travel agents)
- Lodging establishment front desks (probably influenced by hotel and hotel marketing departments)
- The Internet (possibly influenced by state or local travel agents)
- Partner businesses (influenced by museum networking)
- The museum entrance gate (influenced by museum marketing efforts)

By allocating guest counts and revenues to each of the channels, the museum would arrive at the distribution analysis shown in Table 6-2 . By studying the findings, the museum can determine which channels are most profitable and which are most likely to respond positively to increased marketing efforts.

## TABLE 6-2 Channel Distribution Analysis

| *Distribution Channel* | *Ticket Revenue* | *Number of Guests/Percentage of Total* | *Sales Revenue/Percentage of Total* |
|---|---|---|---|
| Educators | £5.00 | 10,000/20% | £50,000/16% |
| Tour companies | £6.00 | 5,000/10% | £30,000/10% |
| Hotels/hotels | £6.50 | 5,000/10% | £32,500/11% |
| Internet | | | |
| Museum website | £8.00 | 3,000/6% | £24,000/8% |
| Travel agent website | £6.50 | 2,000/4% | £13,000/4% |
| Museum entry gate | | | |
| Museum members | £3.00 | 5,000/10% | £15,000/5% |
| Independent visitors | £8.00 | 15,000/30% | £120,000/39% |
| Partnering businesses | £4.00 | 5,000/10% | £20,000/7% |

Now create your own channel analysis, providing your business with information about how customers reach your business and the levels of sales activity that each channel generates. Put your findings to work by taking these steps:

1. **Track sales changes by distribution channel.**

   If one distribution channel starts declining radically, give that channel more marketing attention or enhance another channel to replace the revenue loss.
2. **Compare percentage of sales to percentage of revenue from each channel.**

Channels that deliver lower-than-average income per unit should involve a lower-than-average marketing investment or deliver some alternative benefit to your business. For example, in the case of the museum in Table 6-2 , the tickets distributed through partnering businesses deliver lower-than-average revenue and likely require a substantial marketing investment. Yet they've an alternative benefit – they introduce new people to the museum and therefore cultivate membership sales, donations and word-of-mouth support.

3. **Communicate with the decision-makers in each distribution channel.**

   When you know your channels, you know who to contact with special promotional offers. For example, if school groups arrive at a museum because the museum is on an approved list from the Department of Education, this department is the decision point, and is where the museum would want to direct marketing efforts. If school groups arrive because art or history teachers make the choice, the museum would want to get information to those teachers.

As part of your channel analysis, consider whether your business can reach and serve prospective customers through new distribution channels, whether that means introducing online sales, off-premises purchase locations, new promotional partnerships or other means of reaching those who fit your target customer profile but who don't currently buy from your business.

# *Seeing Your Product through Your Customers' Eyes*

The best products aren't *sold* – they're *bought* .

You never hear a customer say he *bought* a banger at the used car showroom. Nope, someone *sold* him that banger – but hopefully not you or your business. If you're a good marketer, you aren't *selling* anyone anything. Instead, you're helping customers select the right products to solve their problems, address their needs or fulfil their desires. You're helping them *buy* .

As a result, you can devote the bulk of your marketing efforts to the steps that take place long before and after money changes hands. These efforts involve targeting customers, designing the right product line, communicating your offerings in terms that address customers' wants and needs, and interacting after the sale in a way that builds loyalty and repeat business.

The following sections explore the ways that you and your customers view your products, and why your customers decide to buy your products.

The first step towards stronger sales is to know everything you possibly can about the products you sell and the reasons why your customers buy. Look beyond your primary offerings to consider the full range of solutions that your business provides. You're likely to discover that your offerings are more diverse than you first realise, a finding that can lead to stronger, more targeted marketing efforts.

Consider the products of a lakeside resort. The owners would list the number of cabins, seats in the restaurant and rowing boats for rent. Then they'd include the shopping opportunities in the resort's bait shop. Their list may also include summer youth camps, winter cross-country ski packages, all-inclusive corporate retreats and such intangibles as family memories, based on their finding that many reservations are motivated by an emotional response to the lakeside setting as an annual holiday site.

Similarly, a law firm may describe its products by listing the number of wills, estate plans, company formations, bankruptcies, divorces, adoptions and lawsuits it handles annually. And if they manage this list well, the lawyers know which of those product lines are profitable and which services are performed at a loss in return for the likelihood of ongoing, profitable relationships.

What about your business?

- What do you sell? How much? How many? What times of year or week or day do your products sell best? How often is a customer likely to buy or use your product?
- What does your product or service do for your customers? How do they use it? How does it make them feel? What problem does it solve?
- How is your offering different from and better than your competitors'?
- How is it better than it was even a year ago?
- What does it cost?
- What do customers do if they're displeased or if something goes wrong?

By answering these questions, you gain an understanding of your products and the ability to steer their future sales.

## *When service is your product*

If your business is among the great number of companies that sell services rather than three-dimensional or packaged goods, from here on when you see the word *product* , think *service* . In your case, service *is* your product.

Today, the service sector is the dominant sector of the UK economy and contributes around 73 per cent of GDP. Services – preparing tax returns, writing wills, creating websites, styling hair or designing house plans, to name a few – aren't things that you can hold in your hands. In fact, the difference between services and tangible products is that customers can see and touch the tangible product *before* making the purchase, whereas when they buy a service, they commit to the purchase before seeing the outcome of their decisions, relying heavily on their perception of the reputation of your business.

## *Your product is what Google says it is*

Chances are high that before people contact you or your business directly, they check you out online. Close to a hundred million names are searched on Google every day. Before buying products, visiting businesses or meeting others, people look online to see which businesses dominate the first screens of their search results.

TIP For help determining which terms people looking for businesses like yours use, use Google's Keyword Planner at http://adwords.google.com/keywordplanner . Enter the terms you think people will search to see which ones are most frequently used in your market area, and then optimise your online presence by using those keywords in your website and social media pages.

Customers also look online to see whether their search results turn up credible and trust-building information about your business, including links to positive and descriptive sites and, increasingly, Google +1 recommendations from people they know and regard highly.

TIP See for yourself: conduct searches for your business name, product name, product category, personal name and keywords that customers may use when seeking information about you and your business. Does your business appear prominently – with links to positive information – in search results for keywords that customers are likely to be using? If so, pat yourself on the back and keep up the good work on your online identity. If not, turn to Chapters 6 and 7 in Book 5 to find out more about how you look online.

## *Illogical, irrational and real reasons why people buy what you sell*

Online searches and customer opinion research results reveal what people believe about your product, your product category, what your offering means to them personally and why they make what otherwise may seem like illogical buying decisions. Think about it:

- Why pay £3 for a loaf of bread at the out-of-the-way deli if you can buy bread for under a pound at the supermarket?
- Why pay nearly double for a Lexus than for a Toyota if some models of both are built with many of the same components?
- Why seek cost estimates from three service providers and then choose the most expensive bid if all three propose nearly the same solution?

Why? Because people rarely buy what you think you're selling.

REMEMBER People don't buy your *product* . They buy the promises, the hopes or the satisfaction that they believe your product can deliver.

They buy the £3 loaf of salt-crusted rosemary bread because they believe the loaf is worth it, perhaps because it tastes superior or maybe because it satisfies their sense of worldliness and self-indulgence. They opt for the high-end car for the feeling of safety, quality, prestige and luxury it delivers. They pay top price for services perhaps because they like having their name on a prestigious client roster – or maybe because they simply like or trust the high-cost service provider more than the lower-cost ones.

People may choose to buy from your business over another simply because you make them feel better when they walk through your door.

REMEMBER Don’t fool yourself into thinking that you can win customers simply by matching your competitor’s features or price. People decide to buy for all kinds of irrational reasons. They buy because they see some intangible and often impossible-to-define value that makes them believe the product is a fair trade for the asking price. Often, that value has to do with the simple truth that they like the people they’re dealing with. Never underestimate the power of a personal relationship.

## *Buying decisions: Rarely about price, always about value*

Customers decide to buy based on their perception of the value they’re receiving for the price they’re paying. Whatever you charge for your product, that price must reflect what your customer thinks your offering is worth. If nothing distinguishes your product, it falls into the category of a commodity, for which customers are unwilling to pay extra.

If a customer thinks that your price is too high, expect one of the following:

- The customer won’t buy.
- The customer *will* buy but won’t feel satisfied about the value, meaning you win the transaction but sacrifice the customer’s goodwill and possibly the chance for repeat business.
- The customer tells others that your products are overpriced.

REMEMBER Before you panic over a customer calling you high-priced, keep in mind that the dissatisfied customer’s negative word-of-mouth is bad news only if others respect the person’s opinions regarding price and value. You’re often better advised to lose the business of a cherry-picking bargain hunter than to sacrifice your profit margins by trying to price to that person’s demanding standards. If your prices are on the high side, though, be certain that the quality, prestige and service – the *value* – that you offer is commensurate with your pricing. Also realise that you can definitely *under-price* your offering as well. If a prospect thinks that your product is worth more than its price tag, expect one of the following:

- You may sacrifice the sale if the prospect interprets the low price as a reflection of a second-rate offering.
- You may make the sale, but at a lower price (and lower profit margin) than the customer is willing to pay, leaving lost revenue and possibly customer questions following the transaction.
- The customer may leave with the impression that you’re a discounter – a perception that may steer future opinions and purchase decisions.

WARNING Unless you aim to own the bargain-basement position in your market (a dangerous strategy because some other business can always go lower), you’re better off providing excellent value and setting your prices accordingly.

During the split second it takes for customers to rate your product’s value, they weigh a range of attributes:

- What does it cost?
- What is the quality?
- What features are included?
- Is it convenient?
- Is it reliable?
- Can they trust your expertise?
- How is the product supported?
- What guarantee, promise or ongoing relationship can they count on?

These considerations start a mental juggling act, during which customers determine your offering’s value. If they decide that what you deliver is average, they’ll expect a low price to tip the deal in your favour. On the other hand, if they rank aspects of your offering well above those of competing options, they’ll likely be willing to pay a premium for the perceived value.

REMEMBER Customers match high prices with high demands. Remember the sign you used to see in print shops and garages: ‘Price, quality and speed – choose any two’? How times have changed. Today’s customers expect the companies they buy from to offer price, quality *and* speed. But here’s the good news: they expect you to be *competitive* in all three areas but *exemplary* in only one. Here are a few well-known examples:

- Costco = Price
- John Lewis = Service
- Tesco = Convenience
- FedEx = Reliability
- BMW = Quality

# Sizing Up Competitors

No matter how unique your offering, you always have competition.

When Alexander Graham Bell called to Mr Watson through his new-fangled invention in 1876, he had competition already. He held in his hand the one and only such device in the whole world, yet from its moment of inception, the telephone had to fight for market share. It had to compete with all the existing and more familiar means of message delivery, and it was certain to spawn a crop of copycat products to vie for message delivery in the future.

REMEMBER Competition may not be obvious or direct, but it is always present. The sooner you face it and plan for it, the better. *Competition* is the contest among businesses to attract customers and sales. The opposite of competition is a *monopoly* , where a single company has complete control of an industry or service offering.

Competition occurs whenever winning attention is necessary for selection and survival. In nature, the peacock’s tail, the rose’s scent and the apple’s sweetness are the marketing tools. In business, the battle is fought and won with product innovations and marketing activities designed to attract customers to one business over another.

Thanks to the forces of competition, the free enterprise system is undergoing constant improvement. Here are a few examples of what competition does:

- It prompts product upgrades and innovations.
- It leads to higher quality and lower prices.
- It enhances selection.
- It inspires business efficiencies.

REMEMBER Your business faces three kinds of competition:

- **Direct competitors that eat into your market share:** They offer the same kinds of products or services that you do and appeal to customers in the same markets in which you do business. Your market share increases when you lure business from direct competitors to your business.
- **Indirect competitors that erode your share of customers:** For instance, if you sell paint but your customer buys a paintbrush somewhere else, that paintbrush seller is an indirect competitor because it’s capturing your customer’s secondary sale. Similarly, if you own a marketing company and your client also uses a sales coach to build business, the sales coach is your indirect competitor. To increase your share of customers, find a way to serve as a one-stop solution by offering your primary product and also the secondary, complementary or add-on products that customers currently obtain elsewhere.
- **Phantom competitors that block your share of opportunity:** One of the biggest obstacles to a purchase – and therefore the biggest phantom competition – is your customer’s inclination to buy nothing or to find an alternative or do-it-yourself solution instead of buying what you’re selling. Taking the paint shop example a step further, if you offer a choice between enamel and latex paint but your customers opt for vinyl cladding (which never needs paint), a vinyl cladding outlet is a phantom competitor capable of blocking your business. For that matter, if customers decide that their houses can go another year without a paint job, the option to do nothing is your phantom competitor. To increase your share of opportunity, discover your phantom competitors and then make your product an easier, more satisfying and more valuable alternative.

# *Calculating Your Market Share*

Having a sense of your market share provides a good indication of your competitive rank and a way to monitor your growth within your target market.

## Sizing up your target market

To calculate your share of the market, first define the size of the market in which you compete.

The *total* market includes the entire nation or world – a market area that matters enormously to major global marketers like Nike or Levi's. But to a small business like yours, what matters is your *target* market – the one within the sphere of your business's influence. You can assess your target market's size by using the following criteria:

- **Geographic targeting:** Where are your customers, and how many are there? For example, a retailer may determine that its geographic target market consists primarily of people who live or holiday within a two-hour drive of the retailer's place of business. An accountant may determine that her geographic target market is concentrated within a city's boundaries. A consultant may target businesses in her local region.
- **Customer targeting:** How many people or businesses actually fit your customer profile? (See the earlier section 'Anatomy of a Customer ' for profiling information.) An office furniture manufacturer may target all the nation's office-furnishing retail establishments, along with architects and interior designers who specify office furnishings. An online florist may focus exclusively on wedding planners and brides-to-be within a single county or region.
- **Product-oriented targeting:** Sometimes, the most effective way to measure your target market's size is through an analysis of how many sales of products like yours occur in the market. For instance, a microbrewery may measure its share of a market as a percentage of all premium beer sold in its geographic target area. (The microbrewery wouldn't measure its sales against *all* beer sales; it would focus on premium beer sales, because that's the microbrewery's sphere of business influence.) Likewise, a lawyer who specialises in land-use planning would assess the number of land-use cases in the target market area before trying to calculate market share.

## Doing the sums

When you've a good sense of your total target market's size, you can use several approaches to calculate your share:

- **Unit sales:** Some businesses can easily figure out the total number of products like theirs sold each year. A hotel manager, for instance, can divide the number of rooms the hotel rents out by the total number of hotel rooms in an area and then multiply by 100 to arrive at the hotel's percentage share of the market.
- **Number of potential customers:** If you know that 30,000 adults are in your target market area, and if you can make an educated guess that one in ten of them – or 10 per cent – is a consumer of services like yours, you can assume that your business has a total potential market of 3,000 adults. If you serve 300 of those adults, you've a 10 per cent share of your target market.

TIP To aid in your guesswork, visit your local library and search electronic databases like Key Note and Mintel for information on customers in your market area.

For instance, imagine a fabric and sewing supply store that serves a geographic area that includes 7,000 homes within a 15-minute drive of the store. The owners can find out from Key Note or Mintel that 18.5 per cent of the households in the area participate in home sewing. If they multiply their 7,000-household market area by 18.5 per cent, they'll discover that they've 1,295 potential customers in their geographic market area. If the owners currently serve 250 of these potential customers, they've a market share of just less than 20 per cent – meaning plenty of opportunity for growth.

- **Total sales volume:** Another way to estimate market share is to calculate how much people spend at businesses like yours in your market area each year and then divide that figure by your sales revenue. For example, if annually in your market area people spend a total of £1 million on products like those you sell, and if your business does £100,000 annually in sales, then you have a 10 per cent market share.

TIP Regional business journals and newspapers compile lists that rank sales by businesses in specific industries or service sectors. Businesses submit their revenues (often slightly inflated, so read them with a realistic eye) as a basis for appearing in these lists. Study the lists for your industry to find clues to regional sales revenues in your field.

### MARKET SHARE: A SAMPLE CALCULATION

Suppose that Green Gardens, a residential landscaping business, serves a market area that includes 20,000 houses, of which approximately 10 per cent use landscape services. Thus, the potential residential landscape service market is 2,000 homes. If Green Gardens serves 200 homes, it has a 10 per cent market share.

Another way to look at market share is by sales volume. Green Gardens can estimate the revenues of each of its competitors and then add those figures to the Green Gardens revenue figure to produce a rough estimate of total target market residential landscape service sales. If target market sales total £4 million, and if Green Gardens has annual sales of £600,000, Green Gardens has a 15 per cent market share.

If Green Gardens combines its knowledge of market share based on unit sales (number of houses served) *and* market share based on sales volume, its owners would see that they've a 10 per cent share of all houses served, yet they've a 15 per cent share of total sales volume. This finding may lead them to conclude that they serve larger-sized accounts than some of their competitors. And based on that, they should have a small celebration!

# *Introducing Market Research*

You need to ensure that enough customers, with sufficient money to spend, exist to create a viable marketplace for your products or services. You must also see who's competing against you for their business. In other words, you need to research your market.

Market research is something that potential financial backers – be they banks or other institutions – insist on. In this, they're doing you a favour. Many businesses started with private money fail because the founders don't thoroughly research the market at the outset.

Whatever your business idea, you must undertake some well-thought-out market research before you invest any money or approach anyone else to invest in your venture.

## Budgeting for your research

Market research isn't free, even if you do it yourself. At the very least, you have to consider your time. You may also spend money on journals, phone calls, letters and field visits. And if you employ a professional market research firm, your budgeting shoots to the top of the scale.

For example, a survey of 200 executives responsible for office equipment purchasing decisions cost one company £12,000. In-depth interviews with 20 banking consumers cost £8,000.

Doing the research in-house may save costs but limit the objectivity of the research. If time is your most valuable commodity, getting an outside agency to do the work may make sense. Another argument for commissioning professional research is that it may carry more clout with investors.

REMEMBER Whatever the cost of research, you need to assess its value to you when you're setting your budget. So if getting it wrong costs £100,000, spending £5,000 on market research may be a good investment.

## Doing the preliminary research

Research methods range from doing it all from your desk to getting out in the field yourself and asking questions – or hiring someone to do it for you. The following sections explore the various methods you can use to find out what you need to know.

REMEMBER When you know the questions you want answers to, the next step is finding out whether someone else has the answers already. Much of the information you need may well be published, so you can do at least some of your market research in a comfortable chair, in your home or in a good library. Even if you use other research methods, doing a little desk research first is worthwhile.

### Gathering information at the library

Thousands of libraries in the UK and tens of thousands elsewhere in the world between them contain more desk research data than any entrepreneur ever requires. Libraries offer any number of excellent information sources. You can take yourself to your local library or bring the library's information to you via the Internet if you're dealing with one of the reference libraries in a larger city or town.

As well as some fairly conventional business books, libraries contain many hundreds of reference and research databases. For example, the official Census of Population supplies demographic data on size, age and sex of the local populace. You can also find a wealth of governmental and other statistics that enable you to work out the size and shape of the market nationwide and how much each person spends.

You can find details of every journal, paper and magazine's readership in *BRAD* (the British Rates and Data directory). In addition, every company has to file details of its profits, assets, liabilities and directors at Companies House, the place where all business details and accounts are kept ( www.companieshouse.org.uk ). Their WebCHeck service offers a free-of-charge, searchable Company Names and Address Index that covers 2 million companies by name or unique company registration number. Some market information data costs hundreds of pounds and some is available only to subscribers, who pay thousands of pounds to have it on tap. Fortunately for you, your library (or an Internet link to a library) may have the relevant directory, publication or research study on its shelves.

Librarians are trained to archive and retrieve information and data from their own libraries and increasingly from Internet data sources as well. Thus they represent an invaluable resource that you should tap into early in the research process. You can benefit many times from their knowledge at no cost, or you may want to make use of the research service certain libraries offer to business users at fairly modest rates.

TIP Apart from public libraries, you can access hundreds of university libraries, specialist science and technology libraries, and government collections of data with little difficulty.

### *Using the power of the Internet*

The Internet can be a powerful research tool. However, it has some particular strengths and weaknesses that you need to keep in mind when using it.

Strengths of the Internet include:

- Access is cheap and information is often free.
- It helps you gather good background information.
- You can access information quickly.
- It covers a wide geographic scope.

Weaknesses of the Internet include:

- The bias is strongly towards the USA.
- Coverage of any given subject may be patchy.
- Authority and credentials are often lacking.

It would be a brave or foolhardy entrepreneur who started up in business or set out to launch new products or services without at least spending a day or two surfing the Internet. At the very least, this surfing tells you whether anyone else has taken your business idea to market. At best, it may save you lots of legwork around libraries, if the information you want is available online.

You can gather market research information on the Internet in two main ways:

- Use directories, search engines or telephone directories to research your market or product.
- Use blogs, bulletin or message boards, newsgroups and chat rooms to elicit the data you require.

These two useful search portals can help get you started:

- Business.com ( www.business.com )
- Easy Searcher ( www.easysearcher.com )

Here are a few of the most useful online sources of information on markets:

- **Blogs** are sites where people, both informed and uninformed, converse about a particular topic and, as a result, the information you find on blogs is more straw in the wind than hard fact. Google ( www.google.com/blogsearch ) has a search engine through which you can access the world's blogs.
- **Corporate Information** ( www.corporateinformation.com ; go to Tools and then Research Links) is a business information site covering the main world economies, offering plenty of free information. This link takes you to sources of business information in over 100 countries.
- **Doing Business** ( www.doingbusiness.org ) is the World Bank's database that provides objective measures of business regulations across 185 countries and produces occasional reports on major cities within those countries. You can find out everything from the rules on opening and closing a business to trading across borders, tax rates, employment laws, enforcing contracts and much more. The site also has a tool for comparing countries to rank them by the criteria you consider most important.
- **Google Trends** ( www.google.co.uk/trends ) provides a snapshot of what the world is most interested in at any one moment. For example, if you're thinking of starting a bookkeeping service, entering that term into the search pane produces a snazzy graph showing how interest, measured by the number of searches made, has grown or contracted since January 2004 (when Google started collecting the data). You can tweak the graph to show seasonality, geographical information and 'demand' peaks.
- **Google News** ( http://news.google.co.uk ) contains links to any newspaper article anywhere in the world. You can search for articles covering a particular topic from over the last decade or list them by year. Asking for information on baby clothes, for example, reveals recent articles on how much the average family spends on baby clothes, the launch of a thrift store specialising in second-hand baby clothes and the launch of an organic baby clothes catalogue.
- **MarketResearch.com** ( www.marketresearch.com ) claims with some justification to be the world's largest continuously updated online collection of market research, offering over 250,000 market research reports from over 700 leading global publishers. Whether you're looking for new product trends or competitive analysis of a new or existing market, alerts from this source keep you on top of the latest available intelligence.
- **NationMaster** ( www.nationmaster.com ) provides a compilation of data from such sources as the *CIA World Factbook* , the United Nations and the Organisation for Economic Co-operation and Development. Using the tools on the website, you can generate maps and graphs on all kinds of statistics with ease. Its aim is to be the Web's one-stop resource for country statistics on everything.
- **Pew Research Center** ( http://pewinternet.org/Trend-Data-(Adults)/Whos-Online.aspx ) is a non-profit 'fact tank' that provides information on issues, attitudes and trends. At this site, you can find Internet user demographics and information about what those users do online. (If you'd like to get information on how use of the Internet has changed over time, for example, you

can download a large spreadsheet that contains data stretching back to online activity surveys done in 2000.)

- **Trade Association Forum** ( www.taforum.org ; go to Directories and then Trade Association) is the online directory of trade associations on whose websites are links to industry-relevant online research sources. For example, you can find the Baby Products Association listed, at whose website you can find details of the hundreds of companies operating in this sector, along with their contact details.
- **Warc** ( www.warc.com ) claims to provide the most comprehensive marketing information service in the world. Their online guide to world advertising trends is based on the annual advertising expenditure data across all main media for more than 100 countries, outlining key trends in media investment over the last ten years.

### *Getting to the grass roots*

If the market information you need isn't already available – and the chances are that it isn't – you need to find the answers yourself.

Going out into the marketplace to do market research is known as *field research* , or sometimes *primary research* , by marketing professionals.

Field research allows you to gather information directly related to your venture and to fine-tune the results you get from other sources. For example, entrepreneurs interested in opening a classical music shop in Exeter aimed at young people were encouraged when desk research showed that of a total population of 250,000, 25 per cent were under 30. However, the research didn't tell them what percentage of this 25 per cent was interested in classical music nor how much money each potential customer may spend. Field research showed that 1 per cent of young people were interested in classical music and would spend £2 a week, suggesting a potential market of only £65,000 a year (250,000 multiplied by 25% multiplied by 1% multiplied by £2 multiplied by 52)! The entrepreneurs sensibly decided to investigate Birmingham and London instead. But at least the cost had been only two damp afternoons spent in Exeter, rather than the horror of having to dispose of a lease on an unsuccessful shop.

Most field research consists of an interviewer putting questions to a respondent. No doubt you've become accustomed to being interviewed while travelling or resisting the attempts of an enthusiastic salesperson on your doorstep posing as a market researcher (*slugging* , as this practice is known, has been illegal since 1986).

The more popular forms of interview are

- Personal (face-to-face) interviews (especially for consumer markets)
- Telephone interviews (especially for surveying businesses)
- Postal surveys (especially for industrial markets)
- Test and discussion groups
- Internet surveys

Personal interviews and postal surveys are clearly less expensive than getting together panels of interested parties or using expensive telephone time. Telephone interviewing requires a highly positive attitude, courtesy, an ability not to talk too quickly and to also listen while sticking to a rigid questionnaire. Low response rates on postal surveys (normally less than 10 per cent) can be improved by including a letter explaining the purpose of the survey and why respondents should reply; offering rewards for completed questionnaires (a small gift); associating the survey with a charitable donation based on the number of respondents; sending reminder letters; and, of course, providing pre-paid reply envelopes.

Internet surveys using questionnaires similar to those conducted by post or on the telephone are growing in popularity. On the plus side, the other survey methods involve having the data entered or transcribed at your expense, but with an Internet survey the respondent enters the data. Internet survey software also comes with the means of readily analysing the data, turning it into useful tables and charts. Such software may also have a statistical package to check out the validity of the data itself and so give you an idea how much reliance to place on it.

TIP If you plan a large survey, the limited scope provided by free surveys may not be enough for your needs. Buying software to carry out Internet surveys can be expensive, but you can rent it and pay per respondent for each survey you do.

Check out companies such as Free Online Surveys (`http://free-online-surveys.co.uk`) and SurveyMonkey (`www.surveymonkey.com`) – both provide software that allow you to carry out online surveys and analyse the data quickly.

Once upon a time samples of Internet users were heavily biased towards students, big companies and university academics. Not any more. In 2014, according to the Office for National Statistics, 38 million adults (76 per cent) in Great Britain accessed the Internet every day, 21 million more than in 2006. This means that you can canvass almost everyone's views.

## Conducting the research

Field research means that you have to do the work yourself: decide the questions, select the right people to ask those questions and then interpret the data when you have it. This is completely different from desk research, where all that work has been done for you. But field research can be worth every ounce of sweat that goes into it. You get information that no one else is likely to have at their fingertips, and knowledge in the business start-up arena is definitely power. When you come to writing up your business plan (see Chapter 4 in Book 1), you have the evidence to support your belief in your business.

### Setting up a sample

It's rarely possible or even desirable to include every potential customer or competitor in your research. Imagine trying to talk to all pet owners before launching Petfeed.com! Instead, you select a sample group to represent the whole population.

Sampling saves time and money and can be more accurate than surveying an entire population. Talking to every pet owner may take months. By the time you complete your survey, the first people questioned may have changed their opinions, or the whole environment may have changed in some way.

You need to take care and ensure that you've included all the important customer segments you've targeted as potential users or buyers of your products or services in your research sample.

The main sampling issue is how big a sample you need to give you a reliable indication of how the whole population behaves. The accuracy of your survey increases with the sample size, as Table 6-3 shows. There you see that a sample of 250 is generally (95 per cent of the time) accurate only to between plus 6.2 per cent to minus 6.2 per cent. Up the sample to 6,000 and the error range drops to between plus 1.2 per cent and minus 1.2 per cent, a range of just 2.4 per cent. You need to include each of your main customer segments – for example, the over-50s, people earning between £20,000 and £30,000 a year or those without university degrees, if those are groups of people whose views are important to your strategy – in the sample in numbers sufficient to make your sample reasonably reliable.

## TABLE 6-3 Sample Size and Accuracy

| *Number in Sample* | *Percentage Accuracy of 95% of Surveys* |
|---|---|
| 250 | Accurate to a range of + to – 6.2% of true figure |
| 500 | Accurate to a range of + to – 4.4% of true figure |
| 750 | Accurate to a range of + to – 3.6% of true figure |
| 1,000 | Accurate to a range of + to – 3.1% of true figure |
| 2,000 | Accurate to a range of + to – 2.2% of true figure |
| 6,000 | Accurate to a range of + to – 1.2% of true figure |

For most basic research, a small business may find the lower sample sizes accurate enough, given the uncertainty surrounding the whole area of entering new markets and launching new products.

### *Asking the right questions*

To make your field research pay off, you have to ask the questions whose responses tell you what you need to know. Writing those questions is both an art and a science – and you can master both aspects by using the following tips:

- Keep the number of questions to a minimum. A dozen or so should be enough – 25 is getting ridiculous.
- Keep the questions simple. Answers should be Yes/No/Don't Know or somewhere on a scale such as Never/Once a Month/Three or Four Times a Month/Always.
- Avoid ambiguity. Make sure that the respondent really understands the question by avoiding vague words such as *generally* , *usually* and *regularly* . Seek factual answers; avoid opinions.
- Make sure that you have a cut-out question at the beginning to eliminate unsuitable respondents. You don't want to waste time questioning people who never use your kind of product or service.
- Put an identifying question at the end so that you can make sure that you get a suitable cross-section of respondents. For example, you may want to identify men from women, people living alone from those with children, or certain age groups.

The introduction to a face-to-face interview is important. Make sure that you're prepared, carrying an identifying card (maybe a student card or watchdog card) or with a rehearsed introduction (such as 'Good morning. I'm from Cranfield University [show card] and we're conducting a survey and would be grateful for your help'). You may also need visuals of the product you're investigating (samples, photographs) to ensure that the respondent understands. Make sure that these visuals are neat and accessible.

TIP Try out the questionnaire and your technique on your friends prior to using them in the street. You may be surprised to find that questions that seem simple to you are incomprehensible at first to respondents!

### *Digging up the numbers*

Remember, above all, that questioning is by no means the only or most important form of fieldwork. Also get out and look at your competitors' premises, get their catalogues and price lists, go to exhibitions and trade fairs relevant to your chosen business sector and get information on competitors' accounts and financial data. One would-be business starter found out from the company's accounts, obtained from Companies House ( www.companieshouse.org.uk ), that the 'small' competitor near to where he planned to locate was in fact owned by a giant public company that was testing out the market prior to a major launch itself.

TIP If you want to research financial intelligence about potential competitors and customers, the information stored at Companies House may be like gold dust. However, there are better ways of interrogating this data than simply going directly to Companies House. Suppose, for example, you are looking for potential customers in your immediate area and you think that companies of a certain size – say £1 million in turnover and with about 100 to 200 employees – can make ideal customers, but you don't how to find them. Help is at hand; there are organisations that provide a way to access this information at Companies House. Avention ( www.avention.com ) and FAME ( https://fame.bvdinfo.com ) are two such data analysis providers. Using either of these two products, you can carry out a search on all the companies on the Companies House register that asks specifically for the companies that match your criteria – specified post codes, turnover size and employee numbers. Both of these products offer free trials so you can see what use they will be for you. You won't be able to afford to buy or subscribe to these two products, but one or both are available to use at the larger city libraries and university libraries.

All methods can be equally valid depending only on the type of market data you need to gather. Carefully record the results of each piece of market research for subsequent use in presentations and business plans.

After the primary market research (desk and field research) and market testing (stalls and exhibitions) are complete, if you're investing a substantial amount of money upfront in your venture you should pilot test the business in one location or with one customer segment before launching fully into business. Only then can you make a reasonably accurate prediction of sales and the cash-flow implications for your business.

### *Finding test subjects*

Now you need someone to ask your questions of. If you're doing a street survey, you have to make do with whoever comes along. Otherwise, to carry out a survey your best bet is to buy or rent a mailing list. Typically, you pay a fee to the list owner, such as a magazine with its list of subscribers. You negotiate a fee for how many times you're allowed to use the list. Note that you aren't the owner of the list.

Several individual freelancers specialise in brokering lists and building lists. You may want to consider hiring an individual for a consultation or to manage the entire process. Marketing professionals claim that buying lists is a science, but you can master this science on your own, especially if you're trying to reach a local or regional market. Think of publications, organisations and businesses whose lists are most likely to contain people who may buy your product or service. Don't overlook trade magazines, regional magazines or non-competing businesses with a similar customer base. You can then select and narrow your lists by looking at nearly any demographic variable to arrive at as close to your description of your target market as possible. Listbroker (www.listbroker.com) and Electric Marketing (www.electricmarketing.co.uk) between them can provide lists of all types.

# Book 2

# Sorting Out Your Finances

# Contents at a Glance

# Chapter 1

# Finding the Money

**IN THIS CHAPTER**

**Working out how much outside money you need**

**Looking at the different types of money available to you**

**Choosing the best source of money for you**

**Finding money to work with**

Businesses need a continuous flow of customers, products or services to sell, and space to work from or store unsold goods. But they need money to make all these things happen. The more the business actually does, the more money it needs.

Even during the recent world credit crunch, small businesses needed (and, despite some anecdotal evidence to the contrary, accessed) money. The latest British Banking Association (BBA; www.bba.org.uk ) statistics published in March 2016, reporting on the fourth quarter of 2015, showed more than 327,800 finance applications were made in the preceding year for small and medium-sized enterprises (*SMEs* ; that is, businesses with up to 250 employees), and eight out of every ten applications for funds were approved. All in all, banks had lent £107.5 billion as at the end of December 2015, and they're the biggest single source of money for small and new businesses in the UK.

Starting a business on the road to success involves ensuring that you have sufficient money to survive until the point where income continually exceeds expenditure. You need a steady flow of money from many different sources along the way. Data from a recent survey of SMEs by Warwick Business School shows that over a three-year period, about 55 per cent make use of a personal or business credit card; 53 per cent use an overdraft; 24 per cent use a term loan; 6 per cent have access to a grant; 3 per cent use invoice discounting; and 3 per cent use equity finance. Karan Bilimoria, founder of Cobra Beer, raised money from almost every source imaginable in the decade or so it took to get his business from start-up to £100 million annual turnover. (Search under his name at www.startups.co.uk for his story.)

This chapter helps you to find the right type of money for your business and avoid common pitfalls.

## *Assessing How Much Money You Need*

You should work out from the outset how much money you need to get your business off the ground. If your proposed venture needs more cash than you feel comfortable putting up yourself or raising from others, the sooner you know the better – then you can start to revise your plans. The steps that lead to an accurate estimate of your financial requirements start with the budget, covered in Chapter 4 in Book 2, along with advice on estimating costs for initial expenditure such as retail or production space, equipment, staff and so on.

Forecasting cash flow is the most reliable way to estimate the amount of money a business needs on a day-to-day basis.

TIP Here are dos and don’ts for creating a cash-flow forecast:

- Do ensure that your projections are believable. This means that you need to show how you’re going to achieve your sales.
- Do base projections on facts, not conjecture.
- Do describe the main assumptions that underpin your projections.
- Do explain what the effect of these assumptions not happening to plan may be. For example, if your projections are based on recruiting three salespeople by month three, what would happen if you can find only two suitable people by that date?
- Do, for all forecasting, come up with best and worst outcomes as well as the most likely outcomes.
- Do make sure that you include things like job losses and losses of confidence in the markets that you serve. After all, even if your products and services are excellent, if people have lost confidence because of the bad actions of one of your competitors, you may suffer also.
- Don’t use data to support projections without saying where it came from.
- Don’t forget to allow for seasonal factors. At certain times of the year, most businesses are influenced by regular events. Sales of ice cream are lower in winter than in summer, sales of toys peak in the lead-up to Christmas, and business-to-business sales dip in the summer and Christmas holiday periods. So rather than taking your projected annual sales figure and dividing by 12 to get a monthly figure, you need to consider what effect seasonal factors may have.
- Don’t ignore economic factors such as an expanding (or shrinking) economy, rising (or falling) interest rates and an unemployment rate that is so low that it may influence your ability to recruit at the wage rate you want to pay.
- Don’t make projections without showing the specific actions that can get those results.
- Don’t forget to get someone else to check your figures out – you may be blind to your own mistakes, but someone else is more likely to spot the flaws in your projections.

You calculate the cash-flow projection by estimating how much cash you expect to get in and pay out every period. By subtracting one figure from the other, you arrive at the cash on hand or, if the figure is negative, the amount of cash you need to raise to stay afloat.

## *Projecting receipts*

Receipts from sales come in different ways, depending on the range of products and services on offer. Aside from money coming in from paying customers, business owners may, and in many cases almost certainly will, put in cash of their own.

You may be drawing on other sources of outside finance, say from a bank or investor, but these sources are best left out at this stage. In fact, the point of the cash-flow projection, as well as showing how much money the business needs, is to reveal the likely shortfall after you, the owner, have put what you can into the business and the customers have paid up.

TIP Be sure to have contingency approaches in place, in case people are late in paying you.

You should total up the projected receipts for each month and for the year as a whole. You’re well advised to carry out this process using a spreadsheet program, which saves you from any problems caused by faulty maths.

REMEMBER A sale made in one month may not result in any cash coming into the business bank account until the following month, or even much later if your customers are slow payers. Make sure that you know how quickly people pay their bills in the sectors in which you’re working.

## *Estimating expenses*

Some expenses, such as rent, rates and equipment leases, you pay monthly. Other bills, such as telephone, utilities and bank charges, come in quarterly.

If you haven’t yet had to pay utilities, for example, put into your forecast your best guesstimate of how much you’re going to spend and when. Marketing, promotion, travel, subsistence and stationery are good examples of expenses you may have to estimate. You know that you face costs in these areas, but they may not be all that accurate as projections.

After you’ve been trading for a while, you can get a much better handle on the true costs you’re likely to incur.

Total up the payments for each month and for the year as a whole.

## *Working out the closing cash balances*

This is crunch time, when the real sums reveal the amount of money your great new business needs to get it off the ground. Working through the cash-flow projections allows you to see exactly how much cash you have in hand, or in the bank, at the end of each month, or how much you need to raise. This is the closing cash balance for the month. It’s also the opening cash balance for the following month, because that’s the position you’re carrying forward.

## *Setting out your cash-flow projection*

Figure 1-1 shows the first five-week cash-flow projection for a new business. Sales receipts are £250 in the first week, gradually increasing and resulting in a total of £4,000 cash coming into the business over the five-week period.

| Week | 1 | 2 | 3 | 4 | 5 | Totals |
|---|---|---|---|---|---|---|
| **Receipts: Cash In** | | | | | | |
| Sales | 250 | 500 | 750 | 1,000 | 1,500 | **4,000** |
| | | | | | | **0** |
| | | | | | | **0** |
| **Total Receipts** | **250** | **500** | **750** | **1,000** | **1,500** | **4,000** |
| **Payments: Cash Out** | | | | | | |
| Stock | 500 | 250 | 350 | 500 | 400 | **2,000** |
| Advertising | 200 | 200 | 100 | 0 | 0 | **500** |
| Rent | 100 | 100 | 100 | 100 | 100 | **500** |
| Utilities | 100 | 0 | 0 | 100 | 0 | **200** |
| **Total Payments** | **900** | **550** | **550** | **700** | **500** | **3,200** |
| **Cashflow Surplus/Deficit (-)** | **-650** | **-50** | **200** | **300** | **1,000** | **800** |
| **Opening Bank Balance** | **0** | **-650** | **-700** | **-500** | **-200** | |
| **Closing Bank Balance** | **-650** | **-700** | **-500** | **-200** | **800** | |



**FIGURE 1-1:** A start-up five-week cash-flow projection.

Week one sees payments going out totalling £900, for stock of product to be sold, advertising, rent and utilities such as heat, light and power. Subtracting the total receipts from the total payments leaves the business short of £650.

In week two, the process is repeated. However, instead of an opening cash balance of £0 (as at the start of week one), week two starts with the negative cash position (–£650) that week one finished with.

Cash receipts in week two are projected to be less than cash payments (£500 – £550 = –£50), which is added to the –£650 brought forward from week one. So the negative cash-flow position in week three is –£700.

The owner-manager can resolve this position by injecting £700 himself, raising £700 from an outside source such as a bank, or raising a smaller amount and cutting back on some element in the payment area.

## *Testing your assumptions*

Little disturbs a financier more than a firm that has to go back cap in hand for more finance too soon after raising money, especially if you should've seen and allowed for the additional requirement at the outset.

So, in making projections you have to be ready for likely pitfalls and the unexpected events that knock your cash flow off target. Forecasts and projections rarely go to plan, but you can anticipate the most common pitfalls and to some extent allow for them.

### *Spotting the pitfalls*

You can't really protect yourself against freak disasters or unforeseen delays, which can hit large and small businesses alike. But some events are more likely than others to affect your cash flow.

In particular, watch out for sales taking longer to come in than you thought. Customers take time to make decisions, particularly if they already have a satisfactory alternative supplier.

Also make sure that they'll pay on time. Research published in November 2015 by Bacs Payment Schemes Limited (www.bacs.co.uk), the organisation behind Direct Debit and Bacs Direct Credit, shows that small firms in the UK were owed £26.8 billion in the autumn of 2015 with over half having to wait more than 30 days for a payment – and 12 per cent had to wait over 90 days. These figures arose despite the Prompt Payment Code Advisory Board initiative set up in 2014, with the remit of encouraging businesses to move towards 30-day payment terms as a norm.

TIP You can check out potential customers by using a credit reference agency such as Snoop4 Companies ( www.snoop4companies.co.uk ) for businesses or Experian ( www.experian.co.uk ) for private individuals. Basic credit reports cost between around £4 and £35 and may save you time and money if you've any reservations about a potential customer's ability to pay.

WARNING During periods of economic downturn – in other words, during a recession – unsurprisingly customers take longer to settle their bills. Big firms, though perhaps a safer bet and more likely to survive, are rarely sympathetic to a small firm's plight. Expect them to go to the wire when it comes to settling up.

Costs are also a difficult area to predict because not all are easy to anticipate. An increase, for example, in your motor insurance rate as a consequence of using a car for your business is one cost often missed from projections.

### *Allowing for the unexpected*

Even if you haven't anticipated events, you can allow for them when estimating financing needs. Analysis using a cash-flow spreadsheet, as shown in Figure 1-1 , enables you to identify worst-case scenarios that can knock you off-course, and you can change and insert new figures at will to test out what may happen to your cash flow under various conditions. After this, you end up with a realistic estimate of the financing requirements of the business or project.

REMEMBER You need to make your cash-flow projection sufficiently far forward so that you can see when you'll start to have positive cash flow. After you've made some reasonably prudent assumptions, such as cash from sales coming in later and for smaller amounts, and for costs to be higher, you can see how much money you need to raise. The sum of money you need to raise is the highest negative cash position in your cash-flow projection. The example in Figure 1-1 shows a business that has to have £700 of additional cash to survive its first five weeks and perhaps a few hundred more as a cushion against unexpected problems.

## *Reviewing Your Financing Options*

Knowing how much money you need to get your business successfully started is an important first step, but only that – a first step. Many sources of funds are available to small firms. However, not all are equally appropriate to all firms at all times. These different sources of finance carry different obligations, responsibilities and opportunities. You have to understand the differences to allow an informed choice.

Most small firms confine their financial strategy to long-term or short-term bank loans, viewing other financing methods as too complex or too risky. In many respects, the reverse is true. Almost every finance source other than banks shares some of the risks of doing business with you to a greater or lesser extent.

You have three main options when it comes to raising money: borrowing it, and paying it back over time with interest added; finding an investor and letting them own a piece of your business; and getting some free money by way of a grant or award (this third option is covered in Chapter 2 of Book 2).

## Deciding between debt capital and equity capital

At one end of the financing spectrum lie shareholders – individual *business angels* who put their own money into a business, or corporate organisations such as *venture capital providers* (also known as venture capitalists or VCs), who provide equity capital that buys a stake in a business. These investors share all the risks and vagaries of the business alongside you and expect a proportionate share in the rewards if things go well. They're less concerned with a stream of dividends – which is just as well because few small companies ever pay them – and instead hope for a radical increase in the value of their investment. They expect to realise this value from other investors who want to take their place for the next stage in the firm's growth, rather than from any repayment by the founder. Investors in new or small businesses don't look for the security of buildings or other assets to underpin their investment. Rather, they look to the founder's vision and the core management team's ability to deliver results.

At the other end of the financing spectrum are debt financiers – banks that try hard to take no risk and expect some return on their money irrespective of your business's performance. They want interest payments on money lent, usually from day one. They too hope that the management is competent, but they're more interested in making sure that you or the business has some type of asset such as a house that they can grab if things go wrong. At the end of the day, and that day can be sooner than the borrower expects, a bank wants all its money back, with interest. Think of bankers as people who help you turn part of an illiquid asset such as property into a more liquid asset such as cash – for a price.

REMEMBER Understanding the differences between *lenders* , who provide debt capital, and *investors* , who provide equity or share capital, is central to a sound grasp of financial management.

In between the extremes of shareholders and the banks lie myriad other financing vehicles that have a mixture of lending or investing criteria. You need to keep your business finances under constant review, choosing the most appropriate mix of funds for the risks you plan to take and the economic climate ahead. The more risky and volatile the road ahead, the more likely it is that taking a higher proportion of equity capital will be appropriate. In times of stability and low interest, higher borrowings may be more acceptable.

TIP As a rule of thumb, you should use debt and equity in equal amounts to finance a business.

If the road ahead looks more risky than usual, go for £2 of equity to every £1 of debt.

Table 1-1 illustrates a few of the differences between risk-averse lenders and risk-taking investors.

**TABLE 1-1 Comparing the Benefits of Lenders and Investors**

| *Category* | *Lenders* | *Investors* |
|---|---|---|
| Interest | Paid on outstanding loan | None, though dividends sometimes paid if profits warrant it |
| Capital | Repaid at end of term, or sooner if lender has concerns | Returned with substantial growth through new shareholders |
| Security | Either from assets or personal guarantees | From belief in founders and their business vision |

If your business sector is viewed as particularly risky – and perhaps the most reliable measure of that risk is the proportion of firms that go bust – then financing the business almost exclusively with borrowings is tantamount to gambling. Debt has to be serviced whatever your business performance, so in any risky, volatile marketplace, you stand a good chance of being caught out one day.

If your business risks are low, profits are probably relatively low too. High profits and low risks always attract a flood of competitors, reducing your profits to levels that ultimately reflect the riskiness of your business sector. Because venture capitalists and shareholders generally look for better returns than they can get by lending the money, they'll be disappointed in an investment in a low-risk, low-return business. So if they're wise, they don't get involved in the first place; if they do, they don't put any more money in later.

## *Examining your own finances*

Obviously, the first place to start looking for money to finance your business is in your own pockets. You may not have much in ready cash, but you may have assets that you can turn into cash or use to support borrowing.

Start by totalling your assets and liabilities. The chances are that your most valuable *assets* are your house, your car and any life assurance or pension policies you may have. Your *liabilities* are the debts you owe. The difference between your assets and your liabilities, assuming that you've more of the former than the latter, is your *net worth* . That, in effect, is the maximum security you can offer anyone outside the business from whom you want to raise money.

The big questions are: what is your appetite for risk, and how certain are you that your business will be successful? The more of your own money you can put into your business at the outset, the more you're truly running your own business in your own way. The more outside money you have to raise, the more power and perhaps value you have to share with others.

Now you have a simple piece of arithmetic to do. How much money do you need to finance your business start-up, as shown in your worst-case scenario cash-flow forecast? How much of your own money are you willing and able to put into your business? The difference is the sum you're looking to outside financiers to back you with.

If that sum is more than your net worth, you're looking for investors. If less, bankers may be the right people to approach.

If you do have free cash or assets that you can but won't put into your business, you should ask yourself whether the proposition is worth pursuing. You can be absolutely certain that any outsider you approach for money will ask you to put up or shut up.

REMEMBER Another factor to consider in reviewing your own finances is your ongoing expenses. You have to live while getting your business up and running. So food, heat and a roof over your head are essential expenses. But perhaps a two-week long-haul summer holiday, a second car and membership of a health club aren't essentials – great while you were a hired hand and had a salary cheque each month, but an expendable luxury when you're working for yourself.

# *Determining the Best Source of Finance for You*

Choosing which external source of finance to use is to some extent a matter of personal preference. One of your tasks in managing your business's financial affairs is to keep good lines of communication open with as many sources as possible. The other key task is to consider which is the most appropriate source of finance for your particular requirement at any one time. The following sections explore the main issues that you need to think about.

## *Considering the costs*

Clearly, if a large proportion of the funds you need to start your business is going to be consumed in actually raising the money itself, your setup costs are going to be high. Raising capital, especially if the amounts are relatively small (under £500,000), is generally quite expensive. You have to pay your lawyers and accountants, and those of your investor or lender, to prepare the agreements and to conduct the due diligence examination (the business appraisal). Spending between 10 and 15 per cent of the first £500,000 you raise on setup costs isn't unusual.

An overdraft or factoring agreement is relatively cheap to set up, usually a couple of per cent or so. However, long-term loans, leasing and hire-purchase agreements can involve legal costs.

## *Sharing ownership and control*

The source of your money helps determine how much ownership and control you have to give up in return. Venture capitalists generally want a large share of stock and often a large say in how the business is run. At the other end of the spectrum are providers of long-term loans, who generally leave you alone so long as you service the interest and repay the capital as agreed. You have to strike the balance that works best for you and your business.

If you don't want to share the ownership of your business with outsiders, then clearly raising equity capital isn't a good idea. Even if you recognise that owning 100 per cent of a small venture isn't as attractive as owning 40 per cent of a business ten times as large, it may not be the right moment to sell any of your shares – particularly if, in common with many business founders, long-term capital gain is one of your principal goals. If you hold on to your shares until profits are reasonably high, you realise more gain for every share sold than if you sell out in the early years or while profits are low.

Parting with shares inevitably involves some loss of control. Letting 5 per cent go may be merely a mild irritation from time to time. However, after 25 per cent has gone, outsiders can have a fair amount of say in how you run things. At that point, even relatively small groups of shareholders can find it easy to call an Extraordinary General Meeting and vote to remove you from the board. Nevertheless, while you have over 51 per cent you're in control, if only just. When you're past the 51 per cent things can get a little dangerous. Theoretically, you can be outvoted at any stage.

Some capital providers take a hands-on approach and may express a view on how you should run the business.

## *Limiting personal liability*

As a general rule, most providers of long-term loans and overdrafts look to you and other owners to provide additional security if the business assets are in any way inadequate. You may be asked to provide a personal guarantee – an asset such as your house. Only when you raise new share capital, by selling more stock in your company, do you escape increasing your personal liability. Even with the new share capital, you may be asked to provide warranties to assure new investors that you've declared everything in the company's history.

# *Going for Debt*

You can explore borrowing from a number of possible sources in your search for outside finance. Give those in the following sections the once-over.

Most people start and stop at a bank. The other major first source of money is family and friends, but many business starters feel nervous about putting family money at risk, and prefer to deal with professional financiers.

## *Borrowing from banks*

Banks are the principal, and frequently the only, source of finance for nine out of every ten new and small businesses.

Banks are usually a good starting point for almost any type of debt financing. They're also able to provide many other cash-flow and asset-backed financing products, although they're often not the only or the most appropriate provider. As well as the main clearing banks, a number of the former building societies and smaller regional banks are competing hard for small-firm lending.

If you import raw materials, your bank can provide you with Letters of Credit that guarantee your suppliers payment from the bank when they present proof of satisfactory delivery. If you have a number of overseas suppliers who prefer settlement in their own currency for which you need foreign currency, cheque facilities or to buy money at a fixed exchange rate before you need it, banks can make the necessary arrangements.

### HIPPYCHICK

When new mother Julie Minchin discovered the Hipseat, she knew she'd found a helpful product. Anything that makes carrying a baby around all day without ending up with excruciating back ache has got to be a benefit. It was only later that she realised that selling the product for the German company that made the Hipseat could launch her into business. At first, Julie acted as its UK distributor, but later she wanted to make major improvements to the product. That meant finding a manufacturer to make the product especially for her business. China was the logical place to find a company flexible enough to make small quantities as well as being able to help her keep the cost of the end product competitive.

Julie funded the business, Hippychick, with a small family loan, an overdraft facility and a variety of government grants. By its tenth year, the company had a turnover of £3 million a year, selling 14 new and unique products aimed at the baby market. Hippychick supplies national chains such as Boots, Mothercare and Blooming Marvellous, as well as independents. It also sells via a catalogue and website, and is in the process of building a network of distributors for its branded products.

### *Running an overdraft*

The principal form of short-term bank funding is an *overdraft* . An overdraft is permission for you to use some of the bank's money when you don't have enough of your own. The permission is usually agreed annually, but can be withdrawn at any time. A little over a quarter of all bank finance for small firms is in the form of an overdraft. The overdraft was originally designed to cover the time between having to pay for raw materials to manufacture finished goods and selling those goods. The size of an overdraft is usually limited to a modest proportion of the amount of money that your customers owe you and the value of your finished goods stock. The bank sees those items as assets, which as a last resort it can use to get its money back.

Starting out in a cleaning business, for example, you need sufficient funds initially to buy the mop and bucket. Three months into the contract, you've paid for these items and so getting a five-year bank loan to cover this expenditure is pointless, because within a year you'll have cash in the bank.

However, if your overdraft doesn't get out of the red at any stage during the year, you need to re-examine your financing. All too often companies utilise an overdraft to acquire long-term assets, and that overdraft never seems to disappear, eventually constraining the business.

TIP The example in Figure 1-1 is a good one of a situation where an overdraft may be appropriate. Funds in the example are only required for three weeks or so before the business is cash-flow positive.

The attraction of overdrafts is that they're easy to arrange, except in the most unusual of circumstances (such as during a global credit crunch). Also, they take little time to set up. But their inherent weakness is that the key words in the arrangement document are 'repayable on demand', which leaves the bank free to make and change the rules as it sees fit. (This term is under review and some banks may remove the term from the arrangement.) With other forms of borrowing, as long as you stick to the terms and conditions, the loan is yours for the duration – not so with overdrafts.

## KEEPING YOUR FINANCIAL BACKERS HAPPY

Most owner-managers don't give much thought to how to deal with their bank, factoring company or venture capitalist. They just jump right into their business and don't consider how they should treat these people, what their bankers can do for them and what their bankers in turn look for in a client. But with a little thought and effort, you can ensure that you get the most from your banking relationships.

Your banker, or any other source of finance, has the ability to influence the success of your business radically. Developing long-term, personal relationships with the banker is important – if you do that, when you hit the inevitable bumps in the road the banker will be there to help you.

Keep in mind when you meet your banker for the first time that you want to develop a long-term relationship with this person. The meeting should be a two-way interview. You should ask yourself: ‘Is this person genuinely interested in me? Is this person trying to understand my business? Does this person understand my objectives?’ If the answer to any of these questions is ‘no’, find another banker.

You often hire your lawyer and accountant by the hour or job, but your banker is another matter – your banker makes money off the fees that your business generates. Your banker is usually happy to help you, and can therefore be a source of free consulting, though you do need to be a little more careful today because bankers are beginning to get wise to the idea of charging for services. Shop around for the best-buy bank just as you do for any other product or service. Check out Money Facts ( http://moneyfacts.co.uk/bank-accounts/best-bank-accounts ) or Which 4 U ( www.which4u.co.uk/bank-accounts ) to see who’s offering the best deals.

### *Taking on a term loan*

If you’re starting up a manufacturing business, you’ll be buying machinery to last probably five years, designing your logo and buying stationery, paying the deposit on leasehold premises, buying a vehicle and investing funds in winning a long-term contract. Because you expect the profits to flow over a number of years, they need to be financed over a similarly long period, through a bank loan or by inviting someone to invest in shares in the company – in other words, a long-term commitment.

*Term loans* , as these long-term borrowings are generally known, are funds provided by a bank for a number of years. The interest can be variable – changing with general interest rates – or fixed for a number of years ahead. In some cases, you may be able to move between having a fixed interest rate and a variable one at certain intervals. You may even be able to have a moratorium (break) on interest payments for a short period, to give the business breathing space. Provided that you meet the conditions of the loan in such matters as repayment, interest and security cover, the money is available for the period of the loan. Unlike having an overdraft, the bank can’t pull the rug from under you if your circumstances (or the local manager) change.

## *Going with the government*

The government is often on hand with financial support of one sort or another for small firms. Politicians aren’t altruists. They know that helping the 15 per cent of the country’s working population that run their own business equates to votes. Also, the government’s financial support is pretty small beer: the sums involved are miniscule compared to, say, tinkering with the National Health Service or education budgets. But who knows? Some, perhaps many, of the businesses getting financial help now will pay it back in taxes or by creating work for other tax payers.

TIP

You can find out more about the details of all the finance schemes the government helps with on this section of its website: www.gov.uk/business-finance-support-finder .

## *Financing cash flow*

When your business is trading, two sources of finance open up that can smooth out cash-flow troughs when dealing with business customers. Factoring and invoice discounting are both methods of funding sales after you’ve submitted an invoice.

*Factors* provide three related services:

- Immediate financing of up to 80 per cent of invoiced sales, with the balance (minus administration and finance charges) payable after a set period or when the invoice is paid
- Managing the sales ledger, including sending out invoices and ensuring that they're paid
- Advising on credit risk and insuring clients against bad debts

This type of finance is provided against the security of trade debts (the amount of money customers owe you). Normally, when you raise an invoice you send a copy to the factor, who then funds up to 80 per cent against the invoice in advance of the customer paying. The remainder becomes payable on a maturity date or when the customer pays. Because the invoice is assigned to the factor, payment by the customer is direct to the factor.

*Invoice discounting* operates in a similar way, except the seller retains control of its debtors and is responsible for collecting the money.

These forms of finance are directly related to sales levels and can be particularly helpful during growth spurts.

TIP You may find in practice that not all providers of factoring or invoice discounting offer the same terms in light of their experience in your sector. You may need to shop around to get the best deal. The Asset Based Finance Association (`www.abfa.org.uk`) provides a list of over 40 members on its website, which has a search facility to help you define which organisations are best placed to meet your individual business requirements.

## Getting physical

You can usually finance assets such as vehicles, computers, office equipment and the like by leasing them or buying them on hire purchase, leaving your other funds free to cover less tangible expenses such as advertising or living expenses. You can use a lease to take the risk out of purchasing an asset that becomes obsolete or for taking account of repairs and maintenance costs. In return for this 'certainty', you pay a fee that's added to the monthly or quarterly charge. However, knowing the exact cost of purchasing and using an asset can be attractive and worth paying for. Hire purchase differs from leasing in that you've the option eventually to become the owner of the asset after a series of payments. Important tax implications apply to using these types of finance and you should discuss them with your accountant (Chapter 1 in Book 4 covers finding an accountant).

TIP The Finance and Leasing Association website (`www.fla.org.uk`) gives more information on the different products on offer to finance assets and has a directory of members and their contact details.

## Uniting with a credit union

If you don't like the terms on offer from the *high-street banks* , as the major banks are often known, you may consider forming your own bank. The idea isn't as crazy as it sounds. Credit unions formed by groups of small business people, both in business and aspiring to start up, have been around for decades in the UK, the USA and elsewhere. They're an attractive option for people on low incomes, and provide a cheap and convenient alternative to banks. Some self-employed people such as taxi drivers have also formed credit unions. They can then apply for loans to meet unexpected capital expenditure for repairs, refurbishments or technical upgrading.

Established credit unions usually require you to have a particular trade, have paid money in for a number of months or years and have a maximum loan amount limited to the types of assets people in their trade are likely to need.

Credit union usage in the UK has more than doubled in the past five years, with over 400 unions and over 1 million people using them. Worldwide, 56,000 credit unions operate in 101 countries, enabling 200 million members to access affordable financial services. The Association of British Credit Unions Limited (www.abcul.org) offers information and a directory of providers.

## Borrowing from family and friends

Those close to you may be willing to lend you money or invest in your business. This helps you avoid the problem of pleading your case to outsiders and enduring extra paperwork and bureaucratic delays. Help from friends, relatives and business associates can be especially valuable if you've been through bankruptcy or had other credit problems that make borrowing from a commercial lender difficult or impossible.

Involving friends and family in your business brings a range of extra potential benefits – but also costs and risks that aren't a feature of most other types of finance. You need to decide whether these risks are acceptable.

Some advantages of borrowing money from people you know well are that they may charge you a lower interest rate, you may be able to delay paying back money until you're more established and you may have more flexibility if you get into a jam. But after you agree to the loan terms, you've the same legal obligations as with a bank or any other source of finance.

WARNING Borrowing money from relatives and friends can have a major disadvantage. If your business does poorly and those close to you end up losing money, you may damage your personal relationships. So in dealing with friends, relatives and business associates, be careful to establish clearly the terms of the deal and put them in writing, and to make an extra effort to explain the risks. In short, your job is to make sure that your helpful friend or relative doesn't suffer true hardship if you're unable to meet your financial commitments.

REMEMBER When raising money from family and friends, follow these guidelines:

- Do agree proper terms for the loan or investment.
- Do put the agreement in writing, and if it involves a limited partnership, share transaction or guarantee, have a legal agreement drawn up.

- Do make an extra effort to explain the risks of the business and the possible negative implications to the money your loved ones are lending you.
- Do make sure that, when raising money from parents, other siblings are compensated in some way, perhaps via a will.
- Do make sure that you want to run a family business before raising money from your family as your experience will not be the same as running your own business. Your family members may want a say in how the business is run to make sure that their money is safe.
- Don't borrow from people on fixed incomes.
- Don't borrow from people who can't afford to lose their investment.
- Don't make the possible rewards sound more attractive than you would, say, to a bank.
- Don't offer jobs in your business to anyone providing money unless the person is best for the job.
- Don't change the normal pattern of social contact with family and friends after they've put up the money.

# Sharing Out the Spoils

If your business is particularly risky, requires a lot of upfront finance or involves new technology, you usually have to consider selling a proportion of your business's shares to outside investors.

However, if your business plan doesn't show profit returns in excess of 30 per cent per annum for the next three to five years (see Chapter 3 in Book 4 for more on profit ratios), and you aren't prepared to part with upwards of 15 per cent of your business, then equity finance probably isn't for you.

A number of different types of investor may be prepared to put up the funds if the returns are good enough. The following sections talk about each type.

## Benefiting from business angels

One source of equity or risk capital is private individuals, with their own funds and perhaps some knowledge of your type of business, who are willing to invest in your company in return for a share in the business.

Such investors have been christened *business angels* , a term first coined to describe private, wealthy individuals who backed theatrical productions, usually a play on Broadway or in London's West End.

By their nature, such investments are highly speculative in nature. The angel typically has a personal interest in the venture and may want to play a role in the company – often an angel is determined to have an involvement beyond merely signing a cheque.

Business angels are informal suppliers of risk capital to new and growing businesses, often taking a hand at a stage when no one else is prepared to take the chance – a sort of investor of last resort. But although they often lose their shirts, business angels sometimes make serious money. The angel who backed software company Sage with £10,000 in its first round of £250,000 financing saw his stake rise to £40 million, and Ian McGlinn, the former garage owner who advanced Anita Roddick the £4,000 she needed to open a second shop in return for about 25 per cent of her company's shares, eventually wound up with a couple of hundred million pounds from his stake in The Body Shop.

In the UK and the USA, hundreds of networks operate with tens of thousands of business angels who are prepared to put several billion pounds each year into new or small businesses. One estimate is that the UK has approximately 18,000 business angels and that they annually invest in the region of £500 million.

These two organisations can put you in contact with a business angel:

- UK Business Angels Association ( www.ukbusinessangelsassociation.org.uk ) is the national trade association representing angel and early-stage investment in the UK.
- Angel Investment Network ( www.angelinvestmentnetwork.co.uk ) operates a service matching entrepreneurs to angels. Its website also has a number of useful tools to help you get investor ready.

Alternatively, you can apply to appear on the BBC's business reality show *Dragons' Den* ( www.bbc.co.uk/programmes/b006vq92/features/dd-apply ) and put your proposition face-to-face to five angels and 8 million television viewers. Check out the 'Business School' ( www.bbc.co.uk/dragonsden/business ), an online resource to further your business knowledge.

## Going for venture capital

*Venture capital* is a means of financing the start-up, development, expansion or purchase of a company. The venture capitalist acquires a share of the company in return for providing the requisite funding. Venture capital firms often work in conjunction with other providers of finance in putting together a total funding package for a business.

*Venture capital providers* invest other people's money, often from pension funds. They're likely to be interested in investing a large sum of money for a large stake in a company.

Venture capital is a medium- to long-term investment of not just money but also time and effort. The venture capital firm's aim is to enable growth companies to develop into the major businesses of tomorrow. Before investing, a venture capital provider goes through *due diligence* , a process that involves a thorough examination of both the business and its owner (see the later section 'Understanding due diligence '). Accountants and lawyers subject you and your business plan to detailed scrutiny. You and your directors are required to warrant that you've provided *all* relevant information, under pain of financial penalties.

In general, venture capitalists expect their investment to pay off within seven years. But they're hardened realists. Two in every ten investments they make are total write-offs, and six perform averagely well at best. So the one star in every ten investments they make has to cover a lot of duds. Venture capitalists have a target rate of return of 30 per cent plus, to cover this poor success rate.

Raising venture capital isn't a cheap option. The arrangement costs almost always run to six figures. The cost of the due diligence process is borne by the firm raising the money – but is paid out of the money raised, if that's any consolation. Raising venture capital isn't quick either. Six months isn't unusual and over a year has been known. Every venture capitalist has a deal done in six weeks in his portfolio, but that truly is the exception.

Venture capital providers want to exit from their investment at some stage. Their preferred route is via a public offering, taking your company onto the stock market, but a trade sale to another, usually larger, business in a related line of work is more usual.

New venture capital funds are coming on stream all the time and they too are looking for a gap in the market.

TIP The British Venture Capital Association (www.bvca.co.uk) and the European Venture Capital Association (www.investeurope.eu) both have online directories giving details of hundreds of venture capital providers.

TECHNICAL STUFF Venture capital is just a subset of private equity. Both invest in companies and both make money from investments rather than advisory fees. Venture capitalists often invest in start-ups with high growth potential and are often minority shareholders. Private equity firms mostly buy between 80 per cent and 100 per cent ownership of companies in which they invest and focus primarily on established growth businesses.

### *Looking to corporate venturing*

Alongside the venture capital firms are 200 or so other businesses that have a hand in the risk capital business, without it necessarily being their main line of business. For the most part, these firms have an interest in the Internet or high technology and want an inside track to new developments. Their own research and development operations have slowed down and become less and less entrepreneurial as they've grown bigger. So they need to look outside for new inspiration.

Even successful firms invest hundreds of millions of dollars each year in scores of other small businesses. Sometimes, if the company looks a particularly good fit, they buy the whole business. Apple, for example, while keeping its management team focused on the core business, has a $12 million stake in Akamai Technologies, whose software tries to keep the Web running smoothly even under unusual traffic demands.

Not only high-tech firms go in for corporate venturing. Any firm whose arteries are hardening a bit is on the look-out for new blood. McDonald's, for example – hardly a business at the forefront of the technological revolution – has stakes in over a dozen ventures. At one time it had a 35 per cent stake in Pret a Manger, but when it decided that the Pret model didn't fit well with the

McDonald's business, it offloaded its stake to Bridgepoint for £345 million – four times its initial stake, and a good result for both parties.

When Alex Cassie was casting around for cash to get his new business making parts for car companies such as Aston Martin, he was steered to an apparently unlikely source: Michelin, the French tyre firm. Since 2003, Michelin has operated a scheme pledged to put £3 million into small firms near its British plants. Michelin put £20,000 into Cassie's business, which within four years employed 68 people and had an annual turnover of £5 million.

### INNOCENT

In the summer of 1998, when Richard Reed, Adam Balon and Jon Wright had developed their first smoothie recipes but were still nervous about giving up their jobs, they bought £500 worth of fruit, turned it into smoothies and sold them from a stall at a London music festival. They put up a sign saying 'Do you think we should give up our jobs to make these smoothies?' next to bins labelled 'YES' and 'NO', inviting people to put the empty bottle in the appropriate bin. At the end of the weekend the 'YES' bin was full, so they went to work the next day and resigned. The rest, as they say, is history. Virtually a household name, Innocent Drinks has experienced a decade of rapid growth.

But the business stalled in 2008, with sales slipping back and European expansion soaking up cash at a rapid rate. The founders, who had an average age of 28, decided that they needed heavy-weight advice and talked to Charles Dunstone, Carphone Warehouse founder, and Mervyn Davies, chairman of Standard Chartered. The strong advice was to get an investor with deep pockets and ideally something else by way of business experience to bring to the party to augment the youthful enthusiasm of the founders. They launched their search for an investor the day that Lehman Brothers filed for bankruptcy. In April 2009 the Innocent team accepted Coca-Cola as a minority investor in their business, paying £30 million for a stake of between 10 and 20 per cent. They chose Coca-Cola because, as well as providing the funds, the company could help get Innocent products out to more people in more places. They could also learn a lot from Coca-Cola, which has been in business for over 120 years.

## *Understanding due diligence*

Usually, after a private equity firm signs a letter of intent to provide capital and you accept, the firm conducts a *due diligence* investigation of both the management and the company. During this period the private equity firm has access to all financial and other records, facilities and employees to investigate before finalising the deal. The material the firm examines includes copies of all leases, contracts and loan agreements in addition to copious financial records and statements. The firm wants to see any management reports, such as sales reports, inventory records, detailed lists of assets, facility maintenance records, aged receivables and payables reports, employee organisation charts, payroll and benefits records, customer records and marketing materials. It wants to know about any pending litigation, tax audits or insurance disputes. Depending on the nature of the business, it may also consider getting an environmental audit and an insurance check-up.

The sting in the due diligence tail is that the current owners of the business are required to personally warrant that everything they've said or revealed is both true and complete. In the event that this warrant proves not to be so, owners are personally liable to the extent of any loss incurred by those buying the shares.

# Chapter 2

# Seeking (Nearly!) Free Money

**IN THIS CHAPTER**

- **Getting a grant**
- **Winning awards**
- **Using crowdfunding**
- **Making the most of accelerators and incubators**

At the start of your funding journey, you probably immediately think of your bank as the first port of call. A very logical thought, as for the vast majority of people any contact with money, especially when it comes to business, goes through a bank. Your banking relationship often goes back many years. You may still bank where you opened your first savings account, it's where you put your wages, and if you're lucky enough to have a foot on the property ladder, it's where you got your mortgage. So far, so good. However, that's where the logic ends.

In all of these transactions, you're giving the bank money or pledging security in the form of property, so the risk of something going wrong from the bank's point of view is very small indeed. Your new business venture, on the other hand, is probably unproven, has yet to make any profit or perhaps even any money, and you cannot map out a clear path to being able to repay any money that the bank may choose to lend to you. In short, your business venture is chock full of all kinds of risk, in the bank's opinion. Your request for funding, rather than being music to your bank manager's ears, is setting off high-pitched piercing alarm bells, sending her scurrying double-time down the corridors of stability and risk aversion, leaving a vapour trail behind her!

Don't get us wrong. You need a bank when you start a business if for no other reason than to have a place to deposit any money you manage to raise. Plus, you need to pay the bills that inevitably come along, so stick with the relationship, but don't expect to be welcomed with open arms when it comes to asking for money. *Risk* is a dirty word in commercial banking, and at the start-up stage, you are risk with a capital *R* . Bank funding for all stages of your business is covered in Chapter 1 of Book 2.

When the reality of the bank scenario sets in, and after sipping herbal tea to calm your nerves, you logically turn your mind to a potential source of free money: the people who have known and nurtured you for a long time – your family and friends. After all, they like you, even love you, and they care about your happiness, so it must follow that they trust you to have a game-changing idea and all the skills to make it a great success. They must want to give you money to get it off the ground. Right? Nearly right.

It's probably easier to get money from family and friends than to get it from a bank, but it's by no means a given. Family and friends who can afford to lose money if things don't go to plan are a good source of early-stage funding, but as it's literally their own money, it's sometimes like pulling teeth to get them to sign and hand over that cheque or instruct their bank to transfer the funds to your bank. It’s human nature. As they stare down into the abyss that could become your bottomless money pit, imagining their good money going in after others’ bad money, it’s natural for them to feel a sense of panic at the moment of handing over the cash. It’s your job to anticipate this, and, in exactly the same way that you’d convince a total stranger to help fund your business, you need to present a watertight case to your nearest and dearest in order to convince them that investing in your business or lending you money to get started is a good idea, with minimal risks. Find out more detail in Chapter 1 of Book 2.

This is a good time to mention the other often overlooked but nevertheless extremely important source of free finance when it comes to gaining the financial commitment of others – you! Yes, you! You are one of the most obvious sources of finance when you start or expand your business. We know, we know, you’re thinking, ‘Have these guys lost their minds? Don’t they know that I’m putting my heart, my soul, my body, in fact all my time and energy into this business? Isn’t that enough? How can I also be expected to put in actual hard cash?’

Like it not, you are expected to put in some of your own money. If you don’t have enough faith to risk some of your own money in your new venture – have some skin in the game, so to speak – how can you expect anyone else to be a player? Investing your own money has an impact on your ability to get money out of other people. It’s the idea that you’re all in it together that you need to get to grips with, even though you’re doing all the work and having all the sleepless nights. It may not seem fair, but, as you know, life isn’t always fair.

The final frontier in your quest to find low- or no-cost funding, particularly at the early stage of your business but potentially throughout its life, is through grant and awards money, and more recently, through reward-based crowdfunding, where products or experiences are given (instead of equity shares) in exchange for funding.

# Researching and Obtaining Grants

Depending on the industry sector, stage and location of your business, a *grant* (a sum of money given to a business or an individual for a specific purpose) can be a terrific way to get some cash into your business, especially at the very early stages when cash is generally in short supply. You can also use grant monies to widen your network, boost your company profile and potentially enable your business to do some good or make a positive difference to a deprived or marginalised area of society.

Given that some of the more traditional forms of finance may be beyond your current reach, a *research grant* to develop a new product or service, or a *proof of concept grant* to prove that your product or service is viable, for example, may seem like manna from heaven in the start-up phase of your business.

WARNING Nearly every country or region has an agenda and aims that it wants to promote and develop, and using grants to encourage entrepreneurs to help them achieve their objectives is very common now. That’s great news, we hear you say, and it is. However, locating the applications forms, understanding the criteria, taking the time to complete the forms, applying at the right time and understanding how to utilise the money for a commercial proposition can have you spending many precious hours working on something that may or may not give you a positive result. Be prepared to trawl through the mire of dozens of websites, racking up loads of hours and often taxing your brain to understand how you fit into the scheme, with the knowledge that you have a relatively slim chance of success. Although it's tempting to apply for free money, think long and hard before you start off down the grant road. It may well be a long and frustrating journey, with an uncertain destination.

You can stay informed about current programmes by looking at information published and available at

- The business centre in the British Library Business and IP (intellectual property) Centre in London at www.bl.uk . The business centre has low-cost workshops, events, free access to databases on available funding and staff to help you research and identify appropriate grants for your business. They also partner with organisations that may be able to help you identify and apply for grants.
- The Gov.uk site at www.gov.uk covers a variety of funding options, including grants, and has a handy search function on the site, as well as links to the grants it lists.
- The website F6S at www.f6s.com is another good source of information, and has some applications on its site as well. F6S is a leading portal for start-ups to find and discuss information on funding, start-up business support programmes, jobs and events. Some grant-awarding programmes use the F6S portal as an entry point to providing you with information and the initial stages of an application for funding.

TIP Grant applications can use particular terminology and have very strict deadlines. Use these tips to help make your application successful:

- Continually check the websites that provide information about your desired grants, as information, criteria, deadlines and amounts of money available can change.
- Read the full criteria and application forms before you start so you can gather the necessary information and gauge the amount of time and resources you need to complete the application on time.
- If possible, speak to the grant providers to get advice on how to complete the forms, clarify terms and get any other resource contacts that may help you.
- See whether you can speak to or email past recipients for advice, hints or tips.
- Attend free or low-cost workshops on offer online or at business advice centres or local further education colleges in your area that give you guidance on how to complete grant applications.
- Put the word out in your network that you're seeking help with applying for grants (if you need extra help).

REMEMBER Grants and awards come and go on a regular basis. If you're serious about trying to attract some of this money, register on sites such as www.f6s.com and regularly check sites that aggregate grant data, such as www.gov.uk , so you can receive regular newsletters, updates, changes, notices and so on. You don't want to miss out on an opportunity because you didn't know the deadline had passed.

If you're successful in your grant applications, you won't have to chase anyone to get the cash, and as grants are different from debt, you don't have to repay them. They differ from equity as well in that you don't have to provide a return to the investor. In general, they're non-refundable chunks of money, doled out over a pre-determined period of time – usually linked to achieving milestones – and offered as an incentive to entrepreneurs and businesspeople to develop something innovative or positive for the community at large. As such, a grant can provide a very welcome boost to your cash flow.

Grants aren't all good news, though, as they usually have very detailed terms and conditions that you must strictly adhere to, including regular financial updates, quarterly reporting on progress, and updates on whether or not you are achieving your aims and objectives. They give with one hand and take with the other.

WARNING No one would suggest that it's not helpful to have free money – but be warned, there's no totally free lunch. Although you may not have to pay a grant back, nine times out of ten you have to abide by the organisations' specific criteria and desired outcomes, and you may need to match the amount you're awarded.

### PAYING FOR APPLICATION HELP

A number of professional advisers specialise in grant applications. These people charge a fee, but they take away a good deal of the pain from making grant applications.

As with other advisers, it's essential that you check the person's track record and the integrity of the service before you sign on the dotted line. Use your network, rating sites, reviews and past clients to make sure the company is legitimate, relatively successful and good value for your money.

Beware anyone who guarantees success or refuses to explain her process. Grant funding is a highly competitive and complex arena, and no one can guarantee success.

## Applying for Awards

Even though it can be a time-consuming process to hunt them down and fill in the forms, applying for and winning awards can be a great source of additional cash. Winning an award – or even being shortlisted for one – often carries other benefits as part of the prize, including business support, mentoring, free work space and of course, potentially very useful publicity and networking.

Certain sectors, such as technology, biology and life sciences, green energy, long-term healthcare, education, socially minded businesses, manufacturing and certain regional businesses, have more grant funding available from both UK and EU organisations than other sectors. In fact, a number of *evergreen programmes* , awards that roll over each year, may be relevant to you and your business, even in its early stages.

TIP Some programmes are listed in the next sections, but more can be found on the Innovate UK website at www.innovateuk.org . If you're serious about applying for grants and awards, visiting the site can pay dividends. Some of the awards you can find on Innovate UK cover:

- Feasibility studies for cleaner, more efficient fuels
- The agri-tech industry
- Supply chain integration for the construction industry
- Enhancing the user experience in retail

A regular visit to the Innovate UK website is worthwhile to see what's current – and critically, when the deadlines are!

WARNING Most of these applications are complex and lengthy, so do *not* leave them until the night before. Be aware that they can put a strain on the twin resources of time and people, and plan accordingly. Set strict project management timelines and deadlines if you want to have half a chance of success.

## Starting off with a SMART award

One of the most well-known and high-profile awards administered by Innovate UK, the SMART awards – Small Firm Merit Awards for Technology – were first introduced in their original format back in 1988. It is a competition so it has a closing date for entries, and while your application may be outstanding, if there are ones judged as better on the day you may miss out. This doesn't mean you shouldn't consider entering again – perhaps next time get luckier!

TECHNICAL STUFF The central government launched the SMART awards before handing over responsibility to the Regional Development Agencies (RDAs) ten years later. With the demise of the RDAs a few years ago, the baton was passed to the Technology Strategy Board (TSB), which in turn became Innovate UK, and this is where the information and application process now sits.

WARNING The application process isn't generally an easy one. There are a few very important aspects to winning that you need to keep in mind, one of them being the need to match the funding with the same or similar amount. You can get these matching funds from a variety of sources – your own pocketbook, the debt or equity you raise, contributions from investors – but therein lies the rub.

Recently, a total of £75 million awarded over three years has been set aside for innovative small businesses. On average, 70 awards are given each year, broken down into three areas:

- **Proof of market:** A very early-stage award, it covers market research and intellectual property issues. It's important that you apply before you start spending money on the areas it covers, because you can't claim it back later. The maximum award size is £25,000, and it can be used to fund up to 60 per cent of a project's costs over a maximum timeframe of 9 months.
- **Proof of concept:** This grant can be used for carrying out feasibility studies to prove your concept has merit, for creating prototypes and for doing some testing on them. The maximum award size is £100,000 and can cover up to 60 per cent of the cost of the work over a maximum timeframe of 18 months.
- **Development of prototype:** When you've proven there's a market and your concept is a workable one, this grant helps to further develop the prototype, create a working demonstration model and obtain further or additional intellectual property rights. The maximum at this stage is £250,000 to cover up to 35 per cent of a project's costs for mid-sized firms and up to 45 per cent of the costs for a small business with a maximum timeframe of 2 years.

Clearly, you need to have some funds to put into these projects at every stage, so be aware of that before you get started on the forms. You don't have any wiggle room – you will have to come up with the additional cash.

## *Gaining expertise with Knowledge Transfer Partnerships*

Knowledge Transfer Partnerships (KTPs) are, technically speaking, not grants but rather funding to cover up to two-thirds of the cost of a graduate associate with a particular knowledge or expertise. A small- or medium-sized enterprise (SME) can take on that associate for a specific project for a specified period of time (from six months to three years) in order to help bring the project to fruition. You can find out all about KTPs at `www.gov.uk/guidance/knowledge-transfer-partnerships-what-they-are-and-how-to-apply`.

WARNING Because the KTP contribution is £20,000, you really need to have a business that benefits from academic input. You also need to be able to come up with the remaining matching funds that apply to your award for the salary.

If you have an innovative idea, you can apply to work with an expert at a university or research organisation. This person can also help with the graduate recruitment. The logic behind the scheme is to help take academic know-how and apply it in a commercial environment, using the expert as the conduit between research-based and business-led organisations. Seems simple, logical and, dare we say it, laudable, but when academia collides with commerce, it can sometimes be nothing like simple, so make sure you do your research.

You can stay up to date on the latest KTPs through the KTN (Knowledge Transfer Network) and network with other businesses in your sector at `www.ktn-uk.co.uk`.

## *Being nurtured by Nesta*

A very active and high-profile organisation for funding and grants is Nesta (formerly NESTA, National Endowment for Science, Technology and the Arts) at www.nesta.org.uk. Originally funded by a £250 million endowment from the UK National Lottery, Nesta is a well-known independent charity that uses the interest from a trust to meet its charitable objectives and to fund and support projects. It works primarily to enable entrepreneurs to bring exceptional innovative ideas to life by providing opportunities for grant funding, direct investment and competition or challenge prizes. Its funding programmes are supported by policy work to provide a voice for industry, research and the formation of strategic partnerships to promote innovation across a broad range of industry sectors.

Broadly speaking, Nesta funding falls into two categories: direct investment for a share in a business, and challenge prize awards with no share in the business.

### *Direct investment*

With its direct investment, Nesta looks for scalable social ventures with projects that show they can make a significant social impact while still producing a return on investment. This combination isn't something you find on every business street corner, and as a result, not everyone is successful in obtaining funds. Nesta is particularly interested in businesses with projects that address major social needs and that look to create a more inclusive and accessible society, while being able to scale up and reach a wider audience. You can see more on its investments at www.nesta.org.uk/get-funding/impact-investments.

In addition to investing directly in companies, Nesta also launched an impact investment fund for high potential, early-stage social innovations through its fund management subsidiary, Nesta Investment Management. This money is invested in intermediaries that then award funds to the businesses they choose to work with in the area of social impact. Some of the better known custodians of the funds are Bridges Ventures Social Entrepreneurs Fund (www.bridgesventures.com) and Big Issue Invest's Social Enterprise Investment Fund LP (www.bigissueinvest.com).

TECHNICAL STUFF Big Issue Invest's Social Enterprise Investment Fund has invested over £30 million in more than 300 businesses. It backs people looking for anything from £50,000 to £1.5 million.

These funding vehicles provide incubation, business support or corporate finance advice to innovative social ventures via a link to established organisations such as the Shaftesbury Partnership or Bethnal Green Ventures, which extends the reach of the support and helps to ensure its impact.

### *Challenge prize awards*

The second way Nesta provides a bit of so-called free money is through challenge prizes.

TECHNICAL STUFF Challenge prizes have a long and prestigious history in the United Kingdom, going back to the 18th century and the Longitude Prize for navigators through to the 20th century

Schneider Trophy for aviators, which inspired the Spitfire, and the 21st century Ansari X-Prize, which inspires commercial ventures in space.

Nesta offers a variety of challenge prize competitions with varying criteria and deadlines, so it's best to keep checking its website, but here is a sample of what you may see:

- **The European Social Innovation Competition:** €150,000 for ideas that can advance Europe's growth model.
- **The Smart Aging Prize:** A €50,000 challenge prize for efforts to find solutions to improve the lives of older people by reducing isolation and improving mobility.
- **Horizon 2020:** A European challenge (covered later in this chapter) that brings together knowledge and resources across a number of disciplines in order to find and fund breakthrough solutions in the areas of health, transport, bio-economy, creative materials and energy.

So the sky really is the limit when it comes to providing an incentive to find forward-thinking solutions for some of the long-term social issues of the day. As with other awards, prizes are a great way to get your hands on some cash, but also a wonderful showcase for your innovative idea or product, generating much-appreciated free publicity and raising the profile for your business.

## *Winning European awards*

When you read the marketing blurb on EU funding, you'd be forgiven for thinking that it's a piece of cake … or tart … or torte to get grant funding for a worthy cross-border collaboration project. But don't be fooled by the glossy pictures of happy people having important meetings in sunny locations or the upbeat descriptions of the untold riches that await you and draw you into the lengthy application process, all the time glossing over the reality that applying for EU funding is tough, and for first timers, it can feel particularly overwhelming.

TIP In fact, if you're a newcomer to EU funding, it's often advisable to form a consortium and seek an experienced partner to take the lead on your application. Find an experienced guide to help you navigate the choppy waters of the sea of European funding forms.

Be prepared for the red tape and bureaucracy, and strap yourself in for what can be a daunting and challenging journey on the trans-European funding express.

That said, if you manage to crack the code and are successful in obtaining EU funds, it can have a significant positive impact on your research and development (R&D) budget, and escalate your entry to new business markets. So be aware, but don't be put off.

### *Horizon 2020*

Horizon 2020 (`https://ec.europa.eu/programmes/horizon2020/`) covers some European funding awards. Open to everyone, it's the largest EU research and innovation programme ever. Horizon 2020 helps to bring about the realisation of ground-breaking discoveries and life-changing breakthroughs around societal challenges by providing some of the funding needed to take ideas and develop live products or services. It assists with job creation, adds to economic growth and safeguards Europe's position as a competitive innovator.

By connecting research and innovation, Horizon 2020 is helping to cut out some of the red tape that slows down public–private partnerships, which helps to connect innovators with networks and funders and ensure that Europe continues to produce world-class scientific results.

As of 2016, it also covers certain elements of the somewhat mysteriously named EU Seventh Framework Programme (FP7), which targets early-stage innovative companies working collaboratively on research and development with a number of other EU partners and has a current funding budget of around £80 million. The programme is set to continue until 2020.

The newly named EU Framework Programme for Research and Innovation is complemented by measures to further develop the European Research Area (ERA), thereby breaking down national barriers in order to create a genuine single market for knowledge, research and innovation.

The important things for you to know about Horizon 2020 are:

- Applications must come from a consortium of at least three partners from at least two European countries.
- Awards are granted to organisations as well as individuals.
- Successful applicants have projects that run from two to five years, with budgets of hundreds of thousands to millions of Euros.
- Typically, 50 per cent of costs are reimbursed, but the level may be as high as 75 per cent.

Part of the reason for wrapping FP7 up in Horizon 2020 seems to be to make it easier for SMEs to navigate the application process, and to reduce the amount of time it takes to get a decision. But as with all grants, be prepared to wait patiently and keep checking the website to stay up to date on current procedures.

### *Eurostars*

Another transnational programme that sees its second phase moved under Horizon 2020 is the publicly financed €1.2 billion Eurostars Programme (`www.eurostars-eureka.eu`). As with other EU-funded programmes, it's aimed at research-heavy SMEs, helping partnerships to find funding more efficiently and to get a commercial product to market in a shorter time frame.

With a 25 per cent success rate, it gives better results than some of the other EU programmes – but it wouldn't be prudent to count your chickens before they hatch. That still leaves a 75 per cent rejection rate.

# *Raising Money from the Crowd*

If the effort to secure grant funding feels like a mammoth task, and you're unwilling to subject yourself and your team to hours of seemingly futile form filling, perhaps crowdfunding offers a more attractive alternative answer to your funding need.

Over the past few years, the business world has seen the birth and rapid growth of what appears to be a new way of raising funds, known as crowdfunding. *Crowdfunding* is an organised means for a large group of people to make mostly small individual donations to fund a business or an idea. It uses the power of the Internet to bring the two sides together. Crowdfunding replicates some of the more traditional funding activities in an online format, such as pitching for a desired amount of finance. As finance for business goes, this new vehicle puts the entrepreneur in the driving seat, and empowers members of the public and the investor community – the *crowd* – to get a piece of the action as paying passengers in a number of companies. Heady stuff for both entrepreneur and investor.

However, crowdfunding as such is not an entirely new concept. In fact, a type of crowdfunding can be traced back to the 1700s, when what came to be known as *microfinance* was started by Jonathan Swift in Ireland when he set up a fund to give loans to low-income families.

Similarly, a renowned philanthropist, Dr Mohammad Yunus, established the modern version of microfinancing in 1976 when he began giving loans to women on low incomes living in Bangladesh. From these humble beginnings, more and more loans were made, and within a period of seven years, the now world-famous Grameen Bank was formed to carry on the good work. Dr Yunus and the Grameen Bank were awarded a Nobel Peace Prize in 2006.

REMEMBER Crowdfunding can raise funds in one of three ways:

- **Equity:** Offers some share in the business for money invested.
- **Loans:** You can also pay interest to investors and treat the funds as a loan.
- **Reward-based:** Exchanging gifts or rewards based on the amount of giving. As the entrepreneur, you set the amount and the timeframe for your fundraising, determine the reward levels, and the crowd pledges money. Some sites require the campaign to be fully funded before releasing the money; others forward the funds regardless of whether you reach your goal.

  So if you want vitamin-infused water for life, or a spin in a luxury electric vehicle a few times a year for the next ten years, for example, you may find a reward-based platform helps you do something useful or good, and get something useful or good in return.

Get details on both these types of crowdfunding in Chapter 5 of Book 6. You can also find out more about this extremely popular topic in *Crowdsourcing For Dummies* by David Alan Grier (Wiley).

WARNING You may have to pay success fees that vary between 4 and 9 per cent of the amount you raise. In addition, credit card companies and online payment services may charge up to an additional 9 per cent. So the funds aren't entirely free of charge.

You can find a number of crowdfunding sites listed on the UK Crowdfunding Association (established 2012) website at `www.ukcfa.org.uk`, but the two most talked about rewards-based sites are Kickstarter and Indiegogo.

At the moment, both of these well-known sites operate a pledge system. People become backers and support a project with a pledge of money in order to see the project come to life. They receive a reward as a thank you instead of receiving a financial reward. The reward may be something as simple as a book or as extravagant as a walk-on part in a film, depending on how much is pledged to what project. An interesting example is that of an artist who raised funds to create a wall installation, then gave pieces of it to her backers when the exhibit ended.

Although no equity changes hands, you still need to approach reward-based crowdfunding in much the same way you would for an equity-based fund raise.

TIP For a successful crowdfunding experience:

- Produce a well-thought-out video, delivered with enthusiasm and passion, while also ensuring that you get the facts across, as well as the reward structure.
- Tell your story effectively to get people excited about it.
- Get your timing right. From the first day of your campaign until the last day, even down to the time of day you finish, you need to time it for when people are likely to be logged on. You also need to leave enough time to get your network going and to fit the timeframe within which you actually need the money.
- Make sure your perks and rewards are clearly presented and easily understood.
- Maximise the use of the comments section – good comments encourage more people to get involved.
- Create a specific link and hashtag for your campaign; they make it easier to spread the word.

## *Starting up with Kickstarter*

Kickstarter (www.kickstarter.com) is predominantly for creative projects, be they films, games, art, design or music. It has its roots in the United States. In 2012, a UK version was launched to encourage local giving for local projects, and nearly 10 million people have pledged nearly £2 billion. The site is a resounding success, demonstrating the power of people and the life-changing achievements that happen when people get behind each other.

In much the same way that other financially incentivised sites demand that projects reach full pledge subscription, Kickstarter is an *all-or-nothing site* , meaning that you get nothing unless your project is fully funded. You set the pledge amount, and you set the deadline, but you must then go shake the trees and make the golden fruit drop into your funding crate. To some people this seems harsh, but it does mean that you need to mobilise the power of your crowd and get people doing something versus talking about doing something for your idea, so it’s a great financial firecracker.

To date, an impressive 36 per cent of projects have reached their funding goals. Creators keep 100 per cent ownership of their work, but a 5 per cent success fee goes to Kickstarter.

## *Moving up with Indiegogo*

Founded in San Francisco in 2008, Indiegogo (www.indiegogo.com), one of the first crowdfunding sites, has a global audience. It covers the spectrum from creative ideas to start-up business ideas to charity projects.

The success rate is lower than Kickstarter’s, at 34 per cent. Its success fee starts at 5 per cent on a fully funded pledge, and 5 per cent on a partially funded pledge (Kickstarter doesn’t offer partial funding). Indiegogo also charges up to 9 per cent on credit card and PayPal pledges, so the fees can add up.

In 2014, it launched Indiegogo Life (now called Generosity; see www.generosity.com ), enabling people to raise funds for life events, such as celebrations, and for emergencies, medical expenses and so forth. Generosity is different than Indiegogo with regard to the fees it charges for the funds raised, allowing fundraisers to keep more of the money they raise.

# Comparing Accelerators and Incubators

Before we dive deep into the potential benefits of receiving accelerator finance, it's useful to make a distinction between incubators and accelerators. These terms are often used interchangeably, and although you can get funding from both, incubators tend to be advantageous in the idea or pre-start stage of your business, whereas an accelerator guides you as you transition from pre-start to start-up phase and then speed your growth using funding, education, learning, mentoring and showcasing.

REMEMBER In a nutshell, an *accelerator* provides services to support your business, often in return for equity, as your business begins to scale and grow. *Incubators* focus on very early-stage, small companies that have an idea that needs developing into more of a business.

## Incubators

Most incubators are for purely commercial start-ups, providing very early-stage support for an idea that will morph into a business in the not-too-distant future. Others offer support – often securing public funding – to companies focused on the science and technology or higher education sectors, where high-cost, long-term research is required.

An incubator may focus on growing or *hot housing* , helping your seed of a business idea take root. An incubator helps get your idea to a product or service in the market. Equity is usually taken but often funding is *in kind* – office space, mentoring, training, showcasing and so on, and the amount of equity taken is small.

If you're in an incubator, your place in the market is not fully clarified, and the chances are that by the time you leave the safety of the cosseted incubator space, your business will be unrecognisable from what it was when you entered.

## Accelerators

Typically, an accelerator assists you for around 10–15 weeks. Although many accelerators are aimed at tech firms – be they medical, educational, financial technology or otherwise – you can now find some non-tech ones, such as for food and beverages, with more beginning to pop up around the UK.

Accelerators can provide a supportive, safe place to prove your idea has legs and develop your strategy in a meaningful way. They usually have a fantastic network of contacts and a pretty impressive group of experienced, relevant mentors who can help to thrust your business forward and keep you on track and accountable.

Accelerators are focused on the point at which you scale up your growth. You're at the stage just before a venture capitalist (VC) may show interest – VCs are in the wings waiting to see evidence of scalable growth – and many accelerators make introductions to these funders at the end of their support process.

The wider world of funding views businesses in accelerators in one of two ways:

- You're sizzling hot because the competition to be selected is super fierce.
- You're too early to be of interest to anyone who's making serious investments and of no interest at this point.

The people running the accelerator need to do all they can to combat the latter point of view. By making a small investment in your business, an accelerator acts as the touchpaper to ignite your rapid growth in exchange for a single-digit equity share, paving the way for eventually getting you in front of willing and able next-round investors.

### *Exchanging equity for support*

Accelerators provide support in a variety of guises, from training to showcasing. They're also a proving ground for what they hope will be the next colossal success. The aim of an accelerator is to invest early and get in on the ground floor of the next big thing.

Accelerators offer different options for how much equity you're willing to give up in exchange for funds and support. Arrangements may be something like a 3 per cent interest in your business in return for access to all the accelerator's services, but no lump sum of funds; or 7 per cent for access to all the services and an additional lump sum of money on top. Some offer straight money for shares and others offer a combination with what's known as *convertible debt* , which, in simple terms, sees debt offered to you turning into shares at a later date. The range is broad.

In the UK, accelerators come in all shapes and sizes, but some of the more recognisable names are shown in Table 2-1 .

**TABLE 2-1 A Selection of UK Accelerators**

| *Accelerator (URL)* | *Speciality* | *Location* | *Programme Length* | *Investment/ Equity* |
|---|---|---|---|---|
| Accelerator Academy ( http://acceleratoracademy.com) | Digital | London | 12 weeks | £600 flat fee; refunded if your company raises funds within 3 months |
| Bethnal Green Ventures ( www.bethnalgreenventures.com) | Tech | London | 3 months | £15,000 for 6% |
| Collider ( www.collider.io ) | Advertising and marketing | London | 4 months | £50,000 for 11% with charges and a pyramid system for proven success |
| Emerge Education ( www.emerge.education ) | Education | London | 3 months | £15,000 for 3–8% |
| Goldman Sachs 10,000 Small Businesses ( www.goldmansachs.com or www.ucl.ac.uk/advances ) | Scalable business | London and Yorkshire – operating through universities | 6 months | None |
| Idea Alive ( www.ideaalive.co.uk ) | Digital | Manchester/ Liverpool | 10 weeks | Charge of 1% of amount raised or £5,000 (whichever is greater) |
| Ignite 100 ( www.ignite100.com ) | Software | Newcastle-upon-Tyne | 14 weeks | £17,000 for 8% |

| | | | | |
|---|---|---|---|---|
| Level 39 ( www.level39.co ) | Finance, cyber-security, retail | London | Works on a membership basis | Depending on membership |
| Oxygen Accelerator ( www.oxygenaccelerator.com ) | Tech | Birmingham | 13 weeks | €21,000 for 8% |
| Seedcamp ( www.seedcamp.com ) | Tech | London (UK office) | 3 months | €75,000 for 7% |
| Startupbootcamp ( www.startupbootcamp.org ) | Global scaling | London (UK office) | 3 months | Several variable offers |
| Techstars ( www.techstars.com/programs/london-program ) | Tech | London | 3 weeks | $100,000 for 6% |
| Wayra ( www.wayra.co.uk ) | Tech | London (UK office) | 6–12 months | £40,000 in services for 7–10% |

### Checking the benefits

The funding you receive from an accelerator is obviously important, but it's far less useful without the additional benefits that accompany the money and help propel your business forward. Getting you in front of investors, connecting you to commercial opportunities and giving your business a much higher profile in the marketplace are all incredibly valuable benefits of taking part in these programmes.

Although you find slight variations in what they provide, a typical offer from an accelerator in the current marketplace includes:

- A crash course in business development to start you off.
- A tie-in with business providers, giving you discounts on core services including legal and accountancy.
- Workspace and access to accelerator staff.
- Introductions to key investors at home and abroad. Some accelerators run scheduled trips to offices in other cities and other countries for each programme.
- Inclusion in exclusive, invitation-only audiences and to broader networking events, where you can expose your business to other clients of the accelerator, build connections and create further commercial and peer networks.
- Mentoring services that give you regular sessions with specialists and industry experts.
- A full schedule of seminars and lectures to extend your knowledge.

The accelerator may or may not offer a certain amount of money as well.

When you're considering joining an accelerator, research what's on offer in each of the areas on this list, making sure that you're satisfied that you're going to get good value from them all in exchange for transferring some of your equity. Consider what the market value of the services offered adds up to and whether your business needs all of them. Then do your own maths on the value of these services to your company in comparison to the percentage you're giving up now and, more vitally, how that percentage may look in the future. Research and calculate before making any kind of decision.

REMEMBER You're selected by an accelerator because its directors think your business will grow and is worth the risk. When you hit your growth targets, you want to be sure in your own mind that it was all worthwhile and that you got good value from all the services of the accelerator in exchange for giving something up. Look beyond the initial flattery at being asked to be part of it, and look into the true value of what you're getting.

# Chapter 3

# Keeping Track of Finances

**IN THIS CHAPTER**

**Understanding the main accounting reports**

**Making sure your books balance**

**Evaluating financial performance**

**Getting to grips with pricing**

Every business needs reliable financial information for both decision making and accountability. No one is going to be keen to pump money into your venture if you can't demonstrate that you know what's likely to happen to it. Reliable information doesn't necessarily call for complex bookkeeping and accounting systems: simple is often best. As the business grows, and perhaps takes on outside investors, you require more sophisticated information. That's when using a computer and some of the relevant software packages may be the best way forward. But even with a computer errors can occur, so you have to know how to recognise when financial information goes wrong and how you can correct it. You've a legal obligation in business to keep accounting records from the outset and not just wait until your business runs into serious problems. If, as a director or owner of a business, you can't see when you're heading for a financial reef, you may find yourself in deep trouble, if not actually heading for jail – and definitely not collecting £200 on the way.

REMEMBER This chapter gives you a good grounding in keeping track of finances, but keep in mind that now's not the time to be shy in coming forward for advice. According to a recent Small Business Survey carried out for the UK Government, 46 per cent of new business sought advice from an accountant, mostly on financial matters to do with running the business. One hundred per cent would be a far preferable figure.

## *Understanding Your Accounts*

Keeping the books is one thing, but being able to make good use of the information those accounts contain is quite another. You need to turn the raw accounting data from columns of figures into statements of account. Those accounts in turn tell you how much cash your business has, its profit or loss numbers and how much money you've tied up in the business to produce those results. The following sections discuss some of the key accounting statements and performance analyses.

### *Forecasting cash flow*

In the language of accounting, income is recognised when a product or service has been sold, delivered or executed, and the invoice raised. Although that rule holds good for calculating profit (see the next section), it doesn't apply when forecasting cash flow.

Profit is what may be generated if all goes well and customers pay up, and you can think of cash flow as the cold shower of reality, bringing you sharply back to your senses.

*Overtrading* describes a business that's expanding beyond its financial resources. As sales expand, the amount of cash tied up in stocks and customers' credit grows rapidly. Pressure also comes from suppliers of goods and services and from additional employees, who all expect to be paid. The natural escape valve for pressures on working capital is an overdraft (or a substantial increase in the existing one). Monitoring cash flow reduces the risk of overtrading.

## Reporting your profits

A key use of bookkeeping information is to prepare a profit and loss account.

In carrying out any business activity, two different actions go on:

- One is selling your goods and services and getting paid for them. Money comes in – perhaps not immediately, but it usually shows up eventually. This money goes by a variety of names, including *revenues* , *income* and *sales income* .
- The second transaction is the outlay you make in order to provide the goods and services you sell to your customers. Some of the costs you incur are for raw materials, salaries, rents and so on. These costs are known as *expenses* .

By deducting your expenses from your income, you end up with the profit (or loss) for the particular period under review.

At its simplest, the profit and loss account has at its head the period covered, followed by the income, from which you deduct all the expenses of the business to arrive at the profit (or loss) made in the period. Figure 3-1 shows a sample account.

| ***Profit and Loss Account for year to 31 March 201X*** | **£** |
|---|---|
| Income | 1,416,071 |
| Less expenses | 1,389,698 |
| Profit | 26,373 |



**FIGURE 3-1:** A basic profit and loss account.

Although the information shown in the profit and loss account is certainly better than nothing, you can use basic bookkeeping information to give you a much richer picture of events within the business. Provided, that is, that you've set up the right analysis headings in the first place.

The following sections show, step by step, how to build up a profit and loss account, using the trading events of the past year at Safari Europe as an example.

### *Calculating gross profit*

One of the most important figures in the profit and loss account is the gross profit. Whatever your activity, you have to buy certain 'raw materials'. Those include anything you have to buy to produce the goods and services you're selling. So if you sell cars, the cost of buying in the cars is a raw materials cost. In Safari's case, because the company is in the travel business, the costs of airline tickets and hotel rooms are the raw material of a package holiday.

The amount left from the sales revenues after deducting the cost of sales, as these costs of 'making' are known, is the *gross profit* . This is really the only discretionary money coming into the business, where you have some say over how it's spent. Figure 3-2 shows a sample profit calculation.

| | |
|---|---|
| **Safari Europe** | |
| Profit and Loss Account for year to | 31 March 201X |
| | |
| **Income** | |
| Tours sold | 1,402,500 |
| Insurance & other services | 13,571 |
| Non-operating revenue | 0 |
| Total income | 1,416,071 |
| | |
| *Less* **Cost of goods sold** | |
| Tours bought | 1,251,052 |
| Insurance & other services | 4,071 |
| Total cost of goods sold | 1,255,123 |
| | |
| Gross profit | 160,948 |



**FIGURE 3-2:** An example gross profit calculation.

In the account shown in Figure 3-2 , you can see that Safari has two sources of income: one from tours, and one from insurance and other related services. It also, of course, has the costs associated with buying in holidays and insurance policies from suppliers.

The difference between the income of £1,416,071 and the cost of the 'goods' the company has sold is just £160,948. That's the sum that the management has to run the business, not the much larger, headline-making figure of nearly £1.5 million.

Figure 3-3 shows how to calculate gross profit in a business that makes things rather than sells services.

| | £ |
|---|---|
| Sales | 100,000 |
| Cost of goods sold | 65,000 |
| Gross profit | 35,000 |



**FIGURE 3-3:** A manufacturer's gross profit.

In the example in Figure 3-3 , the basic sum is the same as for a service business, as shown in Figure 3-2 . Take the cost of goods from the sales income and what's left is gross profit. The cost of goods is calculated by noting the stock at the start of the period, adding in any purchases made and deducting the closing stock.

You also need to build in the labour cost in production and any overheads, such as workshop usage, and deduct those in order to arrive at the gross profit, as shown in Figure 3-4 .

| | £ | £ | £ |
|---|---|---|---|
| **Sales** | | | **100,000** |
| Manufacturing costs | | | |
| Raw materials opening stock | 30,000 | | |
| Purchases in period | 25,000 | | |
| | **55,000** | | |
| ***Less*** Raw materials closing stock | 15,500 | | |
| Cost of materials used | | 39,500 | |
| Direct labour cost | | 18,000 | |
| Manufacturing overhead cost | | | |
| Indirect labour | 4,000 | | |
| Workshop heat, light and power | 3,500 | | |
| Total manufacturing costs | | 7,500 | |
| Cost of goods sold | | | 65,000 |
| Gross profit | | | 35,000 |

FIGURE 3-4: Expanded gross profit calculation.

### *Reckoning expenses*

After you calculate the gross profit, you have to allow for all the expenses that are likely to arise in running the business. Using the Safari Europe case as a working example, Figure 3-5 shows all the costs usually associated with running the business, such as rent, rates, telephone, marketing and promotion, and so on. Although all these expenses are correctly included, they aren't all allowable for tax purposes in every country.

***Safari Europe***

| Profit and Loss Account for the year to 31 March 201X | Year 1 |
|---|---|
| **Income** | |
| Tours sold | 1,402,500 |
| Insurance & other services | 13,571 |
| Non-operating revenue | 0 |
| Total income | 1,416,071 |
| ***Less* Cost of goods sold** | |
| Tours bought | 1,251,052 |
| Insurance & other services | 4,071 |
| Total cost of goods sold | 1,255,123 |
| Gross profit | 160,948 |
| **Expenditure** | |
| Rent & rates | 18,000 |
| Heat, light & power | 3,500 |
| Telephone system lease | 2,000 |
| Computer leasing | 5,000 |
| Marketing & promotion | 12,500 |
| Postage & stationery | 3,250 |
| Telephone | 3,575 |
| Insurance & legal | 3,500 |
| Wages (not owner's) | 36,000 |
| Consultancy services | 25,000 |
| Membership & subscription | 1,500 |
| Travel & subsistence | 4,250 |
| Training & staff development | 6,000 |
| Depreciation of fixtures | 5,500 |
| Total expenditure | 129,575 |



FIGURE 3-5: Business expenses.

The 'Total expenditure' heading isn't quite accurate. Other expenses associated with running a business aren't included here, but these expenses are treated in a slightly different way, for reasons that should become apparent as you read on about the different types of profit.

### *Appreciating the different types of profit*

You can measure profit in several ways:

- **Gross profit** is the profit left after you've deducted all costs related to making what you sell from income (see the beginning of this section for what represents income).
- **Operating profit** is what's left after you take the expenses (or expenditure) away from the gross profit.
- **Profit before tax** is what you get after deducting any financing costs. This is a measure of the performance of the management, which is important if the owners and managers aren't the same people, as may be the case when you start to employ staff. The reasoning here is that the operating management can have little influence over the way in which the business is financed (no borrowings means no interest expenses, for example), or the level of interest charges.

REMEMBER Interestingly enough, when it comes to valuing the business, the operating profit is generally used as the multiplying factor (so, many times earnings is a typical valuation mechanism and operating profit is used to represent earnings).

In Figure 3-6 , taking away the financing costs, in the example £5,000 interest charges, leaves a profit before tax of £26,373. Finally, you deduct tax to leave the net profit after tax, the bottom line. This sum belongs to the owners of the business and, if the company is limited, is what dividends can be paid from.

*Safari Europe*

| Profit and Loss Account for the year to 31 March 201X | |
|---|---|
| **Income** | |
| Tours sold | 1,402,500 |
| Insurance & other services | 13,571 |
| Non-operating revenue | 0 |
| Total income | 1,416,071 |
| ***Less* Cost of goods sold** | |
| Tours bought | 1,251,052 |
| Insurance & other services | 4,071 |
| Total cost of goods sold | 1,255,123 |
| **Gross profit** | 160,948 |
| **Expenditure** | |
| Rent & rates | 18,000 |
| Heat, light & power | 3,500 |
| Telephone system lease | 2,000 |
| Computer leasing | 5,000 |
| Marketing & promotion | 12,500 |
| Postage & stationery | 3,250 |
| Telephone | 3,575 |
| Insurance & legal | 3,500 |
| Wages (not owner's) | 36,000 |
| Consultancy services | 25,000 |
| Membership & subscription | 1,500 |
| Travel & subsistence | 4,250 |
| Training & staff development | 6,000 |
| Depreciation of fixtures | 5,500 |
| Total expenditure | 129,575 |
| Operating profit | 31,373 |
| *Less* interest charges | 5,000 |
| Net profit before tax | 26,373 |
| Tax | 5,538 |
| **Net profit after tax** | 20,835 |



**FIGURE 3-6:** Levels of profit.

# *Balancing the Books*

You have to know where you are now before making any plans to go anywhere else. Without a starting point, any journey is bound to be a confusing experience. A business sums up its current position in a *balance sheet* , the business's primary reporting document. The balance sheet contains the cumulative evidence of financial events, showing where money has come from and what's been done with that money. Logically, the two sums must balance.

In practical terms, balancing your sums takes quite a bit of work, the hardest bit of which isn't necessarily the balancing part, but figuring out the numbers. Your cash-in-hand figure is probably dead right, but can you say the same of the value of your assets? Accountants have their own rules on how to arrive at these figures, but they don't pretend to be anything more than an approximation. Every measuring device has inherent inaccuracies, and financial controls are no exception.

To help balance the books, the balance sheet sets out a business's assets and liabilities in a way that makes it easier to understand crucial relationships. In the following sections, you discover the balance sheet and the essential technical terms that you need to grasp in order to get the full picture of how a business is faring.

## *A balance sheet*

In formal accounts the figures are set out vertically rather than in horizontal fashion, as reflected in Figure 3-7 . The business's long-term borrowings, in this case the mortgage and hire purchase charges, are named *Creditors*, *amounts falling due in over 1 year* and deducted from the total assets to show the *Net total assets* being employed.

| | £ | £ |
|---|---|---|
| ***NET ASSETS EMPLOYED*** | | |
| ***Fixed assets*** | | |
| Premises | 150,000 | |
| Car | 7,000 | |
| Furniture | 1500 | |
| Jewellery and paintings | 350 | |
| Book value | | 158,850 |
| ***Current assets*** | | |
| Money owed by sister | 135 | |
| Cash | 50 | |
| Total current assets | 185 | |
| ***Less Current liabilities*** | | |
| Overdraft | 100 | |
| Credit cards | 50 | |
| Total current liabilities | 150 | |
| Net current assets | | 35 |
| Total assets | | 158,885 |
| Less: Creditors, amounts falling due in over 1 year | | 45,500 |
| ***Net total assets*** | | ***113,385*** |
| FINANCED BY | | |
| My capital | 113,385 | |
| Total owners' funds | | 113,385 |



**FIGURE 3-7:** Jane Smith Limited Balance Sheet at 5 April 201X.

The bottom of the balance sheet in Figure 3-7 shows how the owner of the business, Jane, has supported these assets, in this case using her own funds. As you can see later, she could also have invested profit made in earlier years back into the business (see the later section 'Understanding reserves '). You can also assume that Jane's house is now a business premises owned by her company. (This assumption has wider implications, but none relevant to the arithmetic or the balance sheet.)

## Categorising assets

Accountants describe *assets* as valuable resources, owned by a business, that were acquired at a measurable monetary cost.

REMEMBER The exception to the *paid for* part is the grey area of goodwill. *Goodwill* is the value placed on the business's reputation and other intangible assets – a brand name, for example. Assessing the value of this asset is of particular interest to those buying or selling a business.

TECHNICAL STUFF You seldom see a value for goodwill included in most company balance sheets – it occurs only after a business has been sold. When you do see a figure for goodwill in a company balance sheet, it indicates the goodwill was acquired when that business acquired some other business or some part of another business such as its IP (intellectual property).

One useful convention recommends listing assets in the balance sheet in their order of permanence; that is, starting out with the most difficult to turn into cash and working down to cash itself. This structure is practical when you're looking at someone else's balance sheet, or comparing balance sheets. It can also help you recognise obvious information gaps quickly.

## Accounting for liabilities

*Liabilities* are claims against the business. These claims may include such items as tax, *accruals* (which are expenses for items used but not yet billed for, such as telephone and other utilities), deferred income, overdrafts, loans, hire purchase and money owed to suppliers. Liabilities can also be less easy to identify and even harder to put a figure on, bad debts being a prime example.

## Understanding reserves

*Reserves* are the accumulated profits that a business makes over its working life that the owner has ploughed back into the business rather than taking them out.

Jane Smith's balance sheet (see the earlier section 'A balance sheet ') shows her capital as being the sole support for the liabilities of the business. The implication is that she put this whole sum in at once. In practice, this sum is much more likely to have been paid over time, and in a variety of ways.

Perhaps she started out in business – because that's how you must now look at her affairs – with a sum of £25,000. In the period since she's been in business, she's made a net profit after tax of £50,000 and put this amount back into her business to finance growth. In addition, the premises that she bought a few years ago for £111,615 have just been re-valued at £150,000, a paper gain of £38,385.

The bottom portion of her company balance sheet may now look as shown in Figure 3-8 .

| | £ | £ |
|---|---|---|
| FINANCED BY | | |
| Capital introduced | | 25,000 |
| Reserves | | |
| Capital reserve | 38,385 | |
| Revenue reserve | 50,000 | 88,385 |
| | | 113,385 |



**FIGURE 3-8:** Jane's reserves.

The profit of £50,000 ploughed back into the business is called a *revenue reserve* , which means that the money actually exists and can be used to buy stock or more assets. The increase in value of the business premises is, on the other hand, a *paper* increase. Jane can't use the £38,385 increase in *capital reserves* to buy anything, because it's not in money form until the premises are sold. However, she can use that paper reserve to underpin a loan from the bank, so turning a paper profit into a cash resource. Both reserves and the capital introduced represent all the money that the shareholder has invested in this venture.

# Analysing Performance

Gathering and recording financial information is a lead-up to analysing a business to see how well (or badly) it's doing. This analytical process requires tools, in this case ratios, and you need to understand their usefulness and limitations before you can use them to good effect.

## Using ratios

All analysis of financial information involves comparisons. Because a business is constantly changing, the most useful way to measure activity is through ratios. A *ratio* is simply one number expressed as a proportion of another. Travelling 100 miles may not sound too impressive, until you realise it took one hour. The ratio here is 100 miles per hour. If you know that the vehicle in question has a top speed of 120 miles per hour, you've some means of comparing it to other vehicles, at least in respect of their speed. In finance, too, ratios can turn sterile data into valuable information in a wide range of different ways and help you make choices.

The key financial ratios you need from the outset are described in the following sections. Monitor all these at least on a monthly basis.

### Gross profit percentage

To calculate gross profit percentage (*percentage* is one form of ratio where everything is described in terms of a relationship to 100), you deduct the cost of sales from the sales and express the result as a percentage of sales. The higher the percentage, the greater the value you're adding to the goods and services you're producing. Figure 3-9 shows the calculation.

$$\text{Gross profit percentage} = \frac{\text{Profit}}{\text{Sales} - \text{Cost of sales}} \times 100$$



**FIGURE 3-9:** Formula for calculating gross profit percentage.

### *Operating profit percentage*

Calculating the operating profit percentage gives you a measure of how well the management is running the business, because operating expenses for which the management is responsible form a component of the calculation. Financing decisions are presumed to be the owner's responsibility; interest and taxation are set by the government, so those numbers are out of management control and accountability.

To calculate this number, you deduct from profit not only the cost of sales but also expenses, as Figure 3-10 shows.

$$\text{Operating profit percentage} = \frac{\text{Profit}}{\text{Sales} - (\text{Cost of sales} + \text{Cost of operations})} \times 100$$



**FIGURE 3-10:** Calculating operating profit.

### *Net profit percentage*

Working out your net profit essentially gives you your business's *bottom line* , telling you how much money is left for you to take out or reinvest in your business. A higher percentage means that you're making more money from each pound of sales generated.

You can calculate net profit after you pay tax or before – earnings before interest and tax, known as EBIT.

In its after-tax form, which Figure 3-11 shows, net profit percentage represents the sum available for the business to distribute as dividends or retain to invest in its future.

$$\text{Net profit percentage} = \frac{\text{Profit}}{\text{Sales} - (\text{Cost of sales} + \text{Cost of operations} + \text{Taxes paid})} \times 100$$



**FIGURE 3-11:** Calculating net profit percentage.

### *Return on capital employed*

This number, frequently abbreviated to ROCE, is the primary measure of performance for most businesses. If, for example, you invested £10,000 in a bank and at the end of the year it gave you £500 interest, then the return on your capital is 5 per cent ($\text{£}500 \div 10{,}000 \times 100 = 5 \text{ per cent}$ ).

A business calculates this ratio by expressing the operating profit (profit before interest and tax) as a percentage of the total capital employed – both in fixed assets and in working capital, called *net current assets* in the balance sheet. Figure 3-12 shows the formula for calculating ROCE.

$$\text{ROCE} = \frac{\text{Operating profit}}{\text{Fixed assets} + \text{Working capital}} \times 100$$

**FIGURE 3-12:** Calculating return on capital employed.

TIP If you think about it, return on capital employed is the same as the return on the shareholders' funds plus the long-term loans, or the 'financed by' bit of the balance sheet.

### *Current ratio*

You calculate the current ratio by dividing your current assets by your current liabilities. Only one rule exists about how high (or low) the current ratio should be: it should be as close to 1:1 as the safe conduct of the business allows. This rule isn't the same for every type of business, though. For example, a shop buying in finished goods on credit and selling them for cash can run safely at 1.3:1. A manufacturer, with raw material to store and customers to finance, may need over 2:1. This difference is because the period between paying cash out for raw materials and receiving cash in from customers is longer in a manufacturing business than in a retail business.

### *Average days' collection period*

Any small business selling on credit knows just how quickly cash flow can become a problem. You calculate the average collection period ratio by dividing the value of your debtors by the value of credit sales, and then multiplying that by the days in the period in question (usually one year or 365 days). The result is expressed in days, so you can see in effect how many days it takes for your customers to pay up, on average.

A period of 60 days is fairly normal for customers to take before paying up. Around 45 days is a good target to aim for and 90 days is too long to let payment go without chasing. The preceding is a good control ratio, which has the great merit of being quickly translatable into a figure any businessperson can understand, showing how much giving credit costs you.

TIP If you're selling into overseas markets, the practice on punctual payments can vary widely. Knowing your average collection period for these markets can help you to plan cash flow more effectively.

### *Stock control ratio*

A simple way to tackle stock control is to see how many times your business turns its stock over each year. Dividing the cost of sales by the value of your stock gives you this ratio. The more times you can turn your stock over, the better.

## *Gearing down*

The more borrowed money a business uses, as opposed to the money the shareholders have put in (through initial capital or by leaving profits in the business), the more highly *geared* the business is. Highly geared businesses can be vulnerable when sales dip sharply, as in a recession, or when interest rates rocket, as in a boom. Figure 3-13 shows how to calculate gearing percentage.

$$\text{Gearing percentage} = \frac{\text{Debt (long-term borrowings)}}{\text{Debt + Shareholders' funds}} \times 100$$

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**FIGURE 3-13:** Calculating gearing percentage.

Gearing levels in small firms average from 60 per cent down to 30 per cent. Many small firms are probably seriously over-geared, especially when they're in the first stages of growth.

TIP Try these tools:

- **Bankrate.com** , an aggregator of financial rate information, has a number of free business ratio calculators that cover all aspects of measuring financial performance ( www.bankrate.com/calculators.aspx?ic_id=home_calculator_financial-planning_globalnav ).
- **SME Toolkit** , by the International Finance Corporation (IFC), a member of the World Bank Group, includes free ratio calculator tools (go to www.smetoolkit.org , Accounting and Finance, and then Financial Management and Reporting).

# Accounting for Pricing

Setting a selling price for your wares is one of the most important and most frequent business decisions that anyone running a business has to make. At first glance, it doesn't seem such a big deal. Just add up all the costs, add a healthy profit margin and, as long as the customers don't rush for the exit, you're in business. Unfortunately, the first part of that sentence contains a few traps for the unwary.

Complications start when you have to get to grips with the characteristics of costs. Not all costs behave in exactly the same way. For example, the rent on a shop, office or workshop is a fixed sum, payable monthly or quarterly. Your landlord doesn't usually expect you to pay more rent if you get more customers, nor is he especially generous if you've a particularly lean period. (One exception to this rule comes if you're able to negotiate a rent geared to performance, an offer landlords have been known to make to some retailers.) The business rates on any premises and the cost of an advertisement in the local paper are also *fixed costs* . That term shows that the cost in question doesn't vary directly with the volume of sales, not that the cost itself has been immutably settled and you're committed to pay it. You don't have to advertise and you do have to pay business rates, but both are fixed costs.

Contrast that with the cost of the products you plan to sell. Assume for a moment that you're selling just one product, a bottle of wine costing £3 to buy in. The more you sell, the more your stock costs to buy. That type of cost varies directly with the volume of sales you achieve, and in a rare display of user-friendliness from the accounting profession is known as *variable* . The cost of each individual bottle may or may not vary – your supplier may or may not change the price, perhaps lowering it to win more business from you or upping it to meet the chancellor of the exchequer's ever-growing demand for more tax. But the nature of the cost means that the total cost does vary as your sales volume changes.

The main tool that can help you with pricing decisions is *break-even analysis* , which is the point at which your sales income covers all your costs. Using that tool, which is explained in the following sections, helps you to set the best price for single or multiple products, see how much you have to sell to hit your profit goals, and deal with changing your prices.

## Breaking even

To keep things simple: your business plans to sell only one product, for example the wine mentioned earlier, and you have only one fixed cost, the rent. Figure 3-14 sets out a graphical picture of how your costs stack up. The vertical axis shows the value of sales and costs in thousands and the horizontal axis shows the number of units sold, in this case bottles of wine. The rent is £10,000 for the year, represented by a horizontal line labelled ‘fixed costs’. The angled line running from the top of the fixed costs line shows the amount of the variable costs. Sell zero bottles and you incur zero additional costs. In this case, the total costs are £10,000 plus £0 equalling £10,000. Every bottle you buy in adds £3 of variable costs (you have to buy the wine in!) to the total costs.

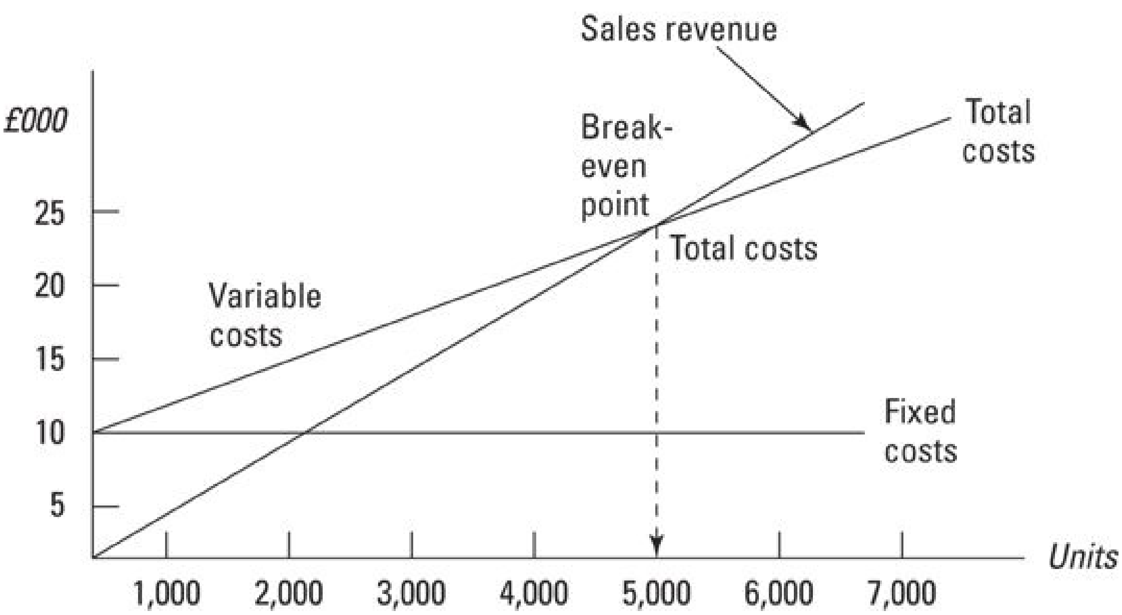



**FIGURE 3-14:** Break-even chart.

You need to calculate the break-even point – that is, when you’ve made enough money from selling wine to pay the rent. The sales revenue line moves up at an angle from the bottom left-hand corner of the graph. If you plan to sell your wine at £5 a bottle, you calculate the figures for this line by multiplying the number of units sold by that price.

The break-even point is the stage at which a business starts to make a profit – when the money coming in from sales is higher than the fixed and variable costs added together. For your wine business, you can see from the chart that this point arises when you’ve sold 5,000 bottles.

You don’t have to draw a chart every time you want to work out your break-even point – you can use a simple formula:

$$\text{Break-even point} = \frac{\text{Fixed costs}}{\text{Selling price} - \text{Unit variable cost}}$$

$$= \frac{10{,}000}{5-3}$$

$$= 5{,}000 \text{ units}$$

## Pricing for profit

You have to break even if you want to remain in business, but doing so isn't enough on its own. You need to make a profit over and above your break-even point.

Profit isn't an accident of arithmetic discovered by your accountant at the year's end. Profit should be a specific, quantified goal that you set in advance. Look again at the earlier wine selling example: you plan to invest £10,000 in a year's rent, and you need to hold at least £5,000 worth of stock too, making £15,000 total costs. So what return can you expect on the money you're investing? If you invested the same amount in other people's businesses by buying an average bundle of shares on the stock market, you may expect to get a return of £1,200, around 8 per cent. If you went for risky start-up and early-stage ventures, a venture capital firm may recommend that you look for a return of between 20 and 30 per cent.

To keep the numbers simple again, say your profit goal is to make £4,000 profit, a return of 27 per cent ($\$500 \div 10{,}000 \times 100 = 5$ per cent). How many bottles of wine do you need to sell to break even and meet your profit goal? The new equation must include your desired profit, so it looks like this:

$$\text{Break-even profit point (BEPP)} = \frac{\text{Fixed costs} + \text{Profit goal}}{\text{Selling price} - \text{Unit variable cost}}$$

$$= \frac{10{,}000 + 4{,}000}{5-3}$$

$$= \frac{14{,}000}{2}$$

$$= 7{,}000$$

From the formula, you now know that to reach your profit goal you have to sell 7,000 bottles of wine. Better still, this powerful little equation allows you to change each element and experiment to arrive at the optimum result. For example, say that after doing market research you conclude that you're unlikely to sell 7,000 bottles of this wine, but that you can sell 6,000. What does your selling price have to be to make the same profit?

Using the BEPP equation and inserting '*x*' for the element you're changing, you can calculate the answer:

$$\text{Break-even profit point (BEPP)} = \frac{\text{Fixed costs} + \text{Profit goal}}{\text{Selling price} - \text{Unit variable cost}}$$

$$= 6{,}000 = \frac{10{,}000 + 4{,}000}{x-3}$$

$$\text{Therefore, } x - 3 = \frac{10{,}000 + 4{,}000}{6{,}000} = 2.33$$

$$x = 3 + 2.33 = 5.33$$

So your new selling price has to be £5.33 a bottle if you need to make £4,000 profit from the sale of 6,000 bottles. If the market can bear that price, great; if not, then you need to look for ways to decrease the fixed and variable costs, or to sell more, if you're to meet your profit goal.

TIP Working with that formula may have frightened you if your algebra is a bit rusty! The easy option is to use a spreadsheet to take the pain out of the number crunching. So far you've been working with only one fixed cost and one variable cost; in practice, you obviously have many more, and using a spreadsheet makes changing the calculation much easier. Harvard Business School offers a free, downloadable, interactive break-even workbook ( http://hbswk.hbs.edu/archive/1262.html ), one of several workbooks/tutorials from the HBS Toolkit used by its students (you may have to register to gain access, but registration is free). Bankrate, a leading aggregator of financial rate information, also has a number of financial spreadsheets on its website, including a neat tool for working out your break-even point ( www.bankrate.com/brm/news/biz/Cashflow_banking/breakeven.XLT ). And your second option? If you're a glutton for punishment and want to do the sums yourself, boost your algebra at the BBC's Bitesize website ( www.bbc.co.uk/schools/gcsebitesize/maths/algebra ).

## Building in more products

The example so far has been for a one-product company, but what if you plan to sell more than just one type of wine – or perhaps even add crisps and chocolates too? When you reach this stage, you need to work from your gross profit percentage (for how to calculate this percentage see 'Analysing Performance ', earlier in this chapter).

If, for example, you're aiming for a 40 per cent gross profit, your fixed costs are £10,000 and your profit goal is £4,000, then the sum is as follows:

$$\begin{aligned}\text{BEPP} &= \frac{10{,}000 + 4{,}000}{0.4}\\ &= \frac{14{,}000}{0.4}\\ &= £35{,}000\end{aligned}$$

TIP If you got a bit lost about where the 0.4 came from, don't worry; that's just 40 per cent expressed as a decimal, a step you need to take before you can use the number. What you now know is that at a 40 per cent gross profit margin you need to sell £35,000 worth of wine, chocolates and crisps to hit your profit goal. Your accountant can help with these calculations, and the Harvard Business School website has a useful tutorial that links with its break-even spreadsheet (refer to the preceding section).

## Handling price changes

The most sensitive and revisited area of business strategy is pricing. You can check out the impact of a particular pricing policy on your profitability using break-even analysis (see 'Pricing for profit ', earlier in this chapter, for more details). As part of your strategy, you may consider changing your price. All things being equal, a lower price should open up a bigger market and so increase sales. But should you reduce your price?

As a rule of thumb, if you decrease your prices by 5 per cent you have to increase your sales by three times that percentage, just to make the same level of profit. This increase depends on the gross profit you're achieving, but the figure given holds good for gross profits of 30 to 40 per cent.

Conversely, if you push your prices up by 5 per cent, you can lose around a seventh of your business before you're any worse off in terms of profit.

TIP

BizPep has a useful piece of software that allows you to calculate your optimal selling price under a wide range of business conditions ( www.bizpeponline.com/PricingBreakeven.html ). A fully functioning download is available free for a seven-day trial. The outputs include break-even charts for current, increased, decreased and optimum pricing calculated for prices ranging from –50 to +50 per cent of your current actual or proposed price. You can carry out the same analysis yourself using the free software from the Harvard Business School (see the earlier section 'Pricing for profit '), but BizPep's templates do some of the grunt and groan for you.

# Chapter 4

# Budgeting for Beginners

**IN THIS CHAPTER**

**Building a budget**

**Looking at alternatives**

**Calculating capital budgets**

An unpleasant truism in business, and in much else, is that after resources are allocated they become misallocated over time. Another way of looking at this problem is to say that just because something ‘ain’t broke’, it doesn’t mean you can’t make it perform better still. For your business to grow and keep growing, you need to make a continuous effort to improve every aspect of the business.

One sure-fire way to get poor performance back on track – or, better still, to turn satisfactory results into exceptional ones – is to set specific goals to make that happen. Sure, you have a long-term business plan that looks out to the distant horizon (refer to Chapter 4 in Book 1 for details). But you also need something with a bit more immediacy and a whole lot of bite. In the business world, this process is known as *budgeting* . Budgets set goals in terms of revenues and expenses for the year ahead and are usually reviewed at least halfway through the year and often quarterly. At that review, you can add a further quarter or half year to the budget to maintain a one-year budget horizon – known in the trade as a *rolling quarterly (half yearly) budget* .

Budgets are a great way to get everyone on the management team involved in planning the direction of travel and keeping track of performance over the period concerned. By being involved in setting goals in a budget, people are more committed to their achievement. That in turn should improve the likelihood of the desired results being achieved.

## *Constructing a Budget*

You can think of a budget as doing much the same as a coach does with an athlete in setting improvement targets to be achieved by a specific date in the future. The coach gets a stopwatch out, checks on performance and cheers or cajoles as the situation warrants. In business, you set financial goals for the period ahead and then see how you’ve performed against them, while trying to understand where things haven’t gone to plan and learning from the experience.

### *Setting the guidelines*

REMEMBER Your budget should adhere to the following general principles:

- **Based on realistic but challenging goals.** Those goals combine both the top-down aspirations of the boss (you) and the bottom-up forecasts of what the employees or departments concerned see as possible.
- **Prepared by those responsible for delivering the results.** The salespeople should prepare the sales budget and the production people the production budget.
- **Agreed by those involved.** During the budgeting process, several versions of a particular budget should be discussed. For example, the boss wants a sales figure of £20,000 but the sales team's initial forecast is for £15,000. After some debate, £18,000 is the figure agreed upon. After a figure is agreed upon, a virtual contract exists that declares a commitment from employees to achieve the target and commitments from the employer to be satisfied with the target and to supply resources in order to achieve it. It makes sense for this contract to be in writing.
- **Finalised at least a month before the start of the year,** not weeks or months into the year.
- **Reviewed periodically throughout the year** to make sure that all the basic assumptions that underpin it still hold good. Accurate information reviewing performance against the budget should be available seven to ten working days after the month's end.

## *Analysing the variances*

Understanding variances is a key task. As the boss, you need to carefully monitor and compare performance against the budget as the year proceeds, taking corrective action where necessary. You do this monitoring on a monthly basis (or using shorter time intervals if required), showing both the company's performance during the month in question and throughout the year so far.

### *Looking at the fixed budget*

Looking at Table 4-1 , you can see at a glance that the business is behind on sales for this month, but ahead on the yearly target. The convention is to put all unfavourable variations in brackets. Hence, a higher-than-budgeted sales figure doesn't have brackets, but a higher materials cost does. You can also see that although profit is running ahead of budget, the profit margin is slightly behind (–0.30 per cent). It is behind partly because other direct costs, such as labour and distribution in this example, are running well ahead of budget.

**TABLE 4-1 The Fixed Budget in £'000s**

| | | *Month* | | | *Year to Date* | |
|---|---|---|---|---|---|---|
| | ***Budget*** | ***Actual*** | ***Variance*** | ***Budget*** | ***Actual*** | ***Variance*** |
| Sales | 805 | 753 | (52) | 6,358 | 7,314 | 965 |
| Materials | 627 (78%) | 567 | 60 | 4,942 | 5,704 | (762) |
| Less cost of materials | 178 (22%) | 186 | 8 | 1,416 | 1,610 | 194 |
| Direct costs | 74 | 79 | (5) | 595 | 689 | (94) |
| Gross profit | 104 | 107 | 3 | 820 | 921 | 101 |
| Percentage | 12.92 | 14.21 | 1.29 | 12.90 | 12.60 | (0.30) |

### *Flexing the figures*

A budget is based on a particular set of sales goals, few of which are likely to be exactly met in practice. Table 4-1 shows a company that's used £762,000 more materials than budgeted (see the variance column under Year to Date). Because more has been sold than was budgeted for, this is hardly surprising. The way to manage this situation is to flex the budget to show what, given the sales that actually occurred, would be expected to happen to expenses. Applying the budget ratios to the actual data does this. For example, materials were planned to be 78 per cent of sales in the budget. By applying that to the actual month's sales, you arrive at a materials cost of £587,000 (78 per cent of £753,000).

Looking at the flexed budget in Table 4-2 , you can see that the company has spent £19,000 more than expected on the materials given the level of sales actually achieved, rather than the £762,000 overspend shown in the fixed budget.

### TABLE 4-2 The Flexed Budget in £'000s

| | | *Month* | | | *Year to Date* | |
|---|---|---|---|---|---|---|
| | ***Budget*** | ***Actual*** | ***Variance*** | ***Budget*** | ***Actual*** | ***Variance*** |
| Sales | 753 | 753 | - | 7,314 | 7,314 | - |
| Materials | 587 | 567 | 20 | 5,685 | 5,704 | (19) |
| Less Cost of Materials | 166 | 186 | 20 | 1,629 | 1,610 | (19) |
| Direct costs | 69 | 79 | (10) | 685 | 689 | (4) |
| Gross profit | 97 | 107 | 10 | 944 | 921 | (23) |
| Percentage | 12.92 | 14.21 | 1.29 | 12.90 | 12.60 | (0.30) |

The same principle holds for other direct costs, which appear to be running £94,000 over budget for the year. When you take into account the extra sales shown in the flexed budget, you can see that the company has actually spent £4,000 over budget on direct costs. Although this situation is serious, the problem is not as serious as the fixed budget suggests.

The flexed budget allows you to concentrate your efforts on dealing with true variances in performance.

TIP The SCORE website has a downloadable Microsoft Excel spreadsheet from which you can make sales and cost projections on a trial and error basis ( `https://www.score.org/resources/business-planning-financial-statements-template-gallery` ). When you're satisfied with your projection, use the profit and loss projection to complete your budget. You may also want to have a rummage around the hundreds of other useful tools and tips on the SCORE website.

REMEMBER The figures shown for each period of the budget aren't the same. For example, a sales budget of £1.2 million for the year doesn't translate to £100,000 a month. The exact figure depends on two factors:

- The projected trend may forecast that although sales at the start of the year may be £80,000 a

month, they'll change to £120,000 a month by the end of the year. Sure, the average would be £100,000, but month by month the budget figure against which performance should be measured is going up.
- By virtue of seasonal factors, each month may also be adjusted up or down from the underlying trend. For example, you can expect sales of heating oil to peak in the autumn and tail off in the late spring.

# Exploring Budgeting Alternatives

Fixed and flexed budgets (described earlier in this chapter) are great approaches, but, as in almost everything in finance, there is a third and for that matter a fourth way: you can tear everything up and start again each year – a cathartic experience – or you can imagine a number of alternative scenarios and budget for those eventualities. Obviously you can't budget for every single possibility, but you can think through the handful of real possibilities. Your idea may be a sure-fire success and sales take off fast, or you may find that everything costs a bit more than you expect. On second thoughts, that last eventuality is a near certainty!

## Budgeting from zero

When you sit down with your team and discuss budgets, the arguments always revolve around how much more each section needs next year. The starting point is usually this year's costs, which are taken as the only facts on which to build. So, for example, if you spent £25,000 on advertising last year and achieved sales of £1 million, your advertising expense was 2.5 per cent of sales. If the sales budget for next year is £1.5 million, then it seems logical to spend £37,500 in the next year on advertising. That, however, presupposes that you spent last year's sum wisely and effectively in the first place, which you almost certainly did not.

*Zero-based budgeting* turns the cost argument on its head. It assumes that each year every cost centre starts from zero spending and, based on the goals of the business and the resources available, presents arguments for every pound you're planning to spend, not just arguments for spending increases. So, each year starts out with a blank sheet of paper rather than last year's figures.

## What-if analysis

A disappointing feature in budgeting is how few people accept without question all your arguments and the facts and figures used to support them. Still, this should come as no great surprise, because the people you're pitching your proposition to – bankers, investors, partners or your boss – have a lot at stake if you've got it wrong.

The questions at the front of their minds usually take the form of probing for *risk factors* – things that could work against you under certain circumstances. What if the economy turns sour, your patent takes longer to come through, you can't recruit staff as quickly as you had hoped, sales take longer to build up than you have forecasted … and many more 'what ifs'?

The questions are designed to check out the likely impact of these 'what if' events on your cash flow. Remember, cash is always king, and without it no business can survive long enough to become profitable. The best framework for stress-testing your business model is to use the cash flow forecast to check the impact of disruptions to your key budgeting assumptions.

### *Checking out sales projections*

It's unlikely that anyone will take your sales revenue projections at face value. The norm in business is for something to not go to plan: for example, you may get fewer customers, your mix of customers may change (say, from cash to credit), you get less repeat business, your prices don't hold as you expect, you get more returns … The list of problems that can adversely affect your sales receipts is endless.

Figure 4-1 shows the effect on cash flow for an example where sales revenue is 20 per cent adrift of the figures projected in the business plan. It's always prudent to leave payments broadly similar despite a drop in sales, although logic suggests that some costs would fall. Variable costs such as materials fluctuate with sales volumes, but in practice you may buy materials for planned future sales. In such cases, you use fewer materials and carry them over in stock for a later period. Nevertheless, your cash position will be much as if you had actually used those materials.

| Category | Business Plan (£) | | Revenue (£) *What if* |
|---|---|---|---|
| **Sales Receipts** | | | |
| Cash sales | 50,000 | | 40,000 |
| Credit sales | 50,000 | Sales –20% | 40,000 |
| Total cash in | 100,000 | | 80,000 |
| **Payments** | | | |
| Salary and wages | 25,000 | | 25,000 |
| Utilities | 10,000 | | 10,000 |
| Rent and rates | 15,000 | | 15,000 |
| Materials | 35,000 | Payments (same) | 35,000 |
| Equipment | 40,000 | | 40,000 |
| **Total Cash Out** | 125,000 | | 125,000 |
| **Net Cash Flow** | –25,000 | | –45,000 |
| | | Funding needs +20,000 | |
| **Funding Needs** | –25,000 | | –45,000 |



**FIGURE 4-1:** Testing the revenue model.

In the 'what if' scenario in Figure 4-1 , funding requirements go up from £25,000 to £45,000.

### *Checking out costs*

As with sales revenue, payments can take an unexpected turn for the worse. Inflationary pressures can push up wages and materials costs: for example, utilities and motoring costs moved up by nearly 40 per cent in the UK between 2008 and 2010.

Figure 4-2 shows what can happen to cash flow if costs rise and sales revenue remains static. In this example, an additional £17,000 is required to fund the venture, so the business plan would be looking to support a £42,000 investment rather than just the £25,000 originally considered sufficient in the budget.

| **Category** | **Business Plan (£)** | | **Revenue (£)** ***What if*** |
|---|---|---|---|
| **Sales Receipts** | | | |
| Cash sales | 50,000 | | 50,000 |
| Credit sales | 50,000 | | 50,000 |
| Total cash in | 100,000 | Sales the same | 100,000 |
| **Payments** | | | |
| Salary and wages | 25,000 | | 35,000 |
| Utilities | 10,000 | | 15,000 |
| Rent and rates | 15,000 | | 12,000 |
| Materials | 35,000 | | 40,000 |
| Equipment | 40,000 | Payments increase | 40,000 |
| **Total Cash Out** | 125,000 | | 142,000 |
| **Net Cash Flow** | –25,000 | | –42,000 |
| **Funding Needs** | –25,000 | Funding needs +17,000 | –42,000 |



**FIGURE 4-2:** Testing the payments model.

### *Anticipating the worst*

Calamity occurs when two or more relatively unexpected events happen at the same time. From a budgeting perspective, it’s quite likely that a couple of things will go wrong over the planning horizon – but if they happen at the same time, this can spell disaster for your business.

Using the cash flow model, check out a number of possible problem areas and see at what point these problems would cause you or your financial backers sleepless nights. For example, what would the effect be of a major customer going bust, a supplier putting their prices up and a key employee leaving unexpectedly, all in the same quarter?

Figure 4-3 shows a hypothetical example of how you may test the effects of various events – for example, sales being less than expected and payments higher. In this case, the net effect requires you to budget for a funding requirement of £62,000 rather than the £25,000 originally projected.

| Category | Business Plan (£) | | Revenue (£) *What if* |
|---|---|---|---|
| **Sales Receipts** | | | |
| Cash sales | 50,000 | | 40,000 |
| Credit sales | 50,000 | Sales –20% | 40,000 |
| Total cash in | 100,000 | | 80,000 |
| **Payments** | | | |
| Salary and wages | 25,000 | | 35,000 |
| Utilities | 10,000 | | 15,000 |
| Rent and rates | 15,000 | | 12,000 |
| Materials | 35,000 | Payments increase by 17,000 | 40,000 |
| Equipment | 40,000 | | 40,000 |
| **Total Cash Out** | 125,000 | | 142,000 |
| **Net Cash Flow** | –25,000 | | –62,000 |
| | | Funding needs +37,000 | |
| **Funding Needs** | –25,000 | | –62,000 |

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**FIGURE 4-3:** Testing to destruction.

REMEMBER If you're unable to lay your hands on the extra cash you need if these 'what if' events occur, you'll go bust.

## Capital Budgeting

Profit budgeting for the coming year and budgeting the cash flow from that profit are hardcore components of business budgeting – but not the whole story. Another key element of the budgeting process is to prepare a *capital expenditures budget* (spending on fixed assets such as equipment and premises) for top management review and approval. A business has to take a hard look at its long-term operating assets – in particular, the capacity, condition and efficiency of these resources – and decide whether it needs to expand and modernise its fixed assets. In most cases, a business would have to invest substantial sums of money in purchasing new fixed assets or retrofitting and upgrading its old fixed assets. These long-term investments require major cash outlays. So, a business (or each division of the business) prepares a formal list of the fixed assets to be purchased or upgraded.

Accordingly, the capital expenditures budget goes to the highest levels in the organisation for review and final approval. The chief financial officer, the CEO and the board of directors of the business go over a capital expenditures budget request with a fine-tooth comb. One main concern is whether the collective total of cash flow provides enough money for the capital expenditures that have to be made during the coming year for new fixed assets – and to meet the other demands for cash. If it doesn't, the business may have to raise more capital from debt or equity sources during the coming year to close the gap between cash flow from profit and its need for cash.

## *Deducing payback*

The simplest way to evaluate an investment is to calculate *payback* – how long it takes you to get your money back. Figure 4-4 shows an investment that calls for £20,000 cash up-front in the expectation of getting £25,000 cash back over the next five years. The investment is forecasted to return a total of £20,000 by the end of year 4, so you can say that this investment has a four-year payback.

| | £ |
|---|---|
| Initial cost of investment | 20,000 |
| | |
| Annual net cash inflows | |
| Year 1 | 1,000 |
| Year 2 | 4,000 |
| Year 3 | 8,000 |
| Year 4 | 7,000 |
| Year 5 | 5,000 |
| Total cash in | 25,000 |



**FIGURE 4-4:** Calculating payback.

REMEMBER When calculating the return on long-term investments, you use cash rather than profit. This is because you need to compare like with like: investments are paid for in cash or by committing cash, so you need to calculate the return using cash, too.

Imagine that you have two competing projects from which you have to choose only one. Figure 4-5 sets out the maths. Both projects have a four-year payback, in that the outlay is recovered in that period; so this technique tells you that both projects are equally acceptable, as long as you're content to recover your outlay by year 4.

| | £ Project 1 | £ Project 2 |
|---|---|---|
| Initial cost of investment | 20,000 | 20,000 |
| Annual net cash inflows | | |
| Year 1 | 1,000 | 3,000 |
| Year 2 | 4,000 | 5,000 |
| Year 3 | 8,000 | 8,000 |
| Year 4 | 7,000 | 8,000 |
| Year 5 | 5,000 | 10,000 |
| Total cash in | 25,000 | 34,000 |



**FIGURE 4-5:** Comparing investments using payback.

However, this is only part of the story. You can see at a glance that Project 2 produces £9,000 more cash over five years than Project 1. You also get a lot more cash back in the first two years with Project 2, which must be better – as well as safer for the investor. Payback fails to send those signals, but is still a popular tool because of its simplicity.

## Discounting cash flow

A pound today is more valuable than a pound in one, two or more years' time. For you to make sound investment decisions, you need to ask how much you would pay now to get a pound back at some date in the future. If you know you can earn 10 per cent interest from an investment, then you would only pay out 90p now to get that pound in one year's time. The 90p represents the *Net Present Value* (NPV) of that pound – the amount you would pay now to get the cash at some future date.

In effect what you're doing is discounting the future cash flow using a percentage that equates to the minimum return that you want to earn. The further out that return, the less you would pay now in order to get it.

The formula you use to discount the cash flow is:

$$\text{Present Value } (PV) = \pounds P \times 1/(1+r)^n$$

where £*P* is the initial investment, *r* is the interest expressed as a decimal and *n* is the year when the cash will flow in (so in year 1 *n* equals 1, year 2 it will be 2 and so on). For example, if you require a 15 per cent return, you should only be prepared to pay £0.87 now to get £1 in one year's time, £0.76 for a pound in two years' time and just £0.50 now for a pound coming in five years' time.

Take a look at Figure 4-6 . If you use a discount rate of 15 per cent (which is a very average return on capital for a business), the picture doesn't look so rosy. Far from paying back in four years and producing £25,000 cash for an outlay of £20,000, Project 1 is actually paying out less money (£15,642) in real terms, allowing for the time value of money, than you've paid out.

| | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Total |
|---|---|---|---|---|---|---|
| Cash in | 1,000 | 4,000 | 8,000 | 7,000 | 5,000 | 25,000 |
| NPV of cash | 870 | 3,025 | 5,260 | 4,002 | 2,486 | 15,642 |



**FIGURE 4-6:** Comparing cash with the Net Present Value of that cash at a 15 per cent discount rate.

## Calculating the internal rate of return

Net Present Value is a powerful concept, though a slightly esoteric one. All you know so far about your attempt to evaluate Project 1 is that if you aim for a return of 15 per cent, your returns will be disappointing. So, you move on to the next stage in your quest for a sound way to appraise capital investment proposals – calculating exactly what the return on investment will be.

To arrive at this figure, you need to calculate the actual return the project made on the discounted cash flow – the *Internal Rate of Return* (IRR). To do this, you need to find the value for *r* in the Net Present Value formula (refer to the preceding section) that ensures the present value of the future cash flow equals the cost of the investment. You can do this by using a guessing process of trial and error, but the easiest way to do this is to use a spreadsheet that crunches the numbers for you. In the case of Project 1, the IRR is just short of 7 per cent. You would fare little worse by leaving the money on deposit in a bank, in this case.

The IRR is a number you can use to compare one project with another to assess quickly which is superior from a financial point of view. For example, Project 2 has an IRR of 17 per cent, which is clearly better than that of Project 1, a fact not revealed by using the payback method.

TIP Zenwealth, a website run by Mark Lane, has a number of calculators and interactive learning tools for working out payback, discounted cash flow, IRR and a whole lot more calculations relating to capital budgeting ( www.zenwealth.com/businessfinanceonline/index.htm ).

## Arriving at the cost of capital

No new capital investment would make much sense if it didn't at least cover the cost of the capital used to finance it. This cost is known in the trade as the 'hurdle rate', as that is the level of return any project has to beat. Imagine that you've worked out the cost of equity as being 15 per cent. That should cover the dividends and the fairly high costs associated with raising the dosh. Next comes the cost of borrowed capital (and that of any other long-term source of finance such as hire purchase or mortgages). That figure is usually fairly self-evident, as the lender will state this up front; however, you may have to make a judgment call here if your loans have a *variable rate of interest* – that is, one that can go up and down with the general bank rate. Then you have to make an educated guess as to what that figure may be over the life of the loan.

Next you need to combine the cost of equity and debt capital into one overall cost of capital figure, in essence your hurdle rate.

An average cost is required because you don't usually identify each individual project with one particular source of finance. Generally, businesses take the view that all projects have been financed from a common pool of money, except for the relatively rare case when project-specific finance is raised.

Assume your company intends to keep the ratio of borrowed capital to equity in the proportion of 20:80. The cost of new capital from these sources has been assessed, say, at 10 per cent and 15 per cent respectively and corporation tax is 30 per cent. The calculation of the overall weighted average cost is as follows:

| ***Type of capital*** | ***Proportion*** | ***After-tax cost (b)*** | ***Weighted cost (a × b)*** |
|---|---|---|---|
| 10% loan capital | 0.20 | 7.0% | 1.4% |
| Equity | 0.80 | 15.0% | 12.0% |
| | | | 13.4% |

The resulting weighted average cost of 13.4 per cent is the minimum rate that this company should accept on proposed investments. Any investment that's not expected to achieve this return isn't a viable proposition.

# Book 3

# Finding and Managing Staff

# Contents at a Glance

# Chapter 1

# Staying on the Right Side of the Law

**IN THIS CHAPTER**

- **Understanding your employees' rights under the law**
- **Knowing who's an employee and who isn't**
- **Determining the kinds of workplace policies you need to draw up**
- **Managing without a whole lot of support systems**

As a small business employer or in the management level of a small company, you may feel that staying on top of the law is just too much hassle. As long as you don't do anything blatantly illegal, everyone should be content. After all, you've got a business to run and you have to make a living.

While that's true, if you get on the wrong side of the law the results can be devastating. You can end up seriously out of pocket because a tribunal or court finds in favour of a disgruntled, or even worse a seriously injured, employee and awards large amounts of compensation against you. Tribunals can award anything from a very basic amount up to a maximum of £78,335 in unfair dismissal cases. But if they decide that you've discriminated against someone when you've dismissed him or made him redundant, there's no cap on the amount of compensation they can award. The highest sum awarded by an employment tribunal in 2014–15 was £557,039, and this was awarded in a sex discrimination claim. The maximum costs awarded were £235,776. Few small businesses can recover from that kind of financial blow.

But it isn't only the financial penalties that can be seriously damaging. When a dispute or an accident occurs in the workplace it affects everyone, not merely the employee directly involved. People lose trust in an employer if they see that things aren't run properly and safely, or if the employer has no real respect for workers' rights.

Employers frequently struggle to find suitable employees or have to train applicants from scratch. You can't afford to lose employees because they have no confidence in the way your business is run. It costs a lot of money to recruit staff and train them. The more often people leave, the more time you spend fire-fighting instead of improving performance and increasing productivity.

Small business owners are always worried about the amount of legislation that applies to them. There are a lot of laws, regulations and codes of best practice out there, and staying on the right side of the law can be a tough job. Knowing what the law says before setting up a business or before employing your first member of staff is important, and if you start out with all the information you need, it's not as difficult or expensive to apply the law as you go along – and take it into consideration each time you make a business decision. Changing your habits later on can be much trickier.

Good employment practices encourage good employee–boss relationships. In turn that breeds loyalty, and staff will stay with you. People who are loyal work better. They have the interests of your business at heart because you have their interests at heart. Everyone's a winner.

## Cutting Through the Red Tape

'Red tape' is a term that conjures up images of bad regulations, strangling your business and making your life more difficult. Commentators sometimes blame employment laws in the UK for putting too heavy a burden on business owners, but they're really intended to protect employees from bad employers, not from good ones. These laws also help employers protect themselves.

REMEMBER The law isn't a burden to good employers who want to do right by their employees; it's a source of clear guidance that helps you to keep employees instead of losing them to better employers. When hard workers with the skills you need seem hard to find, your business's success depends on your reputation as a desirable employer. Rather than seeing the law as just so much red tape, think of it as a guide to becoming that kind of desirable employer.

TIP Business people most often cite the National Minimum Wage and family friendly legislation about maternity, paternity and parental leave as causing them difficulties. Yet motivated employees who feel fairly paid and who know they can take the time needed to take care of family matters can increase your company's productivity, so it's well worth your investment in sound policies.

Perhaps the biggest problem is that the legislation relating to small businesses is scattered around so many acts and regulations that keeping a grip on them can be difficult. Some acts, like the Data Protection Act 1998 or the Regulation of Investigatory Powers Act 2000, have such a wide scope that it's easy to forget that they can apply to small businesses and their employees. The headache isn't always so much the red tape as pulling it all together and knowing exactly what it means for your business.

## Working Out What the Law Expects from You

Working out what the law expects from you can be a challenge. Most employers wait until something has gone wrong or an employee has taken legal advice and made a claim against them before checking out where they stand legally. But forewarned is forearmed when it comes to small businesses and the law. If you're setting up a business or about to take on your first employee, this is the time to get advice on your legal position. If you already employ people and you haven't put a lot of thought into the legalities of your situation, take the time now to find out what your obligations and responsibilities are as an employer. It makes good business sense and will stop you making costly mistakes in the future.

Employees, whether full-time or part-time – apart from those who are exempt and as long as they've been employed by you for the relevant qualifying period – have employment rights, including the following:

- National Minimum Wage
- Maximum weekly working hours (with breaks)
- Equal pay for equal work
- Paid holiday
- Protection from discrimination
- A safe working environment
- Notice that their employment is ending
- Written Statement of Employment Particulars
- Statutory sick pay and statutory maternity, paternity and adoption pay
- Maternity, paternity and adoption leave
- Parental leave and time off for family emergencies
- To request flexible working arrangements
- Protection from unfair dismissal
- Redundancy pay

WARNING If employees are unfairly treated and denied their employment rights, they can make a claim against you at an employment tribunal or in some cases in the civil courts. If you break the law, you can face prosecution in the criminal courts by an enforcing body such as the Health and Safety Executive.

TECHNICAL STUFF In most cases the legislation is reasonably clear, but some areas of employment law are governed by common law. *Common law* is the body of law that builds up as cases are heard in court and judges make their decisions, as opposed to *statutory law* , which is passed by parliament.

# Going the Extra Distance

Whatever the law says is just the start. You can go further and offer your workers better terms and conditions than the law demands. You can follow various codes of practice that will help you to not merely comply with the law, but go further. For example, following the code on monitoring employees at work will not only help you comply with the Data Protection Act 1998, it will also help you gain your employees' trust.

TIP ACAS – the Advisory, Conciliation and Arbitration Service – produces useful codes of practice on issues such as dismissal and disciplinary procedures, which came into force in October 2004 (last revised March 2015). You absolutely must comply with these codes of practice if you're disciplining, dismissing or making someone redundant. Contact ACAS on 0300 123 1100 (8 a.m. to 8 p.m. Monday to Friday and 9 a.m. to 1 p.m. on Saturdays) or through the website – www.acas.org.uk .

Putting company policies in place to deal with workplace issues that don't come under the scope of legislation is a good idea. For example, you may decide to add a policy on the use of email and the Internet. That's not a legal requirement, but that way everyone knows up front whether employees can use company facilities for personal reasons.

REMEMBER None of this preparation costs much in terms of cash outlay, but planning, writing and distributing policies does take time. However, once you've brought yourself up to date with the law, implemented the codes of practice and drawn up your policies, all employees know where they stand, and staying on the right side of the law becomes second nature to your company's culture.

# Deciding Who Has Rights

The people who work for you may not all have the same employment rights. Employees have different rights to people who work for you on a self-employed basis. Some rights are acquired by working for you for a particular length of time. Some are automatic no matter how long a person has worked for you, and if you try to deny him those rights you'll automatically be in the wrong. Some people who do particular types of work are excluded from rights that other people working in different jobs automatically have. Other rights apply to everyone who works in your workplace regardless of their status. Even people who don't work for you yet but have applied for jobs have some rights (see Chapter 2 in Book 3 on recruiting employees).

Potentially confusing? This section provides some definitions to help you find your way.

## Employees

*Employees* work for you under a contract of employment. They include apprentices. It's all fairly clear-cut where a written document exists labelled 'contract of employment' or *Written Statement of Employment Particulars* . Problems arise when nothing is in writing and the worker argues that he's an employee and the employer argues that he's self-employed.

Employees start off from day one of your employment with some employment rights. Some of those rights are set out by law (known as *statutory rights* ) and others are rights you give your employees through their contract terms and conditions (known as *contractual rights* ). A contract exists as soon as you make an offer of employment and the employee accepts it, so anything in that contract stands and can't be changed without his agreement or you may be in breach of contract.

REMEMBER An employee has statutory rights from day one, such as the right to be paid at least the National Minimum Wage, the right not to be discriminated against and the right to a healthy and safe environment to work in. The right to paid holidays starts to build up from day one and the regulations on working hours and breaks apply. Employees have to be given a Written Statement of Employment Particulars by the time they've been with you for eight weeks. If you try to deny an employee his statutory rights and sack him for asking for them, you've dismissed him unfairly in the eyes of the law.

You also give your employees rights through their contracts. You can give people better terms and conditions than the law allows – longer holidays, better rights to sickness pay, better redundancy payments – but you can't give them less than the law says. If you do offer better terms in the contract, you have to deliver or you're in breach of contract and the employee can make a claim against you.

If a contract is for a particular length of time – for example for three months – the employee has all the same rights as any other employee for those three months, but doesn't acquire the other rights that build up over time (such as maternity or paternity leave or redundancy payments).

WARNING Be careful if you go on extending someone's employment on short-term contracts: continuous employment for a year, or for two years, may allow an employee to argue at a tribunal that he has acquired rights, such as those to claim unfair dismissal and redundancy pay over that period of time.

### Full time

A *full-time employee* is someone who works the normal working hours for your business. *Law for Small Business For Dummies* by Clive Rich (Wiley) details the rules about the maximum number of hours someone can be expected to work in a week and the breaks you must give him, but all your full-time employees are entitled to all the statutory employment rights unless you work in certain employment sectors (see the section 'Exemptions ', later in this chapter).

### Part-time

Anyone who works fewer than the normal number of full-time hours in your business is a *part-time employee* . Part-time employees have all the same statutory rights as full-timers, and they can't be treated less favourably just because they don't work the same number of hours. Some employers try to give part-time employees less favourable conditions through their contracts – perhaps a lower hourly rate of pay – but you have to be careful not to discriminate.

You must pay part-time workers on a pro-rata basis. *Pro-rata pay* means that if they work half the hours of a full-time person, you need to pay them the same amount per hour for half the hours. You need to give them equal rates of pay, overtime pay, holiday pay, and the same rights in their contracts to training, career breaks, sick pay, maternity pay and paternity pay. Similarly, if you offer full-time employees the right to join a company pension scheme and refuse your part-time employees this scheme, you can be judged to be discriminating.

## Self-employed

Someone who works for you on a self-employed basis isn't an employee and doesn't enjoy the same rights as an employee. However, not everyone who works for you on what you may consider to be a self-employed basis is in reality self-employed. Some employers hire people on a self-employed basis in order to avoid giving them employment rights and paying National Insurance, but if a dispute arises and the worker takes a case to a tribunal, the tribunal may find that he has been an employee all along.

Someone who is genuinely self-employed works under a contract for service rather than a contract of employment. You're contracting that person to provide services. He is genuinely self-employed if some or all of the following apply; if he:

- Can send someone else along in his place to do the work
- Can work for more than one business at the same time
- Can work as and when he's required
- Provides his own tools or equipment to do the job
- Pays his own support staff if he needs any
- Is responsible for his own profits and loss

Employers sometimes see proof of self-employed status in the fact that workers pay their own tax, National Insurance and VAT, don't get sickness pay, paid holiday or regular wages, and don't come under the firm's disciplinary procedures. Those factors do count, but if those are the only factors that can be used to prove self-employment, a tribunal may decide that the relationship is really one of employer and employee and that you're just trying to avoid employment legislation.

People who are brought in as genuinely self-employed to do some work for you may not qualify for the same employment rights as your employees, but if they are working on your premises they have the right to a healthy and safe working environment (see *Law for Small Business For Dummies* by Clive Rich, published by Wiley, for more on this), and they have the right to have information about them treated properly and fairly under the Data Protection Act 1998.

## Consultants

Consultants working in your workplace are usually either self-employed or employees of other companies. If you take them on under a contract of employment on a temporary basis, they become employees. If their firms send them to deliver consultancy services under a contract for services, their employers should take steps to ensure that yours is a healthy and safe environment for them to work in, but you have the same obligations as for other self-employed workers.

## Agency workers

Companies often employ temporary workers through agencies. This saves you having to go through lengthy recruitment procedures to employ someone for a short time. These workers have a contract with the agency and the agency has a contract with you. In this case, the agency pays the worker direct and you pay the agency for delivering the service. The contract you have with the agency isn't an employment contract, so the worker isn't your employee.

However, it's not quite that straightforward. Over a period of time it's possible for a relationship to develop where something like a contract of employment exists between you and the agency temp, even if only in implied terms. If you insist that the agency can't send someone else along instead and the person can't work for anyone else; if you supply all the tools and equipment; if you include the temp at your staff meetings and more or less treat him like one of your employees; and, most importantly, if you control the day-to-day supervision of his work, a tribunal can decide that he is in reality an employee. A recent Court of Appeal case decided that once an agency worker has more than one year's service with a single 'end-user' employer, they're almost bound to be the employer of the worker – and other cases have followed suit. If you need to keep him on for longer than originally anticipated, offering him a job as an employee is a good idea.

TECHNICAL STUFF A whole range of EU regulations giving workers protection have effectively given agency workers the rights to paid holidays, rest breaks, minimum wages, maximum working hours and protection from being treated less favourably if they're part time. It seems likely that in time all workers, other than the ones who are genuinely self-employed, will eventually have the same protection as employees.

## *Home workers*

If people work in their own homes they'll be employees unless they're genuinely self-employed. If you have an obligation to provide them with work, they can't pass that work on to someone else, you supply the tools and equipment, and they can't work under more than one contract for different employers at the same time, they are likely to be considered employees.

## *Exemptions*

There are exceptions to every rule, and some employees aren't entitled to all employment rights. For example:

- Police, share fishermen and merchant seamen employed wholly outside the UK and who aren't ordinarily residents in the UK have no right to claim unfair dismissal or statutory redundancy pay.
- People who work for government departments can't claim statutory redundancy pay or minimum periods of notice.
- Members of the armed forces have no statutory employment rights other than the right not to be discriminated against.
- Temporary and casual workers won't usually be able to claim unfair dismissal or redundancy pay because they won't work for an employer long enough to acquire those rights.

REMEMBER The law doesn't protect people working under illegal contracts. If someone is, for example, paid cash in hand to avoid paying income tax and National Insurance, he has no employment rights. Anyone who is employed to do something illegal won't be protected either. The principle is that a wrong-doer mustn't benefit from his wrong-doing.

REMEMBER As an employer, it is your responsibility to ensure that anyone working for you is entitled to work in the UK. You can find out how to make sure of an employee's entitlement at this government website: www.gov.uk/government/publications/right-to-work-checklist. Penalties for breaches of the law are draconian. You may get a civil penalty of up to £20,000 for each illegal worker you employ, and you can be sent to jail for up to two years and receive an unlimited fine if you employ someone who you know is working illegally.

New age discrimination laws came into effect via the Equality Act 2010, so the best advice is to be very careful about treating your older workers less favourably than your younger ones. Of course, you won't be able to discriminate against younger workers either.

### Young people

From the age of 18, workers are entitled to the National Minimum Wage of £5.30 an hour, which goes up to £6.70 an hour when they're 21. And you have to pay 16- and 17-year-olds a National Minimum Wage of £3.87 per hour, although apprentices under 19 are exempt. Anyone aged 16 and 17 may be entitled to time off with pay to study, and you may be expected to help with those costs. You can take on someone under the age of 24 on an apprenticeship scheme. The Skills Funding Agency website has the details – www.gov.uk/government/organisations/skills-funding-agency.

REMEMBER New National Minimum Wage and National Living Wage rates came into force as from 1 April 2016. Workers aged 25 or over and not in the first year of an apprenticeship are legally entitled to at least £7.20 per hour. You can find out more at www.livingwage.gov.uk.

You can't employ a child under 13, and strict rules govern the hours that 13- to 16-year-olds are allowed to work. You can find out all about employing young people at ACAS (www.acas.org.uk, then search in the Advice A-Z in the Advice and Guidance tab).

## Deciding What to Put in the Contract

REMEMBER Employees have statutory rights, and you can't do anything that takes away those rights. When it comes to the contract you can offer more generous terms and conditions of employment, but you can't write in clauses that take away statutory rights.

Employees are entitled to a *Written Statement of Employment Particulars* within eight weeks of starting work. This should include all the main terms and conditions of their employment or refer employees to other relevant written documents.

## Drawing Up Other Employment Policies

Your policies on pay, working hours, holidays, sickness absence, and maternity, paternity and adoption leave should all be covered in the Written Statement of Employment Particulars. Apart from those policies, and the terms that form part of the contract (whether in writing or not), there are also policies for running your business that the law says you have to have in place, and there may be others that would help everyone be clear about where they stand.

Some working parents have the legal right to request flexible working patterns, and you may want to extend these to your whole work force.

You must have written policies on disciplinary procedures, grievance procedures, health and safety, and discrimination, including dealing with bullying, harassment and victimisation (see *Law for Small Business For Dummies* by Clive Rich, published by Wiley, for more details on all these matters).

You may also want to consider drawing up policies on alcohol and drug misuse; telephone, email and Internet usage; smoking; and even dress codes.

Your policies should all be in writing and you should make sure all your employees are aware of them and can access them at any time. They set the standards for everyone to aspire to and everyone knows exactly where they are from the start.

# Managing Without an HR Department

Big firms usually have special departments employing HR (Human Resources) specialists to ensure they stay on the right side of the law, respond to all the government's latest demands on flexibility, and draw up policies that make everyone aware of how the workplace should operate. Most small businesses don't, but that doesn't prevent good small business bosses getting it right. Many of the small businesses that do get it right are no bigger than yours and have no more facilities, no bigger turnover and no more profit. They have the systems in place right from the start to help them make sure they're complying with the law, and good practice has become part of their culture. Each time a change in the law comes along that can pile on the pressure, little change is required because they're most of the way there already.

You don't need an HR or Personnel department if everyone in the workplace knows exactly where they stand and everyone knows who is in charge of what. The person who pays the staff knows the legislation on pay and making deductions from pay, and deals with sick pay and maternity or paternity pay. Someone else looks after the workplace, making sure that you don't break the health and safety regulations. It gets harder when it's just you who has to know everything about everything and make sure you don't break the law. However, it's still a question of putting the systems in place right from the start and building the business around them, instead of grafting on the means of complying with each piece of legislation as you find out about it.

# Getting Help and Advice

TIP

You need good sources of information and some way of keeping up to date with changes as they come along the pipeline:

- Most big banks provide very useful information on all aspects of running a business. Your solicitor and accountant, if you have them, will be helpful, but don't take petty problems to them as you have to pay for their time and there may be more cost-effective ways of getting help and support. Make sure any solicitors and accountants you use have experience when it comes to dealing with small businesses. Big businesses are quite different animals, and the experience of working with big firms doesn't qualify people to work with small ones.

- The government is the primary source of information on employment matters. The website www.gov.uk/browse/employing-people has a directory of all matters relating to this subject.
- ACAS is an invaluable source of help to business. Its helpline number is 0300 123 1100 and the website is www.acas.org.uk.
- The Federation of Small Businesses is a group you may want to join. It has 185 branches around the country. For an annual subscription of starting from £130 (depending on how many employees you have), you get various services, including access to a legal helpline where you can talk to an adviser about any legal problems you have, including all aspects of employment law. The organisation lobbies government on issues of concern to small businesses, so as well as helping you stay on the right side of the law, the Federation can give you a voice. Call 0808 20 20 888 or check out the website at www.fsb.org.uk.

# Chapter 2

# Finding Person Friday – Advertising and Interviewing

**IN THIS CHAPTER**

**Deciding how to fill a vacancy**

**Getting the adverts and the interviews right**

**Checking your candidates' suitability**

**Offering a job correctly (and turning down unsuccessful candidates in the right way)**

As a small business manager, situations arise requiring you to find new members of staff. Whether you're looking to take on your first ever assistant, hoping to replace a worker who's left the business, or expanding and needing an extra pair of hands, you need to get the recruitment process correct. Good recruitment practice brings in good candidates, and ultimately benefits your business.

But first things first! Do you really need to take on a new member of staff? It costs time and money to employ someone new, so take a careful look at how you staff your business at the moment. Be sure that you really need another person, or to replace someone who's left, before you start advertising. Also make sure that the person you advertise for is really the employee you need – if you're replacing someone who has left, think about why she left and the skills she had that you need to replace.

TIP Before heading down an external advertising route, consider promoting current employees, or find out if any of your part-time workers would like full-time jobs, or if anyone would appreciate the chance to do some overtime. Something as simple as changing working hours – allowing some people to start earlier and others to finish later – may be enough to get the work done without recruiting. It has the added benefit of giving your existing employees flexible working patterns.

## *Filling the Gap*

Work out the skills that your new recruit should have and what her job will really involve. Think about whether you need someone permanent or someone to see you through a temporary period of increased workload. Maybe you don't really need another full-time person. Can a part-timer do the job? For many small businesses, part-timers are the answer when it comes to filling the gaps. They have all the same rights as full-time employees, but being part-time allows many people to work and still fulfil their family or caring obligations when working full-time isn't an option. That gives you a wider pool of experienced and skilled people to recruit from.

TIP If the job you have to offer is full-time, think about job sharing. As the name suggests, job sharing means that two (or more) people in effect share one job. They may split the week, work alternate weeks or alternate days, or some of their hours may overlap, but they do one job between them and share the pay and benefits of a full-time job. It can cost you a bit more in terms of training and admin, but job sharing can benefit you in a number of ways. Job sharing:

- Enables you to keep on experienced people who can’t continue working full time but who still want to be employed.
- Gives you more flexibility if you have peaks and troughs in demand.
- Means one job sharer is around when the other is on holiday or off sick, and because they have more control over their hours, job sharers usually have less time off sick and suffer less from stress.

You need to choose people to job share who get on well together, which is never an exact science! They should have complementary skills and experience. Make sure that they divide the work fairly, that they have a way of communicating if they rarely see each other, and that each doesn’t end up doing less or more than the hours you’re paying them for.

Other methods of employment can be useful to know about:

- You can consider having people who work for you in term time and don’t work during the school holidays.
- You can employ people on contracts where they’re available as and when you need them and you pay them for the work they do (called *zero-hours contracts* because you don’t specify any particular number of hours).
- You can recruit people temporarily as and when you need them to see you over periods of increased production.

You also have to think carefully about how much you can afford to pay any new employees. Pay has a bearing on whether or not you can afford to look for someone better qualified than a person who has left, or whether you can afford to entice someone from outside the area (which can be expensive in terms of relocation expenses).

REMEMBER Don’t forget the obvious factors like space and desks. If you’re replacing someone and can use her old workspace that’s fine, but adding an extra employee to the workforce means you need somewhere for her to work without leaving everyone else squashed, leaving you in danger of breaching health and safety regulations.

## Getting It Right from the Start

Getting your recruitment procedure right is crucial for the success of any business. If you hire the wrong person – someone with the wrong skills, someone who can't do the job, or someone who isn't competent and puts your other employees under stress or at risk – your whole operation is in danger of falling apart. At best, working relationships become strained, and at worst, you start losing good employees or good customers – or both. Don't waste time and money taking on the wrong person. And don't forget that certain aspects of employment law, such as the laws on discrimination (refer to Chapter 1 of Book 3), apply to people during the recruitment process before they ever work for you.

## Deciding on full- or part-timers

One important decision you need to make early on is whether you need to hire a full-time person. Some very good reasons may exist for not doing so. If, for example, the demand for your products is highly seasonal and has major peaks and troughs, keeping people on during slack periods may make no sense. This may be the case if you're selling heating oil, where you can expect demand to peak in the autumn and tail off in the late spring because of variations in the weather. Other examples of seasonal fluctuations are increased sales of garden furniture and barbeques in summer, and toys and luxury items before Christmas.

Using part-timers can open up whole new markets of job applicants, sometimes of a higher quality than you may expect on the general job market. Highly skilled and experienced retired workers, or women who've given up successful careers to have a family, can be tempted back into temporary or part-time work. You may sometimes be able to have two members of staff sharing one job, each working part-time. You can also use this tactic to retain key staff members who want to leave full-time employment. This makes for continuity in the work, allows people to fit in their job around their personal circumstances and brings to the business talents that it may lose if it insists on full-time work.

TECHNICAL STUFF

> Part-time work is more prevalent than many people think. Up to a third of all those in employment in some countries are working part-time, and most of those are working in small firms whose flexibility in this area can often be a key strength over larger firms when it comes to recruiting and retaining employees.

You can find part-time staff using the same methods as for full-time employees, which are discussed in the next sections.

## Coming up with the job description

Having put a lot of thought into the kind of job or person you need, write a job description. No law says you have to have one, but it's a valuable exercise that helps you to define very clearly the job you want done. When you send the job description to potential applicants, they can see exactly what they're applying for. A *job description* should:

- Give the job title
- Explain where the job fits into the overall structure – who the applicant will report to and who she will be responsible for

- Say where she will be expected to work
- Give all the duties she will be expected to carry out and the objectives of the job

As well as putting the details of the job on paper, you can draw up a *person specification* of the kind of applicant you're looking for. You need to be careful when you're doing this: it's against the law even at this stage to discriminate against certain people (see *Law for Small Business For Dummies* by Clive Rich, published by Wiley, for more details about discrimination). If specific skills, qualifications and experience are required in order to do the job, you can list those. You can then list the qualities that you'd like the applicant to have that aren't essential for the job, but make it clear what's essential and what isn't.

REMEMBER When writing a person specification, don't put down things that exclude a whole set of people from applying if that quality isn't essential. For example, if you don't need someone with ten years' experience, by putting it in the specification you rule out all those who can do the job but have less experience. Don't discriminate, but equally don't reduce the pool of people you receive applications from or you may not get the best candidates.

## Advertising – what you can and can't say

Writing a job description and a person specification makes writing an ad easier. You can say anything in your ad as long as it isn't discriminatory. If you say in a job ad that you want a man for the job, but in reality it's not absolutely essential, you're discriminating against women. But if you really do need a man (or woman) because it is a 'genuine occupational requirement', you're not discriminating. If, for instance, you run a shop selling women's clothes and you need someone who can help women in the changing-room, being female will be a requirement of the job.

Don't use words like waitress or manageress. Even if you'll take on a man or a woman, it looks as if you intend to take just women and therefore discriminate against men. Use words that apply to both sexes or make it clear in the ad that the job is open to both sexes.

REMEMBER You can't discriminate against anyone on the grounds of age, race, sex, religion or other beliefs, sexual orientation or disability. You can find out more online at www.gov.uk/government/collections/age-positive. You also can't refuse to appoint someone because they belong to a union or won't join a union.

TECHNICAL STUFF In certain instances, you can advertise for someone solely from a particular sex or race. If in the last year, for example, few men or black people have been working in your particular field and you want to get a better representation in your workforce, you can encourage them to apply through your ads. But because the discrimination laws are a minefield, it's advisable to take advice from an organisation like the Equality and Human Rights Commission at www.equalityhumanrights.com or 0808 800 0082.

## Placing your ads

Your ad needs to be to the point, but give enough information to allow people to decide whether or not to apply. Good job ads list:

- Essential skills required
- Relevant experience desired
- Necessary qualifications
- Application processes – where to send a CV or who to contact for an application form
- The job title and an outline of the tasks involved
- The closing date for applications
- A positive story about your business and why you are recruiting

Where you decide to advertise depends on the audience you want to reach. If you're just looking for someone who lives locally, try the local papers (including any free ones that get put through letterboxes), local radio, schools or universities, the window of the premises you trade from and your local newsagent's noticeboard. If you know that you're likely to have to go further afield to get the skills you need, think about the national papers.

TIP Don't forget the trade press and magazines that people who work in your industry read. More employers are now using the Internet to reach a wider audience quickly. If you go into a search engine and type in 'job vacancies', you can see that there are many websites that carry job ads: www.jobsite.co.uk , www.totaljobs.com and www.fish4jobs.co.uk to name just a few. Some websites like www.reed.co.uk will carry job ads for free. If you want to attract people with disabilities, Jobcentre Plus offices are useful, but other options such as the Talking Newspaper Association are also available. You can contact them on 0303 123 9999 or at www.tnauk.org.uk . Think about making job descriptions available in large print or on tape for people with visual impairments or in different languages for applicants whose first language isn't English.

TIP The more widely you advertise, the more applications, CVs, phone calls and emails you're likely to get. Make sure that someone's available to deal with enquiries, send out forms and collate all the applications.

## Using an agency

Employment agencies can advertise on your behalf and can provide lists of possible candidates for you to look at. You have to pay a fee for an agency's services, so find out what they charge before you decide which agency to use.

Many agencies specialise in particular areas of work. These types of agencies can save you a lot of time, but they can also be very expensive.

You can recruit people through an agency on a temporary basis, meaning that the agency employs them rather than you – so the agency looks after their pay, tax and National Insurance. This system enables you to try people out on a temporary basis before deciding whether to employ them yourself permanently. Using an agency also means that your business name doesn't have to be included in the advertising if you'd rather it didn't. Of course, if the agency can't find you anyone suitable you're back to square one and have lost valuable time, but you don't usually have to pay a fee in these circumstances. Just be aware that if you take on agency workers for more than a year, an employment tribunal may decide you've become their employer even if they're described as being self-employed by the agency or by themselves. For more on agency workers, refer to Chapter 1 in Book 3.

Alternatively, you can employ a firm of recruitment consultants to take you through the whole recruitment process from deciding on your person specification, to interviewing, to making a final choice. A recruitment consultancy differs from an employment agency in that the agency offers you the pick of people registered on its books and a recruitment consultancy charges a fee to do the job of recruiting for you. If the job is a very important one within your organisation, you can use a firm of *headhunters* who actively look for the very best person on your behalf. They tend to be very specialised, and because they know a lot about their industry, they know where to look for people already working at the level you require.

## Recruiting over the Internet

The fastest-growing route to finding new job applicants is via the Internet. The number of websites offering employment opportunities has exploded in recent years. The advantages of Internet recruitment to both candidates and clients are obvious. Internet recruitment offers a fast, immediate and cheap service compared to more traditional methods of recruitment. A number of recruitment sites have established formidable reputations in Europe and the US. These include:

- **Futurestep** (`www.futurestep.com`), which is now part of Korn Ferry, a conventional recruitment agency. It covers all job functions and industry sectors.
- **Monster** (`www.monster.co.uk`) has a Power CV Search for employers that quickly sorts the wheat from the chaff in its database, which contains over a million CVs. Its vacancies cover every industry sector and regional area.
- **Web Recruit** (`www.webrecruit.co.uk`) has successfully recruited for over 65,000 roles in 10 years.

Another option is to have a job-listing section on your own website. This is absolutely free, although you're certain to be trawling in a very small pool. This may not matter if the right sort of people are already visiting your site. At least they know something about your products and services before they apply.

WARNING Be prepared to deal with applications from people from the far flung corners of the world who may or may not be suitable and may not have the right to work in your country.

## Using Jobcentre Plus

You get a similar service from Jobcentre Plus as from an employment agency (see the earlier section ‘Using an agency ’), but it doesn’t cost you anything. You can advertise your job and get help from one of the vacancy managers. Advertising in Jobcentre Plus can be a quick way to find new employees, and you can arrange to take someone on, on a trial basis, before you offer them a permanent job. The people who use Jobcentre Plus are actively looking for work and often ready to start work straight away.

REMEMBER If you employ someone through Jobcentre Plus, you employ them and pay their salary direct to them, whereas if you recruit through an agency the person you take on may not be your employee, but paid by the agency (find out more about agency workers in Chapter 1 of Book 3).

TIP Another advantage of using Jobcentre Plus is the advice the centre offers, not only on recruitment but on just about every other aspect of employment, including help with employing people with disabilities.

Plug into Jobcentre Plus’s employer resources at `www.gov.uk/jobcentre-plus-help-for-recruiters/recruitment-advice-and-support`, or contact them by phone on 0345 601 2001.

### *Following up recommendations – and remembering to be fair!*

Finding someone suitable to fill your vacancy can be as simple as asking around! Talk to your existing employees and colleagues; other people working in the area or industry; and friends, family or local business people and organisations. How successful this method is usually depends on the level of expertise you’re looking for. You may find someone if you’re looking for a receptionist, but you may not if you’re looking for a highly experienced financial director. It’s certainly well worth thinking about as part of your recruitment plan, but you may be seen as trying to poach other people’s employees. Also, if you rely on word of mouth alone, you’re limiting the pool of potential applicants to people who know people you know.

## *Considering Diversity*

More and more businesses are realising the advantages of having members of staff of different racial and cultural backgrounds, ages, genders, sexual orientation or religious beliefs, and those with disabilities. Customers and suppliers appreciate being able to do business with a diverse workforce that reflects the community around it, and it may improve your reputation. If you spread your net more widely when recruiting, you’re likely to have more applicants to choose from, with different experiences, knowledge and skills, and your employees from varied backgrounds can help you understand your customers better. Some customers, for example, may prefer to deal with older people because they feel that older staff are more experienced and understand their needs better. If you have only young people on your staff, those customers may well take their custom elsewhere.

REMEMBER Think carefully about having an equal opportunities policy. If you do face a claim for discrimination, an employment tribunal will ask to see that policy. Use these guidelines to help prevent discrimination:

- Make sure that you don't exclude any one group when you write your job ad and job descriptions.
- Think about where you advertise. You may have to advertise in a wider range of publications than you've done in the past in order to get to all the people you'd like to reach.
- Make sure that people with disabilities who apply for jobs with you are able to get to interviews and have access to your premises – otherwise you risk falling foul of the `law`. Check out the current regulations on discrimination at the Office for Disability Issues ( www.gov.uk/government/organisations/office-for-disability-issues ).

# Sorting the Wheat from the Chaff – CVs and Application Forms

You need to decide how to extract the information from your candidates' applications in order to decide which ones to interview. Application forms and CVs both have their advantages and disadvantages, outlined in Table 2-1 for application forms and Table 2-2 for CVs.

### TABLE 2-1 The Pros and Cons of Application Forms

| *Pros* | *Cons* |
|---|---|
| You can decide exactly what you want to find out from your applicants, and can design the form yourself or buy ones from stationery suppliers. | You need to put a lot of thought into how the forms are designed and they need to be easy to fill in, or some people will be put off applying. |
| Every applicant fills in the same form so it's easy to compare skills, experience and qualifications. | You have all the effort and cost of producing them and sending them out. |
| Some people feel happier about filling in a form as it gives them a guide as to what information is needed. | You have to be careful not to ask discriminatory questions. |

### TABLE 2-2 The Pros and Cons of CVs

| *Pros* | *Cons* |
|---|---|
| The way a CV and covering letter are laid out will tell you something about the applicant's abilities. | You have no control over the information that's included in an individual's CV. Some important information that you require may be missing. |
| You don't have any of the costs of production, design or sending them out. | All CVs have different information and layouts, so they're harder to compare. |
| People are more likely to apply if they don't have to fill in a form. | Applicants can easily hide work gaps. |

TIP Some employers prefer to use application forms that allow them to remove the personal information. This takes away the temptation not to see anyone over a certain age or who is of a particular sex or ethnic background. They then use just the parts of the form that refer to skills, experience and qualifications when deciding who to interview, preventing bias or discrimination against a candidate when drawing up their shortlist. That's harder to do with CVs.

Whichever you decide to use, you're likely to get a better response in terms of the information people give you if you send them a copy of the job description and the person specification. Doing so gives applicants a much clearer idea than an ad can of what the job entails and whether they've got a chance of getting it.

REMEMBER If people lie on CVs or application forms about their qualifications or experience and you offer them a job, you can later withdraw the offer or dismiss them if you rumble them. Make it clear that you'll check all their claims.

REMEMBER Under the Data Protection Act 1998, the personal information you collect about individuals has to be used for the recruitment process only. Only those people involved in the recruitment process should have access to it: you can't pass it on to anyone else without the applicant's consent, and it should be kept confidential and in a secure place so it doesn't fall into the wrong hands.

## *Drawing up your shortlist*

After you've got all the applications in, you need to decide who to interview. Decide how many people you have time to interview (allowing 45 minutes to an hour is about right), and come up with a shortlist of that number. Five or six candidates are usually enough.

Whittle the applications down to the number on your shortlist by using this process:

1. **List all the candidates and work out how well they fit your person specification and the job description.**

   Some applicants probably won't have the qualifications you need so you can reject them straight away.

2. **Give the rest a tick or a number of points for how well they meet each of the essential requirements to do the job.**

   If you do use a points system, make sure that you apply it fairly to all the applicants.

3. **Check to see if you now have the right number for your shortlist.**

If you still have too many people in the running, look at how well each one of those who have the essentials match the other qualities you'd like your new employee to have.

WARNING If you don't have enough candidates on your shortlist, consider advertising again to get additional suitable candidates. You should never contemplate making a recruitment decision from just one or two possible candidates. You may make a bad recruitment decision if you don't see a reasonable number of candidates.

WARNING If you take personal information into consideration, be very careful. Having more than one person involved in the shortlisting process is a smart move because it helps avoid any personal bias on your part. For example, many employers still fall into the trap of thinking that men who have children won't want to ask for time off to look after them but that women will, and make biased decisions on that basis. One employer was sued after a candidate submitted the same CV twice – once using an Indian name, the other time using an English name. The application with the English name was shortlisted for an interview and the one with the Indian name wasn't. Be fair.

### Dealing with the ones that don't make the shortlist

Write to the applicants you don't want to interview so that they aren't kept hanging on, hoping. Thank them for their interest. If any of them do contact you to ask why they didn't get an interview, simply explain that other applicants were better suited to the job because they had more relevant qualifications, skills or experience. Don't go down the route of saying that people were too old or too young or that they didn't have skills that you didn't specifically ask for in the job description or person specification.

## Handling the Practicalities of Interviews

After deciding who's on your shortlist, invite them for an interview. However you contact the shortlisted candidates, it's wise to confirm the details in writing.

Include the following information with your invitation:

- Where the interview takes place
- When the interview takes place
- How long the interview will be
- Whether any tests or presentations are required and whether the person will complete them at the time of the interview or during a separate appointment
- Details of anything the candidates need to bring with them
- Details of who will be on the interview panel
- Who to ask for when they arrive

- How to get to the interview (with a map)
- Details of travel expenses

Also give the candidates a person to contact with any questions before the interview if they have problems getting there at the time you've given them or if they have any information they'd like you to know in advance (such as needing a car parking space close to the building because of a disability).

### *Making flexible appointments*

The fun starts when everyone on your shortlist phones up to ask for a different date or time to the one you've allotted. Remember that you do need to hire someone suitable – these few candidates are your best chance so try to be as flexible as possible. Think before you allocate the times: if you're interviewing in Glasgow and someone is coming from Glossop, either allow time for her to get there and back in a day for an interview at a reasonable hour, or offer to put her up overnight in Glasgow. Similarly, there may be people on the list who have caring responsibilities first thing in the morning. In fact, some people may have applied and not told their current employer that they have an interview, so be prepared to start or finish later or earlier to fit them in before or after work. Don't let a request for a later start immediately set alarm bells ringing about bad timekeeping. Keep an open mind.

### *Making sure everyone can get into the building*

When you invite people for interviews, ask them to let you know if they have any special needs. Someone may be a wheelchair-user, for example. You aren't expected to take out walls or build ramps, but be prepared to make reasonable adjustments so that the interview can take place without the candidate being in any way embarrassed or discriminated against. That can be something as simple as making sure someone gives up their car parking space for a few hours so that the candidate can park close to the main entrance. It may mean moving the interview from a room on the first floor to one on the ground floor, or making arrangements to use a room somewhere away from your work premises.

TIP If you do have to move the venue for one interviewee, move the venue for them all in order to avoid any embarrassment or confusion.

### *Paying for expenses*

You don't have to pay for travel expenses. If your applicants are all from your local area, the issue probably won't arise. If they're coming from further afield and you don't cover expenses, you run the risk that your best applicants may not be able to afford the journey or, worse still, form the opinion that your company is mean. After you've selected your shortlist, look at where people are in the country. If you decide that you probably do need to cover some people's costs, it's better to offer to pay everyone's expenses.

## *Planning the Interviews*

Employers often give little thought to either the process building up to the interview or how to conduct the interview itself. You're spending time and money to recruit someone, so preparing for the interview is well worth doing so that you can be sure to get the best out of it.

REMEMBER You'll be gaining first impressions of the people you interview, but they'll also be gaining first impressions of you. If you don't seem very well organised, they may decide there and then that they don't want to work for you.

Work out who, apart from yourself, should be on the interviewing panel. As a small business owner or manager, you may decide to do the interviewing yourself, but it usually helps to have at least one other person's opinion: two heads are normally better than one. Consider involving some of the following people on your interview panel:

- If you have business partners or management colleagues, see if one of them is available to help.
- If the new employee will report directly to someone other than you, consider involving that manager.
- If you have a Human Resources (HR) or Personnel department, enlist their help.
- If you've used a recruitment agency to help find candidates, try to involve the agency in the interviews.
- If the job requires a particular skill, invite a relevant member of staff onto the panel to assess the level of that skill for each candidate.

It really helps if everyone involved in the interview knows the candidates' application forms or CVs reasonably well and has them available at the interview. You can use this information to come up with the list of questions you want to ask. If there are any unexplained mysteries about gaps in employment, you may want to ask the candidate about those.

REMEMBER Decide how long you realistically need for each interview and leave some time afterwards to discuss each candidate with the other people on your interview panel. The length of the interview is important for the candidates as well as for you. You need time to extract the information you want and the interviewees need to feel they've had time to get their points across. So 45 minutes to an hour is usually enough, although you may want to set aside extra time for specific tests.

## *Working out what to ask*

REMEMBER The essential skills, qualifications and expertise to do the job are the most important issues to concentrate on at an interview. Asking good questions should get you good answers in return. Prepare the kinds of questions that don't invite a 'yes' or 'no' answer. Other questions will arise as the interview goes on, depending on what the candidate has to say.

Start by introducing everyone on the panel, explaining a little bit about your business and its structure and where the job fits into that. Outline how the interview will be conducted. That allows time for the interviewees to get settled. Give each interviewee a chance to ask you any questions they have at the end and explain what happens next.

WARNING Be very wary of asking personal questions. You can't ask women about their child-care arrangements and not ask men the same questions – unless you want to end up being sued for discrimination. Only ask questions that are relevant to the job: asking about whether someone is married or not or has children may be used against you later. Questions about disability have to be carefully worded too. You have to discuss how you can help someone with a disability to do the job you're offering rather than talk about why it would stop them doing the job. You can't use a disability as a reason not to employ someone unless it's justified. A person who is seriously visually impaired may not be able to drive your forklift truck, but if the job you're trying to fill is an office job, her visual impairment may not rule her out. If she can do the job as long as you make reasonable adjustments around your workplace, then you have to ignore the disability.

REMEMBER Don't make any rash promises during an interview – if you offer an interviewee the job there and then with a package that includes all sorts of benefits (such as a company car) and she accepts your offer, you can't then change the offer later if you realise you can't afford it.

## Setting tests

If a job requires a very particular skill, you may want to conduct some kind of test of that skill as part of the interview process – for example, a typing or shorthand test, or a forklift driving test. *Psychometric tests* (measuring intelligence, decision-making and problem-solving skills, aptitude and personality) are popular, especially when it's difficult to compare every candidate's skills and experience. If you do decide to include any tests, they must be relevant to the job and not discriminatory.

Tests can be done during, after or before the interview, but you need to use them as part of the selection process rather than as the one and only method of choosing the best person for the job.

TIP Dozens of commercial test publishers exist, producing collectively over 3,000 different tests. You can locate a test and guidance on which is best for your business needs through the British Psychological Society's Psychological Testing Centre ( `www.psychtesting.org.uk` ).

## Taking notes

After each interview, write notes of key information, otherwise you may mix up important points. Only record what was said in the interview. Stick to the facts.

TIP To make accurate notes as soon as possible, build into the interviewing time breaks where you can discuss the candidates and compare notes with fellow interviewers. Otherwise, by the end of a day of interviewing, remembering which candidate said what can become tricky!

After the interviews are finished, you may want to add notes that explain the criteria you used to select the eventual winner. The candidates have the right to see interview notes and may ask to see them if you don't offer them the job and they plan to bring a case against you at a tribunal for discrimination.

After the interviewing is over, only keep personal information if it's relevant to the selection process, and keep the notes and personal information somewhere safe where they can't fall into other people's hands.

# Checking Up on Your Chosen One

After going through the selection process and picking your best candidate, you can carry out a few checks before making the job offer, or you can make the job offer conditional on all your checks being satisfactory. Some checks are essential, while others are your choice, as explained in this section.

REMEMBER When making your checks on the candidate:

- Only do checks that are necessary and for specific purposes.
- Do checks only for the candidates you want to appoint.
- Let people know you're going to do checks beforehand and whom you're checking with.
- Don't use information that doesn't come from reliable sources.
- If the checks throw up something negative, give the person the chance to explain.
- Make sure that the information you get is kept confidential and secure.

## Following up references

You can take up references at any point during the recruitment process, but don't forget that most candidates will probably prefer you not to contact their current employers unless you're making them a firm job offer. You can't contact referees without a candidate's agreement, and previous employers don't have to give references unless they work in the financial services sector.

Despite the fact that many employers complain that they've had good references for employees who later turned out to be a disaster, most bosses do still use referees to check out a candidate's details.

WARNING You can insist on referees' details being given and make a job offer conditional on getting satisfactory references, but an outside chance remains that if the references aren't satisfactory or someone refuses to give one and you do withdraw the job offer, you can still be sued for breach of contract.

REMEMBER When asking for references, you're using personal information supplied to you on application forms and CVs. Under the Data Protection Act 1998 you have to keep that information confidential. Get the applicant's permission before you follow up references. You can have a section on the application form that you ask applicants to sign to give their consent and that makes it clear you'll be using the information they've given you.

Employers have to tell it as it is. If they do agree to give a reference, it has to be truthful. If you later find that someone exaggerated an applicant's skills and you lose out because of that, you can sue the referee. Similarly, employees can make claims against employers who give them references that they feel unfairly damage their careers. The upshot is that many big organisations will now only give references confirming the very basic facts such as length of employment and job title. If you don't get the references you want, think about offering the job on a trial basis.

## *Proving that potential staff are entitled to work in the UK*

REMEMBER All your employees have to be entitled to work in the UK and you have to check that they are. You may get a civil penalty of up to £20,000 for each illegal worker, and you can be sent to jail for up to two years and receive an unlimited fine if you employ someone who you know is working illegally. To make sure of an employee's entitlement to work, check out this government website: `www.gov.uk/government/publications/right-to-work-checklist`. Check and keep a record of the documents you use to confirm that someone is entitled to work before employing her. If you've made your checks and kept copies of the documents used, and done all you can to make sure that the person who showed you the documents was the person they rightfully belonged to, you'll have a good defence if it later turns out that she wasn't telling the truth.

## *Checking convictions*

If the job you're offering involves working with children or adults who are vulnerable – for example, disabled or elderly – you must check convictions with the Disclosure and Barring Service (DBS) (`www.gov.uk/government/organisations/disclosure-and-barring-service`). Only make these checks if you've decided to offer someone the job, and make the offer conditional on getting a satisfactory result. Some legal and financial jobs require these checks too.

Two types of conviction checks may be made:

- **A standard disclosure.** This tells you whether the candidate has any cautions, warnings or reprimands, and any spent or unspent convictions.
- **An enhanced disclosure.** This tells you all the same information plus information from local police forces, such as regarding acquittals.

If the job involves child care, you can also ask on the Criminal Records Bureau application form whether someone is on the government's lists of people considered unsuitable for that kind of work.

REMEMBER Convictions are *spent* if someone was convicted of a crime and had no further convictions during her rehabilitation period. Treat someone with spent convictions as if those convictions had never happened.

WARNING On 10 March 2014 important changes were made to the Rehabilitation of Offenders Act (ROA) that were retrospective. Previously if a person was in prison for more than 30 months because of a conviction, it could never be spent. This is not necessarily the case now, and if the conviction was less than four years, it can be deemed to be spent after a period of seven years plus the length of the prison sentence. For further details, look on the earlier DBS website or on the www.unlock.org.uk website ( http://hub.unlock.org.uk/knowledgebase/spent-now-brief-guide-changes-roa/#Aim of this information ).

## Checking health

Some employers insist on a potential employee having a medical examination before starting the job. If that's the case, make it clear when you make the job offer that you want a satisfactory medical report to show that the candidate is fit to do the job and that if she refuses or the results aren't satisfactory, the job offer won't stand. Other employers ask for a health questionnaire to be filled in, which, if it does throw up problems, can be followed up with a medical.

Only insist on health checks if you're sure that you want to take someone on. Don't insist that someone with a disability has a medical if you wouldn't insist on someone else having the same checks, or you'll be guilty of discriminating. Checks should really only be necessary if there's a legal requirement, such as an eye test for someone doing a driving job.

Some employers worry that candidates may be drug users and insist on health checks for that reason. If the employee may be at risk if her judgement is impaired due to drug use or she may put other employees at risk, tests can be justified. Make it clear when you make the job offer that drug use would rule the candidate out as being unfit to do the job and that relevant tests would be part of the medical.

Candidates have the right to refuse a health check; you have to have their written consent before you ask a doctor to do a medical report. If her own doctor does the examination, a potential employee has a right to see the report and can refuse to let you see it even though you have to pay the doctor's fee. Of course, you have the ultimate sanction in that if you insist on a satisfactory medical report and don't get it, you can decide not to take the person on.

## Checking qualifications

If a qualification is essential for the job, check it! You can make a job offer that's conditional on that check being positive. You can ask for certificates, or check with colleges, universities or any other professional organisations or examining boards.

TIP Qualification Check claims with some justification to be the world's most comprehensive online, automated academic verification service. Its clients are able to verify qualifications at more than 10,000 universities, colleges, schools and professional bodies in more than 80 countries. You get a free search once registered on the site ( www.qualificationcheck.com )

# Offering a Job to Your Dream Candidate

As soon as you make an offer – whether it's over the phone, by email or by letter – and the candidate has accepted it, a contract exists between you and your new employee.

REMEMBER In theory you don't have to put anything in writing at this stage. The law says that an employee has to be given a Written Statement of Employment Particulars not later than eight weeks after she starts employment with you.

REMEMBER If you don't really want to appoint any of the candidates or you don't feel any are right, don't appoint anyone. Get a temp in to tide you over and start looking again. Better this than giving the job to the wrong person.

## Making an offer that can't be refused

After finding the right candidate, you have to discuss money. You may have mentioned ball-park figures during the interview, but now it's time to make an offer and negotiate a deal that suits both you and the employee.

Think about the whole package you're prepared to offer. You may have already thought this through when you were considering employing someone in the first place. You can attract good employees with contributions to an occupational pension scheme, use of a company car, or better holiday and sick pay than most employers. Sometimes it's not just money that matters to employees. Your chosen candidate may be happy to settle for the money you're offering as long as she has a few extra days of holiday or flexible hours of work. Discuss, negotiate and come up with a package she can't refuse. Don't forget that if she's moving from a job outside the area, she may have the costs of selling a home and buying another, plus the costs of moving.

TIP After an agreement has been reached, put the whole deal in a follow-up letter with the main terms and conditions of employment. It makes things easier for everybody and allows no cause for dispute.

## *Setting the start date*

You may want your new employee to start straight away, but unless she's already out of work that's not likely to be possible. Most people have to give their bosses at least a week's notice and many have contracts that stipulate much longer notice periods. She isn't likely to be willing to hand in her notice while there are conditions to the offer, and she may well want an unconditional offer, with all the main terms and conditions in writing, before she takes that final step. She may be able to negotiate that her current boss lets her go sooner than the contract allows, but think about how you'd feel if one of your employees wanted to go without working out her notice.

## *Withdrawing a job offer*

After the job offer has been made and accepted, a contract exists. If you made it conditional on getting satisfactory checks and the results weren't what you'd hoped for, you can withdraw your offer. However, if you made the offer conditional on satisfactory references and you don't get them and withdraw the offer, you can be sued for breach of contract.

WARNING If you just change your mind after making an offer or you made promises of terms and conditions that you later find you can't deliver, the employee can sue you for breach of contract and damages. Someone who has been unemployed would find it difficult to claim damages, but someone who gives up a good job and starts to make arrangements to move homes can run up quite a lot of expenses and have quite a sizeable claim. If a court decides that a contract was breached in such circumstances, it can order an employer to pay damages or compensation. This is usually limited to the wages the person concerned would have earned during the contractual notice period.

You can offer the job on a trial basis (often referred to as a *probationary period* ) for a particular period of time – long enough to find out if the chosen candidate is really up to the job. If you then decide to withdraw the job offer at the end of that time, you have to give the employee the correct period of notice or extend the trial period and provide some training. If you withdraw the job offer after a trial period but you don't come up with the training you promised at the outset, the employee can sue for breach of contract.

### DEALING WITH REQUESTS FOR FEEDBACK

At some stage, you're going to disappoint someone by your decision not to appoint her, and she may want to talk to you about why. Tell her what it was that gave the winning candidate the edge and discuss anything the rejected candidate can do better next time. Stick to the facts, such as that the person you've appointed had more experience or better qualifications. Suggest training courses that may make the person you've turned down more suitable next time. And be impressed that she's keen, really wanted the job and felt that feedback from you can help her progress in her career. She may be exactly the right person for the job next time!

# Chapter 3

# Employing People Successfully

**IN THIS CHAPTER**

**Deciding on motivations and rewards**

**Managing the paperwork**

Unless you intend to work on your own, running a business involves employing and motivating others to do what you want them to do. Even if you don't employ people full-time, or if you outsource some portion of your work to others, you have to choose who to give those tasks to, how to get the best out of people and how to reward their achievements.

Aside from motivation and rewards, the potentially interesting and rewarding side of employing people, there is an almost invariably tedious chore that runs in alongside: keeping full and correct records. Those records have to cover everything from when an employee is recruited to when they leave your employ.

## *Motivating and Rewarding Employees*

After you've recruited the staff you want, you need to manage them in the most suitable way for your business. Management is the art and science of getting people to do what you want them to do because *they* want to do it. This is easier said than done.

Most entrepreneurs believe that their employees work for money and their key staff work for more money. Pay them enough and they'll jump through any hoop. In contrast, most research ranks pay as third or even fourth in the reasons for people coming to work.

If they don't necessarily work for money, why do people work in a particular organisation? The following sections help provide some of the answers.

### *Getting the best out of employees*

Sound advice for getting the best out of your employees is: get to know everyone. This may sound insane in a small firm – after all, you almost certainly recruited everyone in the first place. But by observing and listening to your employees, you can motivate them by making them feel special.

REMEMBER The starting point in getting people to give their best is to assess them as individuals and to recognise their specific needs and motivations. A person's age, gender or job influences these differences, as does the individual's personality. You need to tailor your actions to each person to get the best results.

TIP Some practical tools and techniques can help you get the most out of your employees:

- **Show an interest in people's work.** This has nothing to do with monitoring performance and more to do with managing by walking about, seeing everyone and talking with them as often as possible.

  If you employ fewer than five people, you need to spend some time with each of them every day; if up to ten people, spend time with them every week. After that, you need to have managers doing much the same thing, but you still need to get around as often as possible.

- **Give praise as often as you can.** The rule is simple: minimise your reaction to bad results and maximise your appreciation of good results. Autocratic employers continually criticise and complain, finding only poor performance wherever they look. Criticism reinforces poor behaviour. Everyone wants to be recognised and strangely enough people often prefer to be shouted at than ignored. So if doing things wrong is the only way to get noticed in your company, that's what may well happen.

  If you do need to criticise, keep it constructive and lighten it with some favourable comment. For example, if an employee is making some progress but is short of being satisfactory, saying something like, 'This is certainly an improvement, but we still have a way to go. Let's spend a little time together and I'll see whether we can't get to the bottom of what's holding you back', may produce a better level of motivation than just shouting out your criticism.

- **Create a no-blame culture.** Everything in business is a risk. To a greater or lesser extent, you delegate some of the responsibility for taking risks to your employees. But how should you react when the inevitable happens and things go wrong? If you jump up and down with rage, then no one will ever take a risk again. They'll leave all the decisions to you and you'll become even more overworked. Good people will get highly demotivated and leave. If you take a sympathetic and constructive attitude to failure, you motivate and encourage employees to try again.

  You need to make it clear that tolerance of mistakes has its limits and that repetition of the same mistake won't receive an equally tolerant reaction.

- **Reduce demotivation.** Very often the problem isn't so much motivating people, but avoiding demotivating them! If you can keep off employees' backs, they're more likely to motivate themselves. After all, most people want the same things – a sense of achievement or challenge, recognition of their efforts, an interesting and varied job, and opportunities for responsibility, advancement and job growth.

## Dealing with difficult or demotivated employees

Difficult or demotivated people need prompt and effective managing. Dissatisfaction can spread quickly and lower other people's motivation levels. The first step is to identify the cause of the problem – is it to do with the employee or with the job itself? The problem may be brought about by illness, stress or a personality clash between people working together.

Whatever the cause, the initiative for remotivating an employee has to come from you. However, the only reason for going through this effort is that either the employee has delivered satisfactory results in the past or you believe he has the potential to do so, if you can only find the key.

## *Keeping motivation in the family*

Over 80 per cent of small businesses are family businesses in which one or more relatives work in the organisation. Family businesses have both strengths and weaknesses when it comes to motivation. By being aware of them you can exploit the former and do your best to overcome the latter to give your business a better chance of prospering.

The factors that motivate or demotivate family members can be different to those affecting non-family members.

The overwhelming strength of a family business is its different atmosphere and feel. A sense of belonging and common purpose usually leads to good motivation and performance. Another advantage is that a family firm has greater flexibility, because the unity of management and shareholders provides the opportunity to make quick decisions and to implement rapid change if necessary.

On the downside, several weaknesses exist. Although these weaknesses aren't unique to family businesses, family firms are particularly prone to them:

- **Unwillingness to change is the single most common cause of low motivation in family firms.** Family firms often do things the way they've always done them just because that's the way they've always done them. This can lead to stagnation in the marketplace and failing confidence in investors. Resistance to change is exacerbated by diminishing vitality, as the founders grow old.
- **Family goals and commercial goals can come into conflict.** Unlike other businesses, family firms have additional objectives to their financial performance targets, such as building the family's reputation and status in the community; providing employment for the family; protecting family wealth; ensuring independence; and a dynastic wish to pass on a position, in addition to wealth, to the next generation. However, superimposing these family values on a business can lead to difficulties. For example, nepotism may lead to employment of family members at a level beyond their competence, or a salary above their worth. This can lead to discontent and be demotivational for non-family members.
- **Conflict may exist between growth and ownership.** Families prefer majority ownership of a small company to minority holdings in a big company where they're answerable to outside shareholders. A dilemma that all family managers face is either growing the company, keeping purely commercial goals in mind at whatever risk to family control, or subordinating the firm's welfare to family constraints. This affects all areas of the business, from recruitment through to management.
- **The impact and career prospects of non-family employees may be limited.** At management level, family pride sometimes doesn't allow a situation where its members are subordinate to an

outsider – even if the outsider is a better person for the job. Also, reliance on family management to the exclusion of input from outsiders may starve a growing firm of new ideas. A family firm may become inward-looking, insensitive to the messages of the marketplace, unreceptive to outside ideas and unwilling to recruit competent outside managers. None of these factors is likely to be motivational to others in the business.

A family firm must address these problems to avoid all the effort it puts into motivating employees being seen as a cynical deception. Having a clear statement of family policy on the employment of family members, succession and ownership can be helpful. Then non-family members can either buy into this policy or not join the company in the first place.

## *Rewarding achievements*

Different types of work have different measurable outcomes. You need to identify the outcomes you want and arrive at a scale showing the base rate of pay and payment above that base for achieving particular objectives. Different types of 'payment by results' schemes are in common use; to make sure you pick the right mix of goals and rewards, examine carefully the conditions that most favour these types of pay.

WARNING Regardless of whatever schemes you have in place to match pay to performance, make sure you do not make it a contractual right to always receive the same commission rates, bonuses, profit share or whatever. If a scheme is not working, the employer needs to have the legal right to either change it or set it aside altogether. It's no good having a scheme that only works for the employee. It must work for both sides.

### *Setting pay scales*

People don't come to work just for money, but they certainly won't come if you don't pay them, and they won't stay and be motivated to give of their best if you don't give them the right pay. But how much is the right amount? Get it too low and you impair your ability to attract and retain productive and reliable people capable of growing as your business grows. But pay too much and your overheads rise so high that you become uncompetitive. Small firms face the very real danger of a wage bill that represents their largest single business expense.

REMEMBER The ground rules for pay aren't very complicated but they are important:

- Pay only what you can afford. Don't sink the company with a wage bill that it can't meet.
- Ensure that pay is fair and equitable and that everyone sees it as such.
- Make sure that people know how you arrive at your pay scales.
- See that pay scales for different jobs reflect the relative importance of the job and the skills required.
- Check that your pay scales are in line with the law on minimum wage requirements. The UK has a statutory minimum wage, the amount of which is governed by the age of the employee and whether an employee is undergoing training. The hourly rate changes over time, so you need to

keep abreast of the latest rates ( www.gov.uk/national-minimum-wage/what-is-the-minimum-wage has information on current rules in this area).
- Ensure that your pay scales are competitive with those of other employers in your region or industry. PayScale ( www.payscale.com/index/UK ) is a site where you can get accurate real-time information on pay scales.

TIP Ways to find out the going rate for a job include:

- Reading articles on pay, as well as job advertisements on the Internet, in local papers and in the relevant trade journals. You may have to correct some pay rates to allow for variations. For example, pay rates for similar jobs are often much higher in or near major cities than they are in rural areas.
- Talking to your chamber of commerce or trade association, some of which publish salary surveys, and to other local employers and business owners in your network.
- Contacting employment agencies, including those run by the government. They're usually a bit ahead of the rest of the market in terms of pay information. Other employers know only what they're paying their present staff. Recruitment agencies know what you have to pay to get your next employee.

REMEMBER Deciding the pay rates of people who work for you arbitrarily may appear to be one of the perks of working for yourself. But inconsistent pay rates quickly upset people and staff members tend to jump ship at the first opportunity.

### *Matching pay to performance*

You may want to add to people's salaries by rewarding them with money or benefits for the level of performance they achieve. We discuss various reward approaches in this section, which all follow the same ground rules for matching pay to performance:

- Make the rules clear so that everyone knows how the reward system works.
- Make the goals to be achieved specific and if possible quantifiable.
- Make the reward visible so that everyone knows what each person or team receives.
- Make the reward matter. It has to be worthwhile and commensurate with the effort involved.
- Make the reward fair, so that people believe it's correctly calculated.
- Make the goals realistic, because if you set the target too high no one will try to achieve it.
- Make the reward happen quickly.

### *Paying a commission*

This is perhaps the easiest reward system, but it really only works for those directly involved in selling. A *commission* is a payment based in some way on the value of sales that the individual or team concerned has secured.

You have to make sure that the order is actually delivered or executed before you pay any commission, and you may even want to make sure that the customer has paid up. However, as with all rewards, you must keep the timescale between doing the work and getting the reward as short as practicably possible, otherwise people forget what the money is for.

TIP Base the commission on your gross profit (the value of sales less the cost of generating those sales) rather than your sales turnover – otherwise you can end up rewarding salespeople for generating unprofitable business.

### *Awarding bonuses*

A *bonus* is a reward for successful performance, usually paid in a lump sum related as closely as possible to the results that an individual, team or the business as a whole has obtained. In general, bonuses are tied to results, so how an individual contributed directly to the result achieved is less obvious. For example, a company bonus may be paid to everyone if the firm as a whole achieves a certain level of output. Keeping everyone informed about how the firm is performing towards achieving that goal may well be motivational, but the exact role that, say, a cleaner or office worker has in helping to attain that goal isn't easy to assess – not as easy as it is to calculate a salesperson's commission.

You can pay bonuses periodically or as a one-off payment for a specific achievement.

### *Sharing profits*

*Profit sharing* involves giving a specific share of the company's profit to its employees. The share of the profits can be different for different jobs, length of service or seniority.

This type of reward has the great merit of focusing everyone's attention on the firm's primary economic goal – to make money. One or more employees can be performing well while others drag down the overall performance. In theory, in such circumstances the high-performing staff put pressure on the others to come up to the mark.

If profits go up, people get more; profits can also go down, which can be less attractive. Also, the business can miss profit targets for reasons outside of employees' direct control. If your company depends on customers or supplies from overseas, for example, and the exchange rate moves against you, profits, and hence profit-related pay, can dip sharply. However unfair this may seem to a receptionist who's been hoping for extra cash to pay for a holiday, this is the hard reality of business. If you think your employees are adult enough to take that fact on board, then profit sharing can be a useful way to reward staff.

### *Sharing ownership*

Share option schemes give employees the chance to share in the increase in value of a company's shares as it grows and prospers.

The attraction of turning employees into shareholders is that doing so gives them a long-term stake in the business, hopefully makes them look beyond short-term issues and ensures their long-term loyalty. Of course, unwelcome side effects can occur if the value of the business goes down rather than up. Share schemes also have some important tax implications that you need to take into account. You can find out all about these online at [www.gov.uk/tax-employee-share-schemes/overview](www.gov.uk/tax-employee-share-schemes/overview).

### Giving skill and competence awards

You can give a skill or competence award when an employee reaches a certain level of ability. These awards aren't directly tied to an output such as improved performance, but you must believe that raising the skill or competence in question ultimately leads to better business results.

REMEMBER The award itself can be cash, gift certificates, extra days of holiday, a trip to a show or sports event, or whatever else your employees may appreciate. Bottles of wine always seem to be well received!

### Creating a menu of benefits

A *benefit* is defined as any form of compensation that's not part of an employee's basic pay and isn't tied directly to his performance in his job. Non-salary benefits such as a pension or changes in working conditions can also play a part in keeping people on your side.

A wide range of other perks is on offer to employees, ranging from being allowed to wear casual dress to on-site child care. Other benefits available in some organisations include personal development training, company product discounts, flexible hours, telecommuting and fitness facilities.

WARNING It's now obligatory to consider flexible working if an employee requests it and has sufficient reason, and setting up some form of pension scheme looks set to become compulsory for most businesses soon.

# Managing the Admin

All businesses have to keep track of their decisions and actions. The accounts are a fairly obvious requirement, not least because the government expects to grab a slice of your profits. But you also need to keep a record of the people you employ and how your business operates.

## Keeping employment records

You need to keep records about your employees, both individually and collectively. Keeping proper records makes the process of employing people run more smoothly. Some of the data you need to keep is a legal requirement, such as information on accidents. Some of the information is also invaluable in any dispute with an employee, for example in a case of unfair dismissal.

REMEMBER The individual employee information you retain should include:

- Application form
- Interview record and results of any selection tests used
- Job history, including details of promotions and assignments
- Current and past job descriptions
- Current pay and bonus details and a record of the amount and date of any changes
- Details of skills and competences
- Education and training records, with details of courses attended
- Details of performance assessments and appraisals
- Absence, lateness, accident, medical and disciplinary records, together with details of any formal warnings and suspensions
- Holiday entitlement
- Pension contribution data
- Termination record, giving date, details of exit interview and suitability for re-engagement
- Copies of any correspondence between you and the employee

Collective information should include:

- Numbers of staff, grades and job titles
- Absenteeism, staff turnover and lateness statistics
- Accident rates
- Records on age and length of service
- Wage and salary structures
- Employee costs
- Overtime statistics showing hours worked and costs
- Records of grievances and disputes
- Training records showing how many person-days have been devoted to training and how much that's cost
- Gender, ethnic and disability profiles

REMEMBER Employees have three basic rights over the information an employer keeps in their employment records:

- To be able to obtain access to their personal data
- To be able to claim damages for losses caused by the use of inaccurate data or the unauthorised use of data, or by the loss or destruction of data
- To apply to the courts if necessary for rectification or erasure of inaccurate data

This means that an employee is entitled to gain access to his personal data at reasonable intervals and without undue delay or expense. This request must legally be put in writing, although you may choose not to insist on this, and you must provide the information within 40 days of the request.

## *Preparing contracts of employment*

You have to give an employee a written statement of certain terms and conditions of his employment (the *Written Statement of Employment Particulars* ) within two months of his starting to work for you.

The terms that form part of this statement include the following:

- The employee's full name
- When the employee started working for you
- How and how much you pay your employee
- Whether pay is weekly or monthly
- The hours you expect the employee to work
- The number of days' holiday the employee is allowed, including public holidays, and how that holiday is accumulated
- The employee's job title or a brief description of his work
- Where you expect the employee to work and what conditions apply if you expect him to work elsewhere
- Whether you intend the employment to be permanent or, if it's for a fixed term, when it starts and finishes
- Details of who manages the employee and whom he can talk to if he has any dispute with that person
- Any terms and conditions relating to sickness or injury, including any provision for sick pay
- Any terms and conditions relating to pensions and pension schemes
- Any disciplinary rules applicable to the employee
- The period of notice required, which increases with length of service; a legal minimum of one week's notice per year of service is required up to a maximum of 12 weeks (express terms in the contract may override this)

TECHNICAL STUFF The job description forms the cornerstone of the contract of employment that exists between employer and employee. However, the contract is rarely a single document and may not even be completely documented. A contract comes into existence as soon as someone accepts an offer of paid employment, even if both offer and acceptance are only verbal. In practice, the most important contractual document may be the letter offering the person the job, and detailing the salary and other basic employment conditions. Many employers don't document the contractual relationship with employees properly and end up with disputes. A contract of employment consists of four sets of terms:

- **Express terms:** Terms specifically agreed to between employer and employee, whether in writing or not.
- **Implied terms:** Terms considered to be so obvious that they don't need spelling out. These include such matters as the employee complying with reasonable instructions and taking care of business property and equipment. For the employer, these can include taking reasonable care of the employee and paying him for work done.
- **Incorporated terms:** Terms from outside sources, most commonly from trade union agreements, which are included in the contract.

- **Statutory terms:** These include any work requirements laid down by law – safety regulations, for example.

TIP The Chartered Institute of Personnel and Development (CIPD), the professional body for HR and people development, has information on everything you need to meet your obligations as an employer when it comes to taking on staff (www.cipd.co.uk/hr-resources/factsheets/retention-hr-records.aspx). You have to register to get access to the information, but there is no cost for doing so.

## Working legal hours

Although the owner of a business may be content to work all hours, the law strictly governs the amount of time employees can be asked to put in. The Working Time Regulations apply to any staff over the minimum school-leaving age. This includes temporary workers, home workers and people working for you overseas.

As an employer, you must keep records that show you comply with the working-time limits and that you've given night workers the opportunity for a health assessment.

TIP The Health and Safety Executive (HSE) website has information on everything you need regarding working hours (www.hse.gov.uk/contact/faqs/workingtimedirective.htm).

## Granting leave

Occasions are bound to arise when you're obliged to give your staff time off work other than their usual holidays or when they're unwell. (You have to meet statutory obligations, of course.) You may not have to pay staff when these occasions occur, but you do have to respect their right to be absent for compassionate or sickness reasons. And if they are off sick, always meet up with them when they return, just to make sure that all is well and that there are not any underlying problems.

### Protecting parents

Employees who become parents either naturally or by adopting a child are entitled to paid time off and other benefits, including Statutory Maternity, Paternity and Adoption Pay. The employee may also be entitled to have his job back at some later date.

TIP workSMART, a Trade Union Council–run website, has a full description of the latest rules and regulations on these ever-changing topics. (Go to www.worksmart.org.uk, click on Work Rights and then Family-friendly Work.)

### Recognising emergency leave

Employees have the right to reasonable unpaid leave if their *dependants* – spouses, children, parents, other people living in an employee's house (except lodgers) and others who rely on an employee in emergencies, such as elderly neighbours – are affected by:

- Illness, injury, assault or childbirth
- Breakdown in child-care/other care arrangements
- The consequences of a death
- A serious incident at school or during school hours

To take this leave, your employee should give notice as soon as reasonably practical, giving the reason for, and likely duration of, his absence. The legislation doesn't define *reasonable* time off, but usually one or two days should suffice.

## Avoiding discrimination

By and large business owners can employ whoever they want. However, when setting the criteria for a particular job or promotion, discriminating on the grounds of sex, race, age, marital status, religious beliefs, sexual orientation or union membership is usually illegal. Regulations also prevent part-time employees from being treated less favourably than comparable full-time employees – that is, someone doing broadly similar work and with a similar level of skills and qualifications.

TIP The Emplaw website (www.emplaw.co.uk) has a free area covering the current regulations in British employment law, and details on how you can find a lawyer in your area who specialises in the aspect of employment law you're concerned with.

Discrimination starts right from when vacancies are advertised – you can't include such phrases as 'women required' or 'young person sought', or 'no blacks' or 'no whites'. It extends to the pay, training and promotion of those who work for you.

REMEMBER Victimising someone who's complained about being discriminated against is illegal. Sexual harassment is also a form of discrimination, defined as the 'unwanted conduct of a sexual nature or other conduct based on sex affecting the dignity of men and women at work'. This can include unwelcome physical, verbal or non-verbal conduct. Finally, it's unfair to include in your reason for dismissing an employee that he's a member of a particular minority group protected by law.

WARNING To avoid discriminating in your employment, you need to ensure that all your policies and procedures meet the following criteria:

- They're applied equally to all who work for you irrespective of sex, race and so on.
- They don't limit the proportion of one group who comply compared with another.
- They don't disadvantage any individual.

- They can be objectively justified. For example, no argument exists when being a man or a woman is a genuine occupational qualification – for example, for the purpose of a particular photographic modelling assignment or an acting role. The same is true when you have a part-time vacancy so have no need of a full-time employee.

REMEMBER To make sure that you're not discriminating at work, follow this six-point checklist:

- Ensure that your business has an equal opportunities policy.
- Train staff in equal opportunities policies.
- Keep records of interviews showing why you rejected candidates.
- Ensure that you take complaints about discrimination seriously, fully investigate them and address any problems that emerge.
- Conduct staff surveys to help determine where discrimination may exist within your business.
- Examine the payroll – pay should reflect employees' job titles, not their gender.

## *Keeping the work environment healthy and safe*

By law, you have to provide a reasonably safe and healthy environment for your employees, visitors and members of the general public who may be affected by what you do. This applies to both the premises you work from and the work itself. An inspector has the right to enter your premises to examine it and enforce legal requirements if your standards fall short in any way.

When you have employees you must take some or all of the following measures, depending on the number of people you employ. However, a prudent employer should take all these measures whether or not the law requires them. Doing so sets a standard of behaviour that's common in the very best firms.

- Inform the organisation responsible for health and safety at work for your business of where you are and what you do. For most small businesses this is the Environmental Health Department of your local authority (you can find contact details in your local telephone directory). The HSE website (www.hse.gov.uk) has a section devoted to small firms, covering both regulations and advice on making your work environment safer.
- Get employer's liability insurance to cover you for any physical injury or disease your employees may suffer as a result of their work. The amount of coverage must be at least £5 million and the insurance certificate must be displayed at all your places of work.

You, as an employer, can in turn expect your employees:

- To take reasonable care of their own health, safety at work and of other people who may be affected by their acts or omissions.
- To co-operate with the employer in ensuring that the requirements imposed by the relevant statutory provisions are complied with.

To find out more about health and safety issues in the workplace, check out *Health and Safety at*

*Work For Dummies* , UK Edition (Wiley).

# Chapter 4

# Disciplining and Dismissing Staff

**IN THIS CHAPTER**

**Implementing a disciplinary procedure**

**Getting rid of employees – the correct way**

**Avoiding wrongful or constructive dismissal**

**Tidying up loose ends**

**Understanding what happens if you do get dismissals wrong**

Sacking people isn't a nice job, but sometimes you're left with no other choice. If the job an employee has been doing no longer needs to be done and you have no other job that's suitable, you can make that member of staff redundant – but if you want to dismiss an employee for another reason and her job still exists, you have to be sure of your standing and tread very carefully through the legal minefield of dismissal.

The Dispute Resolution Regulations that came into force in October 2004 substantially changed the way employers have to deal with disputes and disciplinary and grievance procedures. The regulations were intended to encourage employers to settle disputes before they went to an employment tribunal, but the effect was the opposite; the upward trend continued. The procedures have been revised substantially since 2004, with most changes coming into effect in April 2009.

An employer who dismisses someone and gets the disciplinary and grievance procedures wrong can have a case brought against them at an employment tribunal. They'll be found to have unfairly dismissed the employee, and as a result they can be ordered to pay greatly increased compensation. Don't think you can ignore the rules and procedures. More and more cases are being brought against employers who simply don't know the law has changed.

Most importantly, the reason for the dismissal has to be fair; the way you dismiss also has to be fair and you have to follow all the right procedures. This chapter helps you to work out what's fair and what's not, and begins by taking a look at your disciplinary options *before* deciding to sack a member of staff.

## *Resolving Disputes*

Firing an employee really should be the very last option you consider. If a member of staff's performance is causing you or other employees concern, your first step is to follow your company's disciplinary procedure. You can keep bang up to date in this area by regularly visiting the government website (www.gov.uk/solve-workplace-dispute), and the ACAS (Advisory, Conciliation and Arbitration Service) website has a mass of useful, free-to-download publications (www.acas.org.uk; go to 'Advice and Guidance', and then 'Disputes and problems at work').

REMEMBER Pretty much every story has two sides to it, so if you go into a meeting or begin an investigation with the idea of resolving the problem, rather than being determined to get rid of the thorn in your side, it's better all round. A disciplinary meeting is an opportunity to find a solution to a problem rather than just to mete out discipline and punishment.

Morale around the workplace can plummet when an employee is sacked. Unless the person has been a complete pain, colleagues may feel you've just been looking for an excuse and weren't listening to the employee's views. Resolving a dispute and making things work can have a very positive effect on the rest of the workers, and ultimately your business will benefit.

## *Following a disciplinary procedure … right through to dismissal*

All employers are legally required to have a disciplinary procedure. Some bosses have separate procedures dealing with conduct and underperformance; some use the same procedure for both. When employees join your firm, you have to let them know how the disciplinary procedure operates and the kind of behaviour that gets employees fired. If this information isn't spelled out in detail in the Written Statement of Employment Particulars, it has to be in a company handbook or in some other written document that your employees have easy access to (refer to Chapter 3 in Book 3).

ACAS produces a code of practice on disciplinary procedures with details on how to draw up and operate a disciplinary procedure. The code is used as the yardstick to judge how reasonable an employer has been if an employee brings a claim for unfair dismissal to an employment tribunal, so get a copy and incorporate it into your own procedures. You can contact ACAS at 0300 123 1100 or through its website at `www.acas.org.uk`.

The minimum you have to implement in your disciplinary procedure is the following:

1. **Get all the facts straight, and decide whether or not any further action must be taken.**

   Investigate the situation fully by talking to the employee concerned and any other employees who may be able to throw some light on events. Gather any evidence you can find – emails, letters and so on. Interview any witnesses and take signed written statements from them.
2. **Start informal discussions, coaching or counselling for the employee involved.**

   Make it clear to her that this isn't part of a formal disciplinary procedure – you're trying to help her and to avert more problems.
3. **If the problematic situation doesn't change, let the employee know in writing what she's doing wrong.**

   Be sure to include any evidence you have, and explain to her why the situation cannot continue, what you expect her to do to remedy the situation and by when.

4. **Hold a disciplinary hearing to discuss the situation.**

   The employee can bring along a work companion or a union representative. Before the hearing, you must set out in writing the concerns which have led you to hold the meeting, and the employee must have a copy of that statement. At the hearing, explain your complaint and your evidence and give the employee the chance to state her case, ask questions, give evidence and call her own witnesses.

5. **Let the employee know what you've decided in light of the hearing.**

   If you decide on disciplinary action rather than the sack, give her a written warning spelling out what the misconduct is, what has to be done about it and by when. And explain the consequences if things don't change – perhaps a final written warning and then the sack.

6. **Allow the employee the right to appeal.**

   If she does, hold an appeal meeting. If your business is big enough, try to have a different manager hear the appeal to the one who made the decision to dismiss. Once the appeal is over, you have to let the employee know your final decision.

The list shows the basic statutory requirements – your own disciplinary procedure may allow for more warnings, more meetings and other courses of action such as demotion or suspension.

WARNING If you don't follow this basic procedure and you've employed the member of staff for more than a year (as from 6 April 2012 the qualifying period of employment went up for new employees to two years), she can claim automatic unfair dismissal and the resulting tribunal can increase the compensation it orders you to pay. Under some circumstances dismissal can be deemed to be unfair regardless of how long an employee has been with you.

### Calling in the arbitrators

If you can't resolve a disciplinary problem inside your organisation, think about calling in an outsider as an arbitrator. If your organisation recognises a union, that union may be able to send someone in to arbitrate. ACAS may also be able to help – you can find the contact details in the preceding section.

## Dismissing Staff – the Right Way

Most things in life can be done in a right way and a wrong way, and dismissing staff is definitely one of those areas where you have to get it right. The law protects most employees from being unfairly dismissed or from being forced to quit because of their boss's unreasonable behaviour. And that means that if an employee thinks she has been unfairly dismissed, she can take a case against you at an employment tribunal (described later in this chapter in the section 'Facing Tribunals – Something to Be Avoided ').

TECHNICAL STUFF If you need any incentive to stop and reflect before you wield the axe, just remember that a tribunal can order you to pay compensation if it decides you've got it wrong. The highest unfair dismissal award in 2015 was £238,216 (average: £12,362).

## Having fair grounds to sack an employee

REMEMBER For a dismissal to be fair you have to have an acceptable reason for getting rid of your employee.

It's fair to dismiss a member of staff when:

- Her job no longer exists. But remember it's the job that's redundant, never the person.
- She turns out not to be capable of doing the job or is not qualified (including lying about qualifications in a job application).
- She's guilty of some misdemeanour (constantly being late, absent, careless or having a bad attitude, for example).
- She does something so bad that it amounts to gross misconduct (such as stealing something, hitting someone, committing fraud or sexually harassing other staff). See the later section 'Dismissing for gross misconduct ' for more information.
- You can't let the employee go on doing her job because to do so would be breaking the law (such as a job that involves driving when the employee has been banned from driving).

If none of those reasons apply to the employee you want to sack, one more category may give you a get-out clause. You may be able to fire someone for 'some other substantial reason'. Isn't the law wonderfully clear? Basically, this other reason has to be one that you can defend in a tribunal hearing. One of the most common reasons is that you have to restructure your business for financial reasons and that means jobs aren't redundant but are changing and so your contract with your employee has to change too. If an employee refuses to accept these contractual changes, it can then be fair to dismiss her.

TECHNICAL STUFF The Equality Act 2010 makes it unlawful to discriminate against employees, job seekers and trainees because of age. The greatest amount awarded in an age discrimination case in 2015 was £28,428 (average: £11,211).

## Applying your decision

If you've got good grounds for dismissing an employee, the next step is to go about the dismissal fairly. That means first giving the employee a fair hearing by going through all the necessary disciplinary procedures explained in the earlier section 'Following a disciplinary procedure … right through to dismissal '.

Even if you have no choice but to sack someone because it would be breaking the law for her to carry on in her job, you still have to be fair in how you go about it. You have to discuss, investigate and consider the possibility of keeping the person on in another capacity if other jobs are available. If you end up having to explain yourself to a tribunal panel, they'll want to know that you gave the employee a fair hearing; that you investigated the whole situation fully; and that you were being reasonable when you decided that the reason was substantial enough to merit the sack. A dismissal has to be fair all round.

TIP Keep detailed records of all the procedures you go through – copies of letters, warnings, records of meetings, and the evidence you gather. If the case does come to a tribunal, you'll need to be able to prove that you did everything fairly and squarely.

## *Giving written reasons for dismissal*

If you've investigated, warned, followed the procedure and finally decided you have good reason to dismiss someone, you've got to let the employee know what your reasons are. If you've followed the correct disciplinary procedure outlined in the earlier section 'Following a disciplinary procedure … right through to dismissal ', this shouldn't come as a surprise to the employee and she should be fully aware of all the reasons already – but you still have to put the reasons for dismissal in writing.

## *Giving notice of dismissal*

Except in cases of gross misconduct, you have to give the appropriate period of notice for any dismissal. Details of an employee's notice entitlement should be outlined in her contract.

The law says that someone who has worked for at least a month but less than a year is entitled to one week's notice. Someone who has worked for two full years is entitled to two weeks' notice, three full years means three weeks' notice, and so on up to a maximum of 12 weeks' notice. You may offer more generous terms in your employees' contracts. You can increase the amount of notice employees are entitled to depending on how long they've worked for you, and your more senior employees – such as managers – may have longer notice periods.

If you don't want the employee around the workplace after you've given her notice, you can let her go immediately but you have to pay her in place of the notice period anyway. So if she's entitled to six weeks' notice, you have to give her six weeks' pay. She also has to be paid for any other fringe benefits she may be entitled to under the contract, such as the use of a company car.

## *Dismissing for gross misconduct*

Examples of misconduct can be constantly being late or not turning up at all, making careless mistakes or not really caring how their work goes! Misconduct is irritating in the extreme and possibly a reason to sack someone. While ordinary misconduct may be annoying, beyond that it becomes gross misconduct.

*Gross misconduct* is something so serious that it brings the contract between you and the guilty party to an end immediately. Examples of acts at work that may constitute gross misconduct include:

- Theft
- Dishonesty
- Fraud
- Violence
- Deliberately damaging company property
- Sexual harassment
- Bullying
- Downloading pornographic material from the Internet
- Inciting racial hatred
- Gross insubordination

If you sack someone for gross misconduct without notice, you have to be able to justify that action. What you're actually saying is that the employee has done something that has damaged the relationship of trust and confidence between you, destroyed her working contract and made it impossible for you to carry on as boss and employee. If you can't prove that, the employee may make a claim for wrongful dismissal at a tribunal.

In such cases, the tribunal will want to know:

- Whether any of your other staff ever acted in the same way and whether you took that case seriously enough to fire them without notice.
- If whatever has happened really has broken down the trust and confidence between you and your employee.

This means that you need to have fully investigated the incident and given the employee a fair hearing before you come to your decision. The principles of fairness apply just the same to cases of gross misconduct as they do to ordinary cases of misconduct or poor performance (see the section 'Avoiding wrongful dismissal ' later in this chapter). Employees should already know what kind of gross misconduct will get them fired on the spot – this should be in your staff handbook.

WARNING Be very careful about summarily dismissing someone for what you see as gross misconduct. If she brings a case against you at an employment tribunal and the tribunal decides the conduct didn't amount to gross misconduct, you can end up having to pay greatly increased compensation. You must follow all the basic dismissal and disciplinary procedures outlined earlier in this chapter.

If employees are guilty of actions outside the workplace that would constitute gross misconduct at work, you may be able to fairly dismiss them. If that happens, take your solicitor's advice.

REMEMBER Plain old ordinary misconduct is handled differently. Ordinary misconduct doesn't bring the contract to an immediate end, and you must follow a fair disciplinary procedure with all the necessary warnings.

### Dismissing for underperformance

Everybody has days when they go home without having done much. But you can't sack an employee for the occasional lazy day unless it happens week in, week out.

If an employee is seriously underperforming – her work isn't up to scratch, she just isn't capable of doing the job, she's always off sick or late so that the job isn't getting done properly, or she hasn't got the qualifications she needs – you can have a reason for firing her fairly on the grounds of lack of capability or qualifications.

The minimum procedures you have to go through are the same as for other disciplinary procedures (see the earlier section 'Following a disciplinary procedure … right through to dismissal '), or you can follow your company's own disciplinary procedure.

Give people the chance to improve before dismissing them, and be reasonable about the timescale you set for seeing their work improve. You can allow any amount of time between a few weeks and several months. A tribunal considers how long the employee has been with you, how bad the performance was, what warnings you had given that things had to improve, the effect on your business and the size of the workforce. If you have other people who can 'carry' underperforming employees while they are trying to improve, you can afford to give them a bit longer than if you're dependent on that one person.

TIP Be objective about deciding whether or not an employee has made an improvement. Getting exasperated and being determined not to see any improvement isn't your best way forward. Taking a second opinion from another manager or a colleague is a good idea.

TIP Annual appraisals are a good way of assessing how people are performing and they give you a legitimate reason to discuss any problems. It's good to talk.

## Dismissing Staff – the Wrong Way

If you just snap and fire a member of staff without a full investigation, without giving her the chance to put her case across or to improve, and without going through all the correct procedures, your sacked employee will most likely feel very aggrieved and seek legal advice. And a solicitor is likely to tell her that she has a case for unfair dismissal if she has at least one year's service (two years in the case of employees who started after 6 April 2012). The next thing you know, your former employee has filed a claim, and you have to prepare your case for the defence.

### Avoiding wrongful dismissal

*Wrongful dismissal* is when you decide to end a member of staff's contract by dismissing her without notice or by giving her a period of notice less than what she's entitled to. Doing so means you're in breach of contract, and the aggrieved party can file a claim against you at a tribunal within three months of the event or within six years in the courts.

You must give the notice period set out in the employee's contract unless you're firing her for gross misconduct (refer to the earlier section 'Dismissing for gross misconduct '). If you haven't put a notice period into the employee's contract, the statutory minimum applies (turn to the earlier section 'Giving notice of dismissal ').

You have to give notice or pay in lieu of notice. If the employee can show that she didn't get the right notice and that she has suffered financially as a result, she can claim compensation at an employment tribunal or in the County Court if the sums are substantial (over £25,000).

WARNING If you haven't made clear in the contract how much notice an employee gets and you fire her using the statutory minimum, in some cases she can also ask a court or tribunal to rule that the period of notice, although perfectly legal, was unreasonably short. The more skilled, well-paid and senior an employee is, the more likely the tribunal is to agree.

## *Steering clear of constructive dismissal*

If you behave in such a way that employees feel they have no choice but to quit, that's *constructive dismissal* (to use the full title, *constructive unfair dismissal* ). Once the employee has gone, providing she has one year's service, she can make a claim against you for unfair dismissal and possibly wrongful dismissal too if you haven't got the notice period or pay right.

If as an employer you just keep forgetting to buy the teabags and coffee or are merely an irritable pain, no one can quit and claim constructive dismissal. You have to have done something seriously wrong – such as changing the job she does without any discussion. The trust and confidence that exist in the employee's contract, whether in writing or not, need to have been broken.

If you do something serious, such as reduce an employee's pay without her agreement, the longer she stays on after the event, the more she would be seen to have accepted the change and the less likely she would be to win a constructive dismissal claim. If, however, the employee works 'under protest', making it clear that she doesn't accept the changes, it's possible for her to resign some time after the breach of contract and successfully sue you. If she left because she had a better job offer, she would have a hard time proving that your behaviour was the catalyst pushing her into going.

WARNING As well as doing everything by the book as an employer, you should take some other sensible precautions at every stage of the disciplinary process. Never conduct one-on-one disciplinary meetings – always make sure you have a witness to all such meetings. That avoids any unfounded accusations at a later stage. Also take notes of all such meetings, have them typed up and distribute them to all parties within a very short period of time – one to three days should suffice.

## Automatic unfair dismissal

You can't dismiss an employee for being pregnant or because she has dared to ask for something that she's entitled to by law (such as written terms and conditions of employment or parental leave). A situation where you sack an employee for asking for something she had the right to ask for is known as *automatic unfair dismissal* . In cases of automatic unfair dismissal, the tribunal will automatically come down on the side of the employee.

WARNING If you dismiss someone without following all the right procedures, that is also automatic unfair dismissal, and you can be penalised by being ordered to pay increased compensation.

# Tying Up the Loose Ends

Even when you've gone through all the procedures and a leaving date is settled, that's not the end of the matter. You aren't under any obligation to offer an exit interview to an employee who is leaving, but it can be useful for you as well as the employee. She may have comments to make about the way your business operates that it would be useful to consider – as well as letting her get it off her chest! It can help to clear the air.

REMEMBER Don't forget the paperwork. Just as you have to do when an employee hands in her notice and chooses to leave, there are loose ends that need to be tidied up.

## Handing over paperwork to a new employer

Paperwork is always involved when an employee leaves. Tax forms need to go to HM Revenue and Customs (HMRC) as well as to a new employer. Here's a summary of the paperwork that you need to sort out before your dismissed employee leaves:

- **A P45:** This form is the most important piece of paperwork, because it details where you're up to with deducting tax and National Insurance for the year so far. The P45 can be passed on directly to a new employer, but if the employee doesn't have a job to go to you need to give it to her. She will need it to claim Job Seeker's allowance until she gets back into work.
- **A P60:** If the redundancy happens near the end of the tax year, the employee should get a P60, detailing all of her tax deductions for the year.

You must also give new employers details of all the entitlements employees have taken so far in the current year of employment – maternity leave, paternity leave or parental leave, for example.

Give the dismissed employee a copy of all her tax and benefits details plus any certificates she may have gained while she's been employed by you (such as qualifications, safety certificates or courses related to her job).

TIP You can keep up to date on your responsibilities regarding handing over paperwork at the following government website: www.gov.uk/employee-leaving .

## Sorting out outstanding payments

Check that the dismissed employee has been paid everything she's owed. She may not have taken her full holiday entitlement up to and including her last day.

If this is the case she may be entitled to be paid for that accrued holiday under the terms of her contract or under the working time regulations. You can agree that she takes her remaining holiday during her notice period, but if you want her to do that, make sure that you give her enough notice to do so. You also need to check that a dismissed employee has been fully paid for any overtime, extra hours she's put in, expenses she's due or for anything else that she would normally expect to have been paid for while in your employment, such as bonuses and commissions.

If you decide to take a company car away from an employee during her notice period, you have to work out how much she should be paid to compensate for that loss.

You need to check if the employee is entitled to any tax rebates through the PAYE (Pay As You Earn) scheme. The member of staff who works out wages should be able to sort this out with the help of the HMRC Employer Helpline on 0300 200 3200. Any overpayments are returned in the employee's final pay cheque. All the money due to them should be detailed in their final pay slip.

## Paying instead of allowing staff to work their notice

If you want your employee to go this minute and never darken your door again, you have to pay her money for the period she would otherwise have had to work – money in place of the notice that her contract or the law says she's entitled to. Not only that, but she has to be in the same financial position as she would have been in if you had let her work through the notice period. That may mean paying out more than just a few weeks' pay. For example, if the employee had the use of a company car, she can have expected to use that during the notice period so you'll have to compensate her for the loss of that too.

REMEMBER The right to pay in lieu of notice is always an option open to an employer, whether or not it says so in the employee's contract, and the employee doesn't have the right to demand to work out her notice.

The other thing you can do is to send the employee on garden leave. *Garden leave* means that your dismissed employee spends the period of her notice still employed by you but at home and with no work to do while still being paid. You may decide to do that if you're worried about what damage she could do to your business if she worked out her notice in the office – maybe by stealing all your best customers or contacts.

## Dealing with pensions

When employees leave a job and start a new one, they have to decide what to do about the money they've paid into your company pension, if you provided one. The same goes for employees you dismiss.

## Restricting what employees can do after leaving

In certain cases, the new business activities of a recently dismissed employee can harm your company. For example, if you're a hairdresser and a former employee sets up her own salon in close proximity and takes her customers away, you'll lose out.

You have the option of taking steps to protect your business by putting into your employees' contracts terms that limit what they can do when they leave you. These are known as *restrictive covenants* . You can say that former employees are not to set up in competition with you for a period of three months after leaving your firm or restrict them to setting up their business outside a particular geographical area.

TIP You have to be reasonable about any restrictive covenants you put in a contract if you're not likely to be able to enforce them if the employee ignores them. If you try to sue for breach of contract, the courts can find your restrictive covenants too restrictive and you'll lose – and be out of pocket for the legal fees. Take advice from a good lawyer before you draw up contracts with these kinds of restrictions.

## Giving references

You don't have to give any employee a reference, whether she's resigned or been dismissed, but if you do agree to, the reference has to say what you believe to be accurate and fair and you have to give it without malice.

WARNING If you give an unfair, malicious or negligent reference and the employee loses out as a result, she can sue you. On the other hand, you have to be truthful for the sake of any prospective employers as well. If they lose out as a result of a negligent reference, they can sue you too!

If you've dismissed an employee, you may not be too bothered about how quickly she gets back to work, but be objective about this. She may have been in the wrong job and may be rather good in a different company with a job that suits her better.

Be truthful in your reference, but don't be tempted to exaggerate an employee's negative points. Employees will have the right to see what you've written about them in references once they've started work with their new employer, so make sure that what's in the reference is what has already been discussed in the course of the fair dismissal procedure and can be proved to be true. Don't add little extras out of spite.

Make sure you don't give a discriminatory reference to someone because of her sex, race, disability, religion or religious beliefs, or sexual orientation, and be careful too about age!

WARNING Don’t be tempted to try to smooth things over with an employee you’re dismissing over a dispute by offering a glowing reference. This can backfire on you. The employee can use your reference to prove that she wasn’t guilty of misconduct or incompetence after all.

# *Facing Tribunals – Something to Be Avoided*

Tabloid writers love a good story about an unfairly dismissed employee managing to win thousands of pounds from her employer. Some very high-profile cases take place, for example where employees of big financial firms win huge sums at employment tribunals for discrimination or in court for breaches of contract. They should act as a warning that you can’t afford to be unfair.

If you do unfairly dismiss, wrongfully dismiss or constructively unfairly dismiss an employee, she can take a claim against you at an employment tribunal. Sometimes, even when you’re in the right, vexed employees feel you’ve acted unfairly and want their day in court. If you really do have good reason to dismiss and scrupulously follow the correct dismissal procedures (explained in the earlier section ‘Following a disciplinary procedure … right through to dismissal ’), you’ll be able to convince a tribunal should it come to that. But avoid this scenario if at all possible!

The employee isn’t likely to want reinstatement or re-engagement because the two of you may not be able to work together again comfortably. For a small business, even sums of far less than the maximum compensation figure can be crippling. So you really do want to make sure that you’re on very solid footing before you decide to sack someone. It pays to be fair.

# Chapter 5

# Inspiring Employees to Better Performance

**IN THIS CHAPTER**

**Starting with the Greatest Management Principle in the World**

**Finding out what motivates employees**

**Deciding what behaviours to reward**

**Beginning with the positive**

**Rewarding the little things**

**Using non-monetary rewards**

The question of how to motivate employees has loomed large over managers ever since management was first invented. Most of management comes down to mastering skills and techniques for motivating people – to make them better, more productive employees who love their jobs more than anything else in the world. Well, perhaps not quite that much; but you do want them to turn up and be as happy, effective and productive as possible.

You have two ways to motivate employees – rewards and punishments. If employees do what you want them to do, reward them with incentives that they desire – awards, recognition, important titles, money and so on. These are often called *positive consequences* . Alternatively, if employees don't do what you want, punish them with what they don't desire – warnings, reprimands, demotions, firings and so on – often known as *negative consequences* . By nature, employees are drawn towards positive consequences and shy away from negative consequences.

Increasingly, however, with today's employees, to be an effective manager you have to work harder at providing a greater number of positive consequences on an ongoing basis when employees perform well (they expect it). And you have to be *much* more selective as to when and how you use negative consequences. Firing people is much harder than in previous times, and wrongful and unfair dismissals get you into trouble with the law.

This chapter deals with the positive side of employee motivation – positive consequences, especially recognition and rewards. A hundred years of research in behavioural science and continuing extensive studies at all of the world's major business schools show that you have a much greater impact on getting the performance you want from your employees when you use positive consequences rather than negative ones.

We aren't saying that negative consequences don't have a place; sometimes you have no choice but to punish, reprimand or even dismiss employees. However, first give your employees the benefit of the doubt that they do want to do a good job and acknowledge them when they do so. Make every effort to use positive recognition, praise and rewards to encourage the behaviours you seek, and catch people doing things right. If you follow this approach, your employees are more motivated to want to excel in their jobs, performance and morale improve, and employees consider your company a much better place to work.

REMEMBER By leading with positive reinforcements, not only can you inspire your employees to do what you want, but you can also develop happier, more productive employees in the process – and that combination is tough to beat.

# *Introducing the Greatest Management Principle in the World*

You're about to discover the Greatest Management Principle in the World. This simple rule can save you countless hours of frustration and extra work, and it can save your company many thousands or perhaps even millions of pounds. Sounds pretty awe-inspiring, doesn't it? Are you ready? Okay, the statement is:

REMEMBER You get what you reward.

Don't let the seeming simplicity of the statement fool you – read on to explore it.

## *Recognition isn't as simple as it looks*

You may think that you're rewarding your employees to do what you want them to do, but are you really?

Consider the following example. You have two employees: Employee A is incredibly talented and Employee B is a marginal performer. You give similar assignments to both employees. Employee A completes the assignment before the due date and hands it in with no errors. Because Employee A is already done, you give him two additional assignments. Meanwhile, Employee B is not only late, but when he finally hands in the report you requested, it's full of errors. Because you're now under a time crunch, you accept Employee B's report and then correct it yourself.

What's wrong with this picture? Who's actually being rewarded: Employee A or Employee B?

If you answered Employee B, you're right. This employee has discovered that submitting work that's substandard and late is okay. Furthermore, he also sees that you personally fix his mistakes. That's quite a nice reward for an employee who clearly doesn't deserve one. (Another way to put it is that Employee B certainly has you well trained!)

On the other hand, by giving Employee A more work for being a diligent, outstanding worker, you're actually punishing him. Even though you may think nothing of assigning more work to Employee A, he knows the score. When Employee A sees that all he gets for being an outstanding performer is more work (while you let Employee B get away with doing less work), he's not going to like it one little bit. And if you end up giving both employees basically the same pay rise (and don't think that they won't find out), you make the problem even worse. You lose Employee A, either literally, because he takes another job, or in spirit, because he stops working so hard.

WARNING If you let the situation continue, all your top performers eventually realise that doing their best work isn't in their best interest. As a result, they leave their position to find an organisation that values their contribution, or they simply sit back and forget about doing their best work. Why bother? No one (that means you, the manager) seems to care anyway.

## Biscuit motivation

Giving everyone the same incentive – the same salary increase, equal recognition or even equal amounts of your time – is sometimes called *biscuit motivation* . Although this treatment may initially sound fair, it isn't.

REMEMBER Nothing is as unfair at work as the equal treatment of unequal performers. You need to assess the performance of everyone. You then make clear to all people why they've received rewards and bonuses, or why they haven't. You must evenly and honestly distribute these rewards. And if everyone meets the standards demanded, then reward them all as you've promised.

If people aren't performing to standard, then take the particular individuals aside and tell them why. Tell them what they need to do to make the grade, and how they can go about it. Doing so is much better than letting people go about things without your active involvement and interest. You want everyone working as well as possible, and your job is to sort out those who aren't up to scratch.

REMEMBER Don't forget the Greatest Management Principle in the World – you get what you reward.

Before you set up a system to reward your employees, make sure that you know exactly what behaviours you want to reward and then align the rewards with those behaviours.

TIP After you've put your employee reward system in place, check periodically to see that the system is getting the results that you want. Check with those you're trying to motivate and see whether the programme is still working for them. If it isn't, change it!

### THINKING THROUGH YOUR REWARDS

A City of London branch of an international bank was having problems with sickness absence. Staff were phoning in sick for all kinds of reasons, and collective absenteeism was in the order of 7 per cent (it was taking 107 people to do the work of 100 at any given time).

Being a concerned employer, the bank decided to reward positive behaviour rather than punishing bad or negative behaviour. Consequently, a note went round to all staff informing them that anyone who hadn't taken any self-certificated sickness absence was entitled to an extra week's holiday the following year.

Needless to say, the plan misfired. Genuine hardworking employees who'd had a day or two off as the result of real illnesses and injuries now found themselves slighted – tarred with the same brush as malingerers. Having had a day or two off with genuine ailments, good staff now used holiday entitlement rather than sickness days so as not to miss out on the additional week's holiday that everyone else was getting.

The bank's human resources department met to review the policy. Acknowledging the weakness of the plan, another note informed staff that they would still get their extra week's holiday provided that all absences were covered by a doctor's certificate. In no time at all, HR became swamped with doctors' certificates, and had to take on another member of staff just to deal with them. Those with genuine illnesses and injuries complained about having to visit a doctor – and often paying for a certificate – to prove that their condition was real. For the malingerers, payment for a doctor's certificate simply validated a false position.

The bank reviewed the policy again. The suggestion was raised (seriously) that all those who'd had fewer than five days' self-certificated absence should be entitled to an extra two weeks' holiday the following year. Only at this point did the HR director take matters into her own hands; at last, she cancelled the policy and concentrated efforts on the malingerers rather than the genuine, committed and hardworking staff.

# Discovering What Employees Want

In today's tight, stressful, changing times, what things are most important to employees? A survey of about 1,500 employees from across seven industries answered that question. Here are the top ten items that employees said were most important, along with some thoughts on how you can better provide each of these elements for your own employees:

- **A learning activity (No. 1) and choice of assignment (No. 9):** Today's employees most value opportunities in which they gain skills that can enhance their worth and marketability in their current job as well as future positions. Discover what your employees want to find out, how they want to grow and develop, and where they want to be in five years. Give them opportunities as they arise and the ability to choose work assignments whenever possible. When you give employees the choice, more often than not they rise to meet or exceed your expectations.
- **Flexible working hours (No. 2) and time off from work (No. 7):** Today's employees value their time – and their time off. Be sensitive to their needs outside work, whether they involve family or friends, charity or church, education or hobbies. Provide flexibility whenever you can so that employees can meet their obligations. Time off may range from an occasional afternoon to attend a child's play at school or the ability to start the work day an hour early so the employee can leave an hour early. By allowing work to fit best with employees' life schedules, you increase the chances that they're motivated to work harder while they're at work, and do their best to make their schedules work. And from a managerial standpoint, as long as the job gets done, what difference does it make what hours someone works?

  REMEMBER Employees now have a legal right to request flexible working hours, and you have a legal obligation to consider their request.
- **Personal praise – verbal (No. 3), public (No. 8) or written (No. 10):** Although you can thank someone in 10 to 15 seconds, most employees report that they're never thanked for the job they do – especially not by their manager. Systematically start to thank your employees when they do good work, whether in person, in the hallway, in a group meeting, on voice-mail, in a written thank-you note, in an email or at the end of each day at work. Better yet, go out of your way to

act on and share and amplify good news when it occurs – even if it means interrupting someone to thank him for a great job he's done. By taking the time to say you notice and appreciate his efforts, you help those efforts – and results – to continue. And bring his efforts to your manager's attention; doing so reinforces your own integrity as well as ensuring full credit goes where it's due.

- **Increased autonomy (No. 5) and authority (No. 4) in their job:** The ultimate form of recognition for many employees is to have increased autonomy and authority to get their job done, including the ability to spend or allocate resources, make decisions or manage others. Greater autonomy and authority says, 'I trust you to act in the best interests of the company, to do so independently and without the approval of myself or others'. Award employees with increased autonomy and authority as a form of recognition for their past results. Autonomy and authority are privileges, not rights, which you should grant to those employees who've most earned them – based on past performance, not on tenure or seniority.
- **Time with their manager (No. 6):** In today's fast-paced world of work in which everyone is expected to get more done faster, personal time with your manager is in itself also a form of recognition. Because managers are busier, taking time with employees is even more important. The action says, 'Of all the things I have to do, one of the most important is to take time to be with you, the person or people I most depend on for us to be successful'. Especially for younger employees, time spent with a manager is a valued form of validation and inspiration, as well as serving a practical purpose of learning, communicating, answering questions, discussing possibilities or just listening to an employee's ideas, concerns and opinions.

By the way, you may wonder where money ranked in importance in this survey. A 'cash reward' ranked 13th in importance to employees. (Find out more about the topic of money as a motivator in the later section 'Considering Money and Motivation '.) Everyone needs money to live, but work today involves more than what anyone gets paid.

Employees report that the most important aspects at work today are primarily the intangible aspects of the job that any manager can easily provide – if he makes it a priority to do so. Now we're going to tell you a big secret. This secret is the key to motivating your employees. You don't need to attend an all-day seminar or sign up for the top 150 management and leadership blogs to discover this secret – we're letting you in on it right here and right now at no extra charge:

REMEMBER Ask your employees what they want.

This statement may sound silly, but you can take a lot of the guesswork out of your job by simply being clear about what your employees most value in their jobs. It may be one or more of the items mentioned earlier in this section, or it may be something entirely different. The simplest way to find out how to motivate your employees is to ask them. Often managers assume that their employees want only money. These same managers are surprised when their employees tell them that other things – such as being recognised for doing a good job, being allowed greater autonomy in decision making or having a more flexible work schedule – may be much more motivating than cash. Regardless of what preferences your employees have, you're much better off knowing those preferences explicitly rather than guessing or ignoring them. So:

- **Plan to provide employees with more of what they value.** Look for opportunities to recognise employees for having done good work and act on those opportunities as they arise, realising that what motivates some employees doesn't motivate others.
- **Stick with it over time.** Motivation is a moving target and you need to constantly be looking to meet your employees' needs in order to keep them motivated to help you meet your needs.

Consider the following as you begin setting the stage for your efforts:

1. **Create a supportive environment for your employees by first finding out what they most value.**
2. **Design ways to implement recognition to thank and acknowledge employees when they do good work.**
3. **Be prepared to make changes to your plan, based on what works and what doesn't.**

## *Creating a supportive environment*

Today's new business realities bring a need to find different ways to motivate employees. Motivation is no longer an absolute proposition. The incredible acceleration of change in business and technology is coupled with greatly expanded global competitive forces. With these forces pressing in from all sides, managers can have difficulty keeping up with what employees need to do, much less figure out what to tell them to do. In fact, a growing trend is for managers to manage individuals who are doing work that the managers themselves have never done. (Fortunately, given a little time and a little trust, most employees can work out what needs to be done by themselves.)

Inspiring managers must embrace these changing business forces and management trends. Instead of using the power of their position to motivate workers, managers must use the power of their ideas. Instead of using threats and intimidation to get things done, managers must create environments that support their employees and allow creativity to flourish.

TIP You, as a manager, can create a supportive workplace in the following ways:

- **Build and maintain trust and respect.** Employees whose managers trust and respect them are motivated to perform at their best. By including employees in the decision-making process, today's managers get better ideas (that are easier to implement), and at the same time they improve employees' morale, loyalty and commitment.
- **Remove the barriers to getting to work.** If you ask your employees what are the biggest hurdles they face in coming to work, you get a huge range of answers – rush-hour traffic, getting the kids to school, having to use public transport and so on. By allowing them to choose their hours of work, you give your staff the opportunity to work around these barriers. You're also entitled to expect that, having chosen their hours of work, they then show up and do a good job. You can't do this for every eventuality, and crises always happen. However, as long as the employee is prepared to give you a reasonable and regular pattern of hours, you need to at least

consider being flexible.

- **Open the channels of communication.** The ability of all your employees to communicate openly and honestly with one another is critical to the ultimate success of your organisation and plays a major role in employee motivation. Today, quick and efficient communication of information throughout your organisation can be what differentiates you from your competition. Encourage your employees to speak up, to make suggestions and to break down the organisational barriers – the rampant departmentalisation, turf protection and similar roadblocks – that separate them from one another, wherever and whenever they find them.

TIP One way of encouraging more employees to feedback their views on specific issues is by means of regular anonymous online surveys. TINYpulse offers weekly employee happiness surveys. To find out more, visit www.tinypulse.com.

- **Make your employees feel safe.** Are your employees as comfortable telling you the bad news as they are telling you the good news? If the answer is no, you haven't created a safe environment for your employees. Everyone makes mistakes; people discover valuable lessons from their mistakes. If you want employees who are motivated, make it safe for them to take chances and to let you know the bad along with the good. And use mistakes and errors as opportunities for growth and development; never punish mistakes and errors except those generated as the result of negligence or incompetence.
- **Develop your greatest asset – your employees.** By meeting your employees' needs, you also respond to your organisation's needs. Challenge your employees to improve their skills and knowledge and provide them with the support and training that they need to do so. Concentrate on the positive progress they make, and recognise and reward such success whenever possible.

## *Having a good game plan*

Motivated employees don't happen by accident. You need a plan to reinforce the behaviour you want. In general, employees are more strongly motivated by the potential to earn rewards than they are by the fear of punishment, so a well-thought-out and planned motivation, incentive and rewards system is important for creating a committed, effective workforce. Here are some simple guidelines for setting up a system of low-cost rewards in your organisation:

- **Link rewards to organisational goals.** To be effective, rewards need to reinforce the behaviour that leads to achieving an organisation's goals. Use rewards to increase the frequency of desired behaviour and decrease the frequency of undesired behaviour.
- **Define parameters and mechanics.** After you've identified the behaviours you want to reinforce, develop the specifics of your reward system. Create rules that are clear and easily understood by all employees. Make sure that goals are attainable and that all employees have a chance to obtain rewards, whatever their job and occupation.
- **Obtain commitment and support.** Remember to effectively communicate your new rewards programme to your employees. Many organisations publicise their programmes at group meetings. They present the programmes as positive and fun activities that benefit both the employees and the company. To get the best results, plan and implement your rewards

programme with your employees' direct involvement.

- **Monitor effectiveness.** Is your rewards system getting the results you want? If not, take another look at the behaviours you want to reinforce and make sure that your rewards are closely linked to them. Even the most successful reward programmes tend to lose their effectiveness over time as employees begin to take them for granted. Keep your programme fresh by discontinuing rewards that have lost their lustre and bringing in new ones from time to time.

# Deciding What to Reward

Most organisations and managers reward the wrong things, if they reward their employees at all. This tendency has led to a crisis of epic proportions in the traditional system of incentives and motivation in business. For example:

- A major London commodity market gave bonuses of 6 per cent of salary to outstanding employees and 3 per cent of salary to everyone else. Average and adequate performers were therefore receiving exactly the same reward.
- A top professional footballer on many thousands of pounds a week joined one of the very top football clubs, only to find himself playing in the reserve team at exactly the time when he was trying to develop his career and reputation through playing regularly. He was therefore receiving a very good reward, but not the one that he wanted.
- A council employee rated 'exceptional' was told by her manager that she had to be downgraded to 'average' because her department had no money to pay her bonus.

WARNING If workers aren't being rewarded for doing outstanding work, what are they being rewarded for? As you find out in the earlier 'Biscuit motivation ' section, organisations often reward employees just for showing up for work.

REMEMBER For an incentive programme to have meaningful and lasting effects, it must focus on performance – nothing less and nothing more.

'But wait a second', you may say, 'that isn't fair to the employees who aren't as talented as my top performers'. If that's what you think, it's best to straighten out that particular misunderstanding right now. Everyone, regardless of how smart, talented or productive they are, has the potential to be a top performer.

Suppose that Employee A produces 100 widgets an hour and stays at that level of performance day in and day out. On the other hand, Employee B produces 75 widgets an hour but improves output to 85 widgets an hour. Who should you reward? Employee B! This example embodies what you want to reward: the efforts that your employees make to improve their performance, not just to maintain a certain level (no matter how good that level is).

Consider what measures you should be monitoring, measuring and rewarding in your organisation. Don’t forget, just showing up for work doesn’t count. The following are examples of *performance-based measures* that any manager must recognise and reward:

- Defects decrease from 25 per 1,000 to 10 per 1,000.
- Annual sales increase by 20 per cent.
- The department records system is reorganised and colour-coded to make filing and retrieval more efficient.
- Administrative expenses are held to 90 per cent of the authorised budget.
- Mail is distributed in 1 hour instead of 1½ hours.

Some managers break incentives into two categories – *results measures* , where measures are linked to the bottom line, and *process measures* , where the link to the bottom line isn’t as clear. You need to recognise achievement in both categories.

## *Starting with the Positive*

You’re more likely to lead employees to great results by focusing on their positive accomplishments rather than by finding fault with and punishing their negative outcomes. Despite this fact, many managers’ primary mode of operation is correcting their employees’ mistakes instead of complimenting their successes.

In a recent study, 58 per cent of employees reported that they seldom received a personal thank-you from their manager for doing a good job, even though they ranked such recognition as their most motivating incentive. They ranked a written thank-you for doing a good job as motivating incentive No. 2, but 76 per cent said that they seldom received thanks from their managers. Perhaps these statistics show why a lack of praise and recognition is one of the leading reasons people leave their jobs!

Years of psychological research clearly show that positive reinforcement works better than negative reinforcement for several reasons. Without getting too technical, the reasons are that positive reinforcement:

- Increases the frequency of the desired behaviour
- Creates good feelings within employees

On the other hand, negative reinforcement may decrease the frequency of undesired behaviour, but doesn’t necessarily result in the expression of desired behaviour. Instead of being motivated to do better, employees who receive only criticism from their managers eventually come to avoid their managers whenever possible. Furthermore, negative reinforcement (particularly when manifested in ways that degrade employees and their sense of self-worth) can create tremendously bad feelings in employees. And employees who are unhappy with their employers have a much more difficult time doing a good job than employees who are happy with their employers.

TIP The following ideas can help you seek out the positive in your employees and reinforce the behaviours you want:

- **Have high expectations for your employees' abilities.** If you believe that your employees can be outstanding, soon they'll believe it too.
- **Recognise that your employees are doing their best.** If a shortfall in performance occurs, then support and encourage; punishing people for things that they can't do is pointless.
- **Give your employees the benefit of the doubt.** Do you really think that your employees want to do a bad job? No one wants to do a bad job; therefore, your job is to work out everything you can do to help employees do a good job. Additional training, encouragement and support should be among your first choices – not reprimands and punishments.
- **Catch your employees doing things right.** Most employees do a good job in most of their work, so instead of catching your employees doing things wrong, catch them doing things right. Not only can you reinforce the behaviours that you want, but you can also make your employees feel good about working for you and for your organisation.

## PRAISING GUIDELINES

A basic foundation for a positive relationship is the ability to praise well. To offer effective praise, one option is to use a system called 'ASAP-cubed', which means:

- **As soon:** Timing is very important when using positive reinforcement. Give praise as soon as the person displays the desired behaviour.
- **As sincere:** Words can fall flat if you're not sincere in why you're praising someone. Praise someone because you're truly appreciative and excited about the other person's success. Otherwise, the praise may come across as a manipulative tactic or simply patronising.
- **As specific:** Avoid generalities in favour of details of the achievement. For example, 'You really turned that angry customer around by focusing on what you could do for her, not on what you couldn't do for her'.
- **As personal:** A key to conveying your message is praising in person, face to face. This shows that the activity is important enough to you to put aside everything else you have to do and just focus on the other person.
- **As positive:** Too many managers undercut praise with a concluding note of criticism. When you say something like 'You did a great job on this report, but you made quite a few typos', the *but* becomes a verbal erasure of all that came before.
- **As proactive:** Lead with praise and catch people doing things right. Otherwise, you tend to be reactive – typically about mistakes – in your interactions with others.

You can give praise directly to the employee, in front of another person (in public) or when the person isn't around (via letter, email, voice-mail and so forth). Praising employees takes only a moment, but the benefits to your employees and to your organisation last for years.

# *Making a Big Deal about the Little Things*

Okay, here's a question for you: should you reward your employees for their little day-to-day successes, or should you save up rewards for when they accomplish something really major? The answer to this question lies in the way that most people get their work done on a daily basis.

For most people in business, work isn't a string of dazzling successes that come one after another without fail. Instead, most work consists of routine, daily activities; employees perform most of these duties quietly and with little fanfare. A manager's typical workday, for example, may consist of an hour or two reading memos and emails, listening to voice-mail messages and talking to people on the phone. The manager spends another few hours in meetings and perhaps another hour having one-to-one discussions with staff members and colleagues, much of which involves dealing with problems as they occur. With additional time spent on preparing reports or completing forms, the manager actually devotes precious little time to decision making – the activity that has the greatest impact on an organisation.

For a line worker, this dearth of opportunities for dazzling success is even more pronounced. If the employee's job is assembling lawnmower engines all day (and he does a good, steady job), when does he get the opportunity to be outstanding in the eyes of his supervisor?

Saga, a specialist holiday, travel and financial services company for the over-fifties, had just completed its best ever year. Profits rose by 25 per cent; turnover by 40 per cent. The company was set to be listed on the London Stock Exchange. Sydney De Haan, the company's founder, considered how best to reward everyone involved in this success. He instituted a scheme of annual bonuses, based on both individual and collective performance. At the end of the bumper year, he also paid for a holiday for all staff and their families. This strategy certainly paid off; the company is now capitalised at £2.2 billion.

In an organisation, major accomplishments are usually few and far between, regardless of your place in the organisational chart. Work is a series of small accomplishments that eventually add up to big ones. If you wait to reward your employees for their big successes, you may be waiting a long time.

REMEMBER Reward your employees for their small successes as well as their big ones. You may set a lofty goal for your employees to achieve – one that stretches their abilities and tests their resolve – but remember that praising your employees' progress towards the goal is perhaps even more important than praising them when they finally reach it.

# Considering Money and Motivation

You may think that money is the ultimate incentive for your employees. After all, who isn't excited when they receive a cash bonus or pay rise? The problem is that money really isn't the top motivator for employees – at least not in the way that most managers think. And money can be a huge demotivator if you manage it badly.

## Compensating with wages and salaries

Money is important to your employees to pay bills, buy food and clothes, put petrol in their cars and afford other necessities. Most employees consider the money they receive to be a fair exchange for the work they put in. Payment for work carried out is a legal right. Recognition, though, is a gift. Using recognition, however, helps you get the best effort from each employee.

## Realising when incentives become entitlements

In particular, employees who receive annual bonuses and other periodic, money-based rewards quickly come to consider them part of their basic pay. The problem arises when achieving bonuses and incentives is easy or straightforward. Productivity and output begin to flatten out and the incentive effect of the payments themselves begins to diminish. People work on the basis that the incentives and bonuses are forthcoming anyway.

TIP Incentives work best when they're related to goals or targets and short-term performance. In particular, incentives don't make a bad or boring job more interesting – they make it more bearable, and only in the short term.

So the issue becomes again: what are you rewarding? You need to work out what the goals are, what rewards people expect for achieving them and the best way to deliver these rewards. Consolidating incentives into standard pay and reward packages just puts up payroll costs without any tangible returns.

The ineffectiveness of money as a motivator for employees is a good news/bad news kind of thing. First, the bad news: many managers have thrown lots of money into cash-reward programmes, and for the most part these programmes haven't really had the positive effect on motivation that the managers expected. Although you don't necessarily waste your money on these programmes, you can use your money more effectively.

REMEMBER Now you get the good news: because you know that money isn't the most effective motivation tool, you can focus on using tools that are more effective – and the best forms of recognition cost little or no money!

## Working out what motivates your staff

If you're a busy manager, cash rewards are convenient because you simply fill out a single request to take care of all your motivation for the year. By contrast, the manager-initiated, based-on-performance stuff seems like a lot of work. To be frank, running an effective rewards programme does take more work on your part than running a simple but ineffective one. But as you discover, the best rewards can be quite simple. When you get the hang of using them, you can easily integrate these rewards into your daily routine.

REMEMBER To achieve the best results:

- Concentrate on what the employees need, want and expect. The only way to be absolutely sure is to ask them.
- Concentrate rewards on the things you really want done. And keep in mind that what gets rewarded gets done.

Don't save up recognition for special occasions only – and don't just use them with the top performers. You need to recognise all employees when they do good work in their job. Your employees are doing good things – things that you want them to do – every day. Catch them doing something right and recognise their successes regularly and often.

## TEN WAYS TO MOTIVATE EMPLOYEES

Here are some easy, no-cost things you can do to create a motivating workplace:

- Personally thank employees for doing a good job – one-to-one, in writing or both. Do it promptly, often and sincerely.
- Take the time to meet with and listen to employees – as much as they need or want.
- Provide employees with specific and frequent feedback about their performance. Support them in improving performance.
- Recognise, reward and promote high performers; deal with low and marginal performers so that they improve.
- Provide information on how the company makes and loses money, upcoming products and services, and strategies for competing. Explain the employee's role in the overall plan.
- Involve employees in decisions, especially those that affect them. Involvement equals commitment.
- Give employees a chance to grow and develop new skills; encourage them to be their best. Show them how you can help them meet their goals while achieving the organisation's goals. Create a partnership with each employee.
- Provide employees with a sense of ownership in their work and their work environment. This ownership can be symbolic (for example, business cards for all employees, whether they need them to do their jobs or not).
- Strive to create a work environment that's open, trusting and fun. Encourage new ideas, suggestions and initiative. Learn from rather than punish staff for their mistakes.
- Celebrate successes – of the company, of the department and of individuals. Take time for team- and morale-building meetings and activities. Be creative and fresh.

## *Realising that you hold the key to your employees' motivation*

In our experience, most managers believe that their employees determine how motivated they choose to be. Managers tend to think that some employees naturally have good attitudes, that others naturally have bad attitudes and that managers can't do much to change these attitudes. 'If only we could unleash the same passion and energy people have for their families and hobbies', these managers think, 'then we could really get something done around here'.

As convenient as blaming your employees for their bad attitudes may be, looking in a mirror may be a more honest approach. Managers need to:

- Recognise their employees for doing a good job
- Provide a pleasant and supportive working environment

- Create a sense of joint mission and teamwork in the organisation
- Treat their employees as equals
- Avoid favouritism
- Make time to listen when employees need to talk

REMEMBER For the most part, you determine how motivated (and demotivated) your employees are. Managers create a motivating environment that makes it easier for employees to be motivated. When the time comes, recognise and reward them fairly and equitably for the work they do well.

WARNING When giving rewards, remember that employees don’t want handouts, and they hate favouritism. Provide rewards for performance that help you to be mutually successful. Don’t give recognition when none is warranted. Don’t give it just to be nice, or with the hope that people will like you better. Doing so cheapens the value of the incentive for the employee who received it and loses you credibility in your other employees’ eyes. Trust and credibility are two of the most important qualities that you can build in your relationship with your employees; if you lose these qualities, you risk losing the employee.

# Chapter 6

# Coaching and Development

**IN THIS CHAPTER**

**Understanding what a coach is**

**Developing basic coaching skills**

**Recognising the development needs of your employees**

**Creating the conditions for successful and enduring development**

The best managers are *coaches* – that is, individuals who guide, talk with and encourage others on their journey. With the help of coaches, employees can achieve outstanding results, organisations can perform better than ever and you can sleep well at night, knowing that everything is just fine.

REMEMBER Coaching plays a critical part in the learning process for employees who are developing their skills, knowledge and self-confidence. Your employees don't learn effectively when you simply tell them what to do. In fact, they usually don't learn at all.

TIP As the maxim goes:

- Tell me … I forget.
- Show me … I remember.
- Involve me … I learn.

Nor do your employees learn effectively when you throw a new task at them with no instruction or support whatsoever. Of course, good employees can, and do, eventually work things out for themselves, but they waste a lot of time and energy in the process. 'What on earth am I supposed to be doing? Let's have a go anyway and see what happens!'

Between these two extremes – being told what to do and being given no support whatsoever – is a happy medium where employees can thrive and the organisation can prosper. This is the happy land where everyone lives in peace, harmony, prosperity and achievement – and this happy medium starts and finishes with coaching.

## *Playing a Coach's Role*

Even if you have a pretty good sense of what it means to be a manager, do you really know what it means to be a coach? A coach is a colleague, counsellor and cheerleader, all rolled into one. Based on that definition, are you a coach? How about your boss? Or your boss's boss? Why or why not?

We bet that you're familiar with the role of coaches in other non-business activities. A drama coach, for example, is almost always an accomplished actor. The drama coach's job is to conduct auditions for parts, assign roles, schedule rehearsals, train and direct cast members throughout rehearsals, and support and encourage the actors during the final stage production. These roles aren't all that different from the roles that managers perform in a business, are they?

Coaching a team of individuals isn't easy, and certain characteristics make some coaches better than others. Fortunately, as with most other business skills, you can discover, practise and improve your grasp of the traits of good coaches. You can always find room for improvement, a fact that good coaches are the first to admit. The following list highlights some important characteristics of coaching:

- **Coaches set goals.** Whether an organisation's vision is to become the leading provider of global positioning systems in the world, to increase revenues by 20 per cent a year or simply to get the staffroom walls painted this year, coaches work with their employees to set goals and deadlines for completion. Coaches then withdraw, to allow their employees time to work out how to achieve the goals.
- **Coaches support and encourage.** Employees – even the best and most experienced – can easily become discouraged from time to time. When employees are learning new tasks, when a long-term account is lost or when business is down, coaches are there, ready to step in and help the team members through the worst of it. 'That's okay, Kim. You've learned from your mistake, and I know that you can get it right next time!'
- **Coaches emphasise both team success and individual success.** The team's overall performance, not the stellar abilities of a particular team member, is the most important concern. Of course, you need everyone's contribution; but coaches know that no one person can carry an entire team to success. Winning takes the combined efforts of everyone. The development of teamwork skills is a vital step in an employee's progress in an organisation.
- **Coaches can quickly assess the talents and shortfalls of team members.** The most successful coaches can quickly determine their team members' strengths and weaknesses and, as a result, tailor their approach accordingly. For example, if one team member has strong analytical skills but poor presentation skills, a coach can concentrate on providing support to help the employee develop better presentation skills. 'You know, Mark, I want to spend some time with you to work on making your sales presentations more effective.'
- **Coaches inspire their team members.** Through their support and guidance, coaches are skilled at inspiring their team members to the highest levels of human performance. Teams of inspired individuals are willing to do whatever it takes to achieve their organisation's goals.
- **Coaches create environments that allow individuals to be successful.** Great coaches ensure that their workplaces are structured to let team members take risks and stretch their limits without fear of retribution if they fail.
- **Coaches provide feedback.** Communication and feedback between coach and employee form a critical element of the coaching process. Employees must know where they stand in the organisation – what they're doing right, and what they're doing wrong. Equally important, employees must let their coaches know when they need help or assistance. And this must be a continuous process for both parties. Otherwise problems get raised only at performance reviews

and appraisals, or, worse still, get lost altogether.

REMEMBER Coaches are available to advise their employees or just to listen to their problems if need be, whether the issue is work-related or personal.

WARNING Firing someone doesn’t constitute effective feedback. Unless an employee has engaged in some sort of intolerable offence (such as physical violence, theft or intoxication on the job), a manager needs to give the employee plenty of verbal and written feedback before even considering termination. With employees who simply can’t see what they’re doing wrong, your coaching either makes or breaks. If you simply fire someone, you never know whether the problem was hers – or yours.

## Coaching: A Rough Guide

Besides the obvious coaching roles of supporting and encouraging employees in their quest to achieve an organisation’s goals, coaches also teach their employees *how* to achieve those goals. Drawing from their experience, coaches lead their employees step by step through work processes or procedures. When employees discover how to perform a task, the coach delegates full authority and responsibility for its performance to them.

REMEMBER For the transfer of specific skills, you can find no better way of teaching – and learning – than the *show-and-tell* method. If you need to get people up to speed on workplace skills, knowledge and understanding, then do it on the job. There’s simply no better place. And – if you need to – you can get people working fully productively very quickly.

Show-and-tell or on-the-job coaching has three steps:

1. **You do, you say. Sit down with your employees and explain the procedure in general terms while you perform the task.**

   All businesses now use computers as a critical tool for getting work done. If you’re coaching a new employee in the use of an obscure word processing or spreadsheet program, the first thing you need to do is to explain the technique to the employee while you demonstrate it. ‘I click my left mouse button on the Insert command on the toolbar and pull down the menu. Then I point the arrow to Symbol and click again. I choose the symbol I want from the menu, point my arrow to it and click to select it. I then point my arrow to Insert and click to place the symbol in the document; then, I point my arrow to Close and click again to finish the job.’

2. **They do, you say. Next get the employee to do the same procedure as you explain each step.**

   'Click your left mouse button on the Insert command on the toolbar and pull down the menu. Okay, good. Now point your arrow to Symbol and click again. Excellent! Choose the symbol you want from the menu and point your arrow to it. Now click to select it. All right – point your arrow to Insert and click to place the symbol in the document. Okay, you're almost done now. Point your arrow to Close and click again to finish the job. There you are!'

3. **They do, they say. Finally, as you observe, get your employee to perform the task again as she explains to you what she's doing.**

   'Okay, Millie, now it's your turn. I want you to insert a symbol in your document and tell me what you're doing.'

   'All right, Senti. First, I click my left mouse button on the Insert command on the toolbar and pull down the menu. Then I point the arrow to Symbol and click again. I decide the symbol I want from the menu, point my arrow to it and click to select it. Next, I point the arrow to Insert and click to place the symbol in the document. Finally, I point my arrow to Close and click again to finish the job. I did it!'

TIP Get employees to create a 'crib sheet' of the new steps to refer to until they become habit.

# Coaching Metaphors for Success in Business

In business, when it comes to coaching and teamwork, the metaphor of a company as a winning sports team is often applied. In many organisations, chief executives hire professional athletes and coaches to lecture their employees on the importance of team play and winning. Managers are labelled *coaches* or *team leaders* , and employees are labelled *players* or *team members* .

This being the case, ignoring the obvious parallels between coaching in sport and in business is difficult. So we're going to get this out of our system once and for all and refrain from linking coaching in sport and business anywhere else in this book after the following list of examples:

- Terry Venables, legendary football coach, on his appointment to Barcelona FC: 'The first thing that I had to do was to get this group of highly talented individuals playing as a team.'
- Clive Woodward, World Cup–winning England rugby coach: 'To build a team, you have to coach people as a team. Of course, you work on individual strengths and weaknesses; in the end, however, it is how they perform together, not how they perform individually, that determines your success.'
- Arsène Wenger, manager and head coach at Arsenal FC since 1996, in itself something of a record: 'One of the most important things that I have to do is to maintain the players' belief in themselves. This is easy when you are winning – sometimes you have to rein them in. But when

you are losing – this is the most important part of the job. And if you simply shout at people or threaten them – you will always fail.'

- José Mourinho, legendary (some would say controversial) football coach who's produced winning teams in three different countries and cultures already: 'If the players do not want to do things my way, I do not want them. Good players who will work as team members will always do better than brilliant individuals working in isolation.'
- Alf Ramsey, World Cup–winning England football manager and coach: 'The best teams are not necessarily made up of the best individuals. When one player thanked me for picking him, I replied: "I don't pick individuals, I pick teams."'

One last point: in sport, as in business, *everybody* needs a coach. Who's the greatest tennis player of all time? Pete Sampras? Probably. But most people don't realise that all the time he was playing, even Pete Sampras had a coach to help him stay sharp and to improve.

## Tapping into the Coach's Expertise

Coaching isn't a one-dimensional activity. Because every person is different, the best coaches tailor their approach to their team members' specific, individualised needs. If one team member is independent and needs only occasional guidance, recognise where the employee stands and provide that level of support. This support may consist of an occasional, informal progress check while making the rounds of the office. If, on the other hand, another team member is insecure and needs more guidance, the coach recognises this employee's position and assists as required. In this case, support may consist of frequent, formal meetings with the employee to assess progress and to provide advice and direction as needed.

REMEMBER Although every coach has an individual style, the best coaches employ certain techniques to elicit the greatest performance from their team members:

- **Meet and make time for team members.** Managing is primarily a people job. Part of being a good manager and coach is being available to your employees when they need your help. If you're not available, your employees may seek out other avenues to meet their needs – or simply stop trying to work with you. Always keep your door open to your employees and remember that they're your Number 1 priority. Manage by walking around. Regularly get out of your office and visit your employees at their workstations. 'Do I have a minute, Elaine? Of course, I always have time for you and the other members of my staff.'
- **Provide context and vision.** Instead of simply telling employees what to do, effective coaches explain *why* . Coaches provide their employees with context and a big-picture perspective. Instead of spouting long lists of dos and don'ts, they explain how a system or procedure works and then define their employees' parts in the scheme of things. 'Sanjeev, you have a very important part in the financial health and vitality of our company. By ensuring that our customers pay their invoices within 30 days after we ship their products, we're able to keep our cash flow on the plus side, and we can meet our obligations such as rent, electricity and your salary on time.'

- **Transfer knowledge and perspective.** A great benefit of having a good coach is the opportunity to discover information and know-how from someone who has more experience than you do. In response to the unique needs of each team member, coaches transfer their personal knowledge and perspective. 'We faced this exact situation about five years ago, Hayden. I'm going to tell you what we did then, and I want you to tell me whether you think that it still makes sense today or if you have a better idea that we could try.'
- **Be a sounding board.** Coaches talk through new ideas and approaches to solving problems with their employees. Coaches and employees can consider the implications of different approaches to solving a problem and role-play customer or client reactions before trying them out for real. By using active listening skills, coaches can often help their employees work through issues and come up with the best solutions themselves. 'Okay, David, you've told me that you don't think your customer will buy from us if we put the prices up by 20 per cent. What options do we have with price increases, and are some better than others?'
- **Obtain necessary resources.** Sometimes coaches can help their employees make the jump from marginal to outstanding performance simply by providing the resources that their employees need. These resources can take many forms – money, time, staff, equipment or other tangible assets. 'So, Kathleen, you're confident that we can improve our cash flow if we put two more staff on to invoicing? Okay, let's give it a try.'
- **Offer a helping hand.** For an employee who's learning a new job and is still responsible for performing her current job, the total workload can be overwhelming. Coaches can help workers through this transitional phase by reassigning current duties to other employees, authorising overtime or taking other measures to relieve the pressure. 'Jill, while you're learning how to debug the new software, I'm going to assign the rest of your workload to Rachel. We can get back together at the end of the week to see how you're doing.'

# *Developing and Mentoring Employees*

Developing your employees is the other side of coaching. You have to have employees who can and are willing to be developed. Taking people on in isolation from what you expect of them is useless; they must always be prepared to do things your way, making their expertise work for the good of everyone.

So, it's time for a quick look in the mirror. What kind of manager are you? Do you take on new employees and then just let them go on their merry way? Or do you stay actively involved in the progress and development of your employees, helping to guide them along the way? If you're a manager-to-be, do you know what having a mentor is like, someone who takes a personal interest in your career development? Mentoring is vitally important because as well as needing to make your own mistakes (and you will!), you also need someone to guide you, act as a sounding board, strengthen and test your determination, and indicate areas where you can improve.

Employee development is the process by which you make everyone (including yourself) better at their jobs and improve their willingness to carry them out to the best of their abilities. Employee development is also concerned with the development of skills, knowledge, attitudes and behaviours, which build experiences and achievements into expertise. Employee development concentrates on the key areas of workplace development, professional and occupational priorities, and personal choices, so that everyone benefits and individuals take active responsibility for their own future.

REMEMBER The best employee development is continuous and requires that you support and encourage your employees' initiative. Recognise, however, that all development is self-development; you can really only develop yourself. You can't force your employees to develop; they have to want to for themselves. You can, however, help create an environment that makes it more likely that they want to develop, grow and succeed.

# *Explaining How Employee Development Helps*

Development boils down to one important point: as a manager, you're in the best position to provide your employees with the support they need to advance in your organisation. Not only can you provide them with the time and money required for training, you can also offer unique on-the-job learning opportunities and assignments, mentoring, team participation and more. Besides, someone's got to be there to take your place when you get promoted. Employee development involves a lot more than just going to a training class or two. In fact, approximately 90 per cent of development occurs on the job.

REMEMBER Training, learning and development are all different aspects of the same process:

- **Training** is the most straightforward – you tell people how to do something that's either more or less standard; or you take a step-by-step approach to something more complex.
- **Learning** requires you to create the conditions, environment and context – and employee confidence – in which development is most effective.
- **Development** is what goes on with everyone in all aspects of their lives, including work. From a manager's point of view, you need to see employee development as a combination of personal, professional, occupational and career advancement and enhancement; and the improvement of knowledge, attitudes, behaviour and experience, as well as skills and expertise.

Now, have you ever wondered why your employees continue to mess up assignments that you know they can perform? In case you don't have any inkling whatsoever why developing your employees is a good idea, the following list provides the full justification:

- Development ensures that your employees have the knowledge they need.
- Employees who work effectively are better employees, happier and more content in the workplace.
- Someone has to be prepared to step into your shoes; for example, when you go on holiday, or in case you yourself move on.

  TIP The reason that many managers don't have to call their offices when they're on holiday is because they make it a point to develop their employees to take over when they're gone. You can do the same thing too; the future of your organisation depends on it. Really.

- Your employee wins, and so does your organisation; and most important, you prepare your employees to fulfil the roles that your organisation needs them to fulfil in the future.

REMEMBER Your employees are worth your time and money. And if this sounds almost too obvious to state at all, keep in mind that employees take anything up to three-quarters of the fixed costs of any organisation. So make sure that you make them as capable and as willing to work for you as you possibly can. Constantly offer new challenges and opportunities for all your employees, and make sure that they respond by stretching themselves to the limit.

# Personal Development Plans

The personal development plan (PDP), also known as the career development plan, is the heart and soul of your efforts to develop your employees. Unfortunately, many managers don't take the time to create development plans with their employees, instead trusting that when a need arises, they can find training to accommodate that need. This kind of reactive thinking ensures that you're always playing catch-up to the challenges that your organisation faces.

Why wait for the future to arrive before you prepare to deal with it? Are you really so busy that you can't spend a little of your precious time planting the seeds that your organisation can harvest years from now? No! Although you do have to take care of the seemingly endless crises that arise in the here and now, you also have to prepare yourself and your employees to meet the challenges of the future. To do otherwise is an incredibly short-sighted and ineffective way to run your organisation.

REMEMBER All development plans must contain as a minimum the following key elements:

- **Specific learning goals, supported by milestones along the way:** Each and every employee in your organisation benefits from having learning goals; and you need to set individual goals for each person. For example, say that your employee's career path starts at the position of junior buyer and works up to manager of purchasing. The key learning goals for this employee may be learning the stocks and supplies, training how to plan for stock replacement, spreadsheet analyses and introduction to management.
- **Resources required to achieve the designated learning goals:** Make sure you can resource everything that's needed.
- **Employee responsibilities and resources:** Career development is the joint responsibility of an employee and her manager. A business can and does pay for things, but so can employees. A good development plan should include what the employee is doing in her own time.
- **Required dates of completion for each learning goal:** Make sure that employees stick to these dates, or else that they can give a clear explanation for failure to meet the dates for completion.

- **Standards for measuring the accomplishment of learning goals:** Assess these at each milestone.

# *Helping Employees to Develop*

Employee development takes the deliberate and continuous efforts of employees with the support of their managers. If employees or managers lose heart, commitment or faith, then employees don't develop, and the organisation suffers the consequences of not having the employees it needs to meet the challenges it faces. This outcome definitely isn't good. As a manager, you want your organisation to be ready for the future, not always trying to catch up with it.

The employee's role is to identify the areas where development can help to make her a better and more productive worker, and then to relay this information to her manager. When the employee identifies further development opportunities, the manager and the employee work together to schedule and implement them.

As a manager, your role is to be alert to the development needs of your employees and to keep an eye out for potential development opportunities. Managers in smaller organisations may be assigned to determine where the organisation will be in the next few years. Armed with that information, you're responsible for finding ways to ensure that employees are available to meet the needs of the future organisation. Your job is then to provide the resources and support required to develop employees so that they're able to fulfil the organisation's needs.

To develop your employees to meet the coming challenges within your organisation, follow these steps:

1. **Meet each employee to discuss her career.**

   Meet individuals to discuss where you see them in the organisation and to find out where in the organisation they want to go.

   REMEMBER This effort has to be a joint one! Having elaborate plans for an employee to rise up the company ladder in sales management isn't going to do you any good if your employee hates the idea of leaving actual sales to become a manager of other salespeople.

2. **Discuss your employee's strengths and weaknesses.**

   Have a frank discussion regarding the employee's strengths and areas for development. Your main goal here is to identify the areas that the employee is interested in and good at – that is, the strengths that your employee can develop to allow her continued progress in the organisation and to meet the future challenges that your business faces. Focus the majority of your development efforts and resources on these opportunities.

REMEMBER Spend time developing strengths as well as improving weaknesses. Improving and enhancing a skill that your employee finds easy and enjoyable is more valuable for you and your organisation than forcing the employee to be merely adequate at things others excel in. However, everyone needs to be proficient in essential tasks, even if they don’t like them.

3. **Assess where the employee is now.**

   Determine the current state of your employee’s skills and talents. Doing an assessment provides you with an overall road map to guide your development efforts.

4. **Create a career development plan.**

   A *career development plan* is an agreement between you and your employee that spells out exactly what formal support (tuition, time off, travel expenses and so on) your employee may receive to develop her skills, and when she may receive it. Development plans have review and evaluation points, assessments of progress and agreements on next steps.

5. **Follow through on your agreements, and make sure that the employee follows through on hers.**

   Don’t break the development plan agreement. Make sure that you provide the support that you agreed to provide. Make sure that your employee upholds her end of the bargain too! Check on her progress regularly. If she misses schedules because of other priorities, reassign her work as necessary to ensure that she has time to focus on her development plan.

TIP So when is the best time to sit down with your employees to discuss career planning and development? The sooner the better! Conducting a career development discussion twice a year with each of your employees isn’t too often. Quarterly is even better; a brief chat once a month is best of all. And make sure that you commit to the discussion – it represents time, money and effort well spent! Include a brief assessment in each discussion of the employee’s development needs. Ask your employee what she can do to fulfil these needs. If she requires additional support, determine what form of support the employee needs and when to schedule the support. Adjust career development plans and redirect resources as necessary.

TIP The University of Bath has useful online resources to help you create a personal development plan ( www.bath.ac.uk/learningandteaching/enhance-learning-experiences/personal-development-planning.html ).

# TOP TEN WAYS TO DEVELOP EMPLOYEES

The basics for developing employees are:

- Provide employees with opportunities to learn and grow.
- Be a mentor to an employee.
- Let an employee fill in for you at staff meetings.
- Give employees secondment and project work opportunities.
- Allow employees to pursue and develop any ideas they have.
- Provide employees with a choice of assignments.
- Send an employee to a seminar on a new topic.
- Take an employee along with you when you call on customers.
- Introduce your employees to top managers in your organisation and arrange to have them perform special assignments for senior people.
- Allow an employee to shadow you during your work day.

# Chapter 7

# Being an Expert at Performance Appraisal and Management

**IN THIS CHAPTER**

**Quantifying and qualifying your goals**

**Developing a performance management and appraisal system**

**Putting your system into practice and making sure it works**

**Avoiding the pitfalls of evaluating performance**

Setting goals – for individuals, for teams and for the overall organisation – is extremely important if you are to achieve superior performance. (Chapter 5 in Book 3 addresses the whys and wherefores of encouraging your employees to up their game.) However, ensuring that the organisation is making progress towards the successful completion of its goals (in the manner and timeframes agreed to) is equally important. The organisation's performance depends on each individual who works within it. Achieving goals is what this chapter is all about.

Measuring and monitoring the performance of individuals in your organisation is like walking a tightrope: you don't want to over-measure or over-monitor your employees. Doing so only leads to needless bureaucracy and red tape, which can negatively affect your employees' ability to perform their tasks. Neither do you want to under-measure or under-monitor your employees. Such a lack of watchfulness can lead to nasty surprises when a task is completed late, over budget or not at all. 'What? The customer database conversion isn't completed yet? I promised the sales director that we'd have that job done two weeks ago!'

Please keep in mind that, as a manager, your primary goal in measuring and monitoring your employees' performance isn't to punish them for making a mistake or missing a milestone. Instead, you help your employees stay on track and find out whether they need additional assistance or resources to do so. Few employees like to admit that they need help getting an assignment done – whatever the reason. Because of their reluctance, you must systematically check on the progress of your employees and regularly give them feedback on how they're doing.

REMEMBER If you don't monitor desired performance, you won't achieve desired performance. Don't leave achieving your goals to chance; develop systems to monitor progress and ensure that employees achieve your goals. And you can't measure anything except against what you set out to achieve.

## *Taking the First Steps*

The first step in checking your employees' progress is to determine the key indicators of a goal's success. Set goals with your employees that are few in number and *SMART* (specific, measurable, attainable, relevant and time-bound).

When you quantify a goal in precise numerical terms, your employees have no confusion over how their performance is measured and when their job performance is adequate (or less than adequate). For example, if the goal is to produce 100 sprockets per hour, with a reject rate of 1 or lower, your employees clearly understand that producing only 75 sprockets per hour with 10 rejects is unacceptable performance. You leave nothing to the imagination, and the goals aren't subject to individual interpretation or to the whims of individual supervisors or managers.

How you measure and monitor the progress of your employees towards completion of their goals depends on the nature of the goals. You can measure goals in terms of time, units of production or delivery of a particular work product (such as a report or a sales proposal), for example.

Table 7-1 offers examples of different goals and ways to measure them.

### TABLE 7-1 Sample Goals and Measurements

| *Goal* | *Measurement* |
|---|---|
| Plan and implement a company newsletter before the end of the second quarter of the current fiscal year | The specific date (for example 30 June) that the newsletter is sent out (*time* ) |
| Increase the number of mountain bike frames produced by each employee from 20 to 25 per day | The exact number of mountain bike frames produced by the employee each day (*quantity* ) |
| Increase profit on the project by 20 per cent in financial year 20XX | The total percentage increase in profit in the year to 31 December 20XX (*percentage increase* ) |

REMEMBER Although noting when your employees attain their goals is obviously important, recognising your employees' *incremental* progress towards attaining their goals is just as important. For example:

- The goal for your drivers is to maintain an accident-free record. This goal is continuous – no deadline exists. To encourage drivers in their efforts, you can prominently post a huge banner in the middle of the garage that reads '153 Accident-Free Days'. Increase the number for each day of accident-free driving.
- The goal of your accounts clerks is to increase the average number of transactions from 150 per day to 175 per day. To track their progress, you can publicly post a summary of the daily production count at the end of each week. As production increases, praise the progress of your employees towards the final goal.
- The goal set for your production staff is to turn customer orders around within 24 hours, without errors. You can publicly post the results for all to see; in this case, when orders are not turned around within 24 hours or when errors occur, you have a very quick, public and agreed point for investigation.

REMEMBER The secret to performance measuring and monitoring is the power of positive feedback. When you give positive feedback (increased number of units produced, percentage increase in sales and so on), you encourage the behaviour that you want. However, when you give negative feedback (number of errors, number of work days lost and so on), you aren't encouraging the behaviour you want; you're only discouraging the behaviour that you don't want. Consider the following examples:

- **Instead of measuring this:** Number of defective cartridges
- **Measure this:** Number of correctly assembled cartridges
- **Instead of measuring this:** Number of days late
- **Measure this:** Number of days on time
- **Instead of measuring this:** Quantity of late transactions
- **Measure this:** Quantity of completed transactions

TIP You're more likely to get the results you want when you put group performance measures (total revenues, average days sick and so on) out in the open for everyone to see; however, keep individual performance measures (sales performance by employee, absence rankings by employee and so on) private. The intention is to get a team to work *together* to improve its performance – tracking and publicising group measures and then rewarding improvement in them can lead to dramatic advances in the performance you seek. What you do *not* want to do is embarrass your employees or subject them to ridicule by other employees when their individual performance isn't up to par. Instead, deal with these employees privately, and coach them (and provide additional training and support, as necessary) to improve performance (refer to Chapter 6 in Book 3 for more information on coaching).

# Developing a System for Providing Immediate Performance Feedback

You can measure an infinite number of behaviours or performance characteristics. What you measure and the values you measure against are up to you and your employees. Keep certain points in mind when you design a system for measuring and monitoring. Build your system on the *MARS* – *milestones* , *actions* , *relationships* and *schedules* – system. The elements of the MARS system are described in the following sections.

REMEMBER Application of each characteristic – milestones, actions, relationships and schedules – results in goals that you can measure and monitor. If you can't measure and monitor goals, the chances are that your employees will never achieve them – and you won’t know the difference if they do.

## Setting your checkpoints: The milestones

Every goal needs a starting point, an ending point and points in between to measure progress along the way. *Milestones* are the checkpoints, events and markers that tell you and your employees how far along you are on the road to reaching the goals you’ve set together.

For example, suppose that you establish a goal of finalising corporate budgets in three months’ time. The third milestone along the way to your ultimate goal is that draft department budgets are submitted to division managers no later than 1 June. If you check with the division managers on 1 June and your employees haven’t submitted the draft budgets, you quickly and unambiguously know that the project is behind schedule. If, however, all the budgets are in on 15 May, you know that the project is ahead of schedule and that you may reach the final goal of completing the corporate budgets sooner than you originally estimated.

## Reaching your checkpoints: The actions

*Actions* are the individual activities your employees perform to get from one milestone to the next. To reach the third milestone in your budgeting project – submitting draft department budgets to division managers by 1 June – your employees must undertake and complete several actions after they reach the second milestone in the project. In this example, these actions may include the following steps:

1. Review prior-year expenditure reports and determine the relationship, if any, to current activities.
2. Review current-year expenditure reports and project and forecast final results.
3. Meet department staff to determine their training, travel and capital equipment requirements for the new financial year.
4. Review the possibilities of new staff, lay-offs, redundancies and pay rises to determine the impact on payroll costs.
5. Put the information you’ve gathered onto a computerised draft budget spreadsheet.
6. Print off the draft budget and double-check the results, correcting them if necessary.
7. Submit the draft budget to your own manager before forwarding it to the division manager.

Each action gets your employees a little further along the way towards reaching the third milestone in the project and is therefore a critical element in their performance.

TIP

When developing a plan for completion of any activity or project, note each action in writing. By taking notes, you make concentration easier for your employees because they know exactly what they must do to reach a milestone, how far they've gone and how much further they have to go. And each time they do reach a milestone, record it.

### Acting in sequence: The relationships

*Relationships* are how milestones and actions interact with one another. Relationships shape the proper sequencing of activities that lead you to the successful, effective accomplishment of your goals. Although sequences don't always matter, it's often more effective to perform certain actions before others and to attain certain milestones before others.

For example, in the list of actions needed to achieve the third project milestone (covered in the preceding section), trying to perform the fifth action before the first, second, third or fourth isn't going to work! If you don't work out the right numbers to put into your spreadsheet before you fill in the blanks, your results are meaningless.

REMEMBER You may have more than one way to reach a milestone, so give your employees the scope to find their own ways to reach their goals. Doing so empowers your employees to take responsibility for their work and to benefit from both their mistakes and their successes. The results are successful performance and happy, productive employees.

### Establishing a timeframe: The schedules

How do you determine how far apart your milestones should be and how long project completion should take? You can plan better by estimating the *schedule* of each individual action in your project plan.

Using your experience and training to develop schedules that are realistic and useful is important. For example, if you give someone a deadline of two years' time, he won't take any notice of it until two or three months before the actual date. If you do need to set long-term deadlines, then make sure that you break the activities up into milestones and points of reference that you can realistically measure along the way.

**MEASURING INSTEAD OF COUNTING**

According to management guru Peter Drucker, most business people spend too much time counting and too little time measuring the performance of their organisations. Drucker likens counting to a doctor using an X-ray machine to diagnose an ill patient. Although some ailments – broken bones, pneumonia and so on – do show up on an X-ray, other, more life-threatening illnesses such as leukaemia, hypertension and AIDS don't. Similarly, most managers use accounting systems to X-ray their organisation's financial performance. However, accounting systems don't measure a catastrophic loss of market share or a failure to innovate until the problem has already gone on too long, and the 'patient' is damaged – perhaps irretrievably.

## Reducing Shrinkage

*Shrinkage* refers to the amount of products, equipment and supplies lost through wastage, theft, damage or breakage. Shrinkage is therefore a euphemism for sloppiness, lack of attention and, above all, an inability to set standards of performance that stick.

Many organisations are complacent about shrinkage. This situation is made more difficult because it costs money to find out what the losses are and more still to do something to stop them.

In the past, organisations thought that shoplifting and petty pilfering were the only real sources and causes of shrinkage, and so considered they had little to worry about. Shrinkage, however, occurs through staff dishonesty and information systems failure as well as through theft by customers. Part of the problem is a result of changing patterns of employment with firms employing more part-timers and outside contractors, neither of whom necessarily have much loyalty to their 'employer'. A further problem is the notoriously low pay rates in the retail sector that encourages some employees to justify a degree of pilfering.

WARNING To give you some idea how serious staff theft has become, according to the Retail Crime figures for the UK in 2012/13, employee theft amounted to £1.7 billion. This figure was just slightly lower the £2.2 billion that customer theft accounted for. Ignore it at your peril.

Any organisation faced with a serious shrinkage problem has to be able to establish absolute standards – standards below which it doesn't slip, or allow employees to slip. You can address shrinkage problems only under the following conditions:

- **Recognising the issue at all levels.** Recognition must be underpinned by a determination at board level to deal fully and effectively with the problem.
- **Enforcing zero tolerance for theft or fraud among staff.** No matter how senior, experienced or valued the colleague is, he must be dismissed if he's caught stealing from the business. This is the *only* way to deal with pilfering.
- **Making shrinkage culturally unacceptable.** Make it clear that shrinkage is an enemy of the business. Relate shrinkage rates to turnover and profitability in all staff briefings.
- **Rewarding the desired behaviour.** The desired behaviour is established through a combination of policies and practice. The policies very clearly state both what's required and how people are to behave and not behave. In particular, you need to focus on the conduct of everyone from the point of view of ensuring that:
    - Everyone knows and understands that stealing, lying and cheating are an affront to everyone.
    - You monitor all aspects of shrinkage that concern you, and make sure that you also involve all the staff.
    - Shrinkage is treated from the point of view that, by stealing or lying, individuals affect not just themselves but also everyone else.

REMEMBER The key to solving this problem is to reward honest employees adequately for their work; therefore, you remove any temptation to steal. An open and honest culture needs to underpin the organisation; ensuring that employees are honest is impossible if those further up the organisation aren't. Paying attention to matters such as punctuality, commitment and enthusiasm helps to generate loyalty and engagement – and the more loyal and engaged employees are, the less likely they are to steal from their employer.

# Reading the Results

You establish your goals, you set performance measures and you obtain pages of data for each of your employees and activities. Now what? Now you determine whether your employees achieved the expected results, as follows:

- **Compare results to expectations.** Did your employees achieve the expected goal? Suppose that the goal is to complete the budget by 1 June. When did your employees complete the budget? It was completed on 17 May – well ahead of the deadline. Brilliant! The employees accomplished the mission with time to spare.
- **Record the results.** Make note of the results – perhaps put them in the files that you maintain for each employee or print them out on your computer and post them in the work area.
- **Praise, coach or counsel your employees.** If they did the job right, on time and within budget, congratulate your employees for a job well done and reward them appropriately: a written note of appreciation, a day off with pay, a formal awards presentation – whatever you decide.

  However, if employees didn't achieve the expected results, find out why and what you can do to ensure that they are successful next time. If employees need only additional support or encouragement, coach them for a better performance. Listen to your employees, clarify their difficulties and then formulate a response; consider referring them to other employees for advice or providing your own personal examples that may be applicable to their situation. If the poor results stem from a more serious shortcoming, you may need to retrain, or discipline, your employees. (Refer to Chapter 4 in Book 3 for the lowdown on disciplining staff.)

# Appraising Performance: Why It Matters

You can find many good reasons for conducting regular formal performance appraisals with your employees and of your activities. Formal performance appraisals are just one part of an organisation's system of delegation, goal setting, coaching, motivating and ongoing informal and formal feedback on employee performance. If you don't believe us, try a few of these positive elements of performance appraisals on for size:

- **A chance to meet regularly:** Meeting regularly means that you know what your employees are doing and they know you're available for support. When you establish regular informal meetings, you also have a much better basis for effective regular formal reviews when they happen.
- **A chance to summarise past performance and establish new performance goals:** All employees want to know whether they're doing a good job. Formal performance appraisals force managers to communicate performance results – both good and bad – to their employees and to set new goals. In many organisations, the annual performance appraisal is the only occasion when supervisors and managers speak to their employees about performance expectations and the results of employee efforts for the preceding appraisal period.
- **An opportunity for clarification and communication:** You need to continually compare

expectations. Try this exercise with your manager. List your ten most important activities. Then ask your manager to list what he considers to be your ten most important activities. The chances are that your lists are quite different. On average, business people who do this exercise find that their lists overlap by only 40 per cent at best. Performance appraisals help the employer and the employee to compare notes and make sure that assignments and priorities are in sync.

- **A forum for learning goals and career development:** In many organisations, career development takes place as a part of the formal performance appraisal process. Managers and employees are all very busy and often have difficulty setting aside the time to sit down and chart out the steps that they must take to progress in an organisation or career. Although career development discussions should generally take place in a forum separate from the performance appraisal process, combining the activities does afford the opportunity to kill both birds with the same stone … or something like that.
- **Formal documentation to promote advancement or dismissal:** Most employees get plenty of informal performance feedback, at least of the negative kind along the lines of: ‘You did what? Are you nuts?’ Most informal feedback is verbal and undocumented. If you’re trying to build a case to give your employee a promotion, you can support it more easily if you have plenty of written documentation (including formal performance appraisals) to justify your decision. And if you’re coming to the conclusion that you need to dismiss someone for poor performance, then you must have written evidence, including performance appraisals, that you’ve tried to address performance issues before.

WARNING So, the preceding list gives very important reasons for conducting regular, formal performance appraisals. However, many companies have paid a lot of money to employees and former employees who’ve successfully sued them for wrongful or unfair dismissal, or for other biased and prejudicial employment decisions. Imagine how lonely you’d feel on the witness stand in the following scene, a scene that’s replayed for real in courts of law and employment tribunals the length and breadth of the country:

- **Lawyer:** So, Manager-on-the-spot, would you please tell the court exactly why you terminated Employee X?
- **Manager-on-the-spot:** Certainly, I’ll be glad to. Employee X was a very poor performer – clearly the worst in my department.
- **Lawyer:** During the five years that my client was with your firm, did you ever conduct formal performance appraisals with him?
- **Manager-on-the-spot:** Er … well, no. I meant to, but I’m a very busy person. I was never quite able to get around to it.
- **Lawyer:** Manager-on-the-spot, do you mean to say that, in all the time with your firm, Employee X never received a formal performance appraisal? Exactly how was my client supposed to correct the alleged poor performance when you failed to provide him with the feedback needed to do so?
- **Manager-on-the-spot:** Hmmm …

# Spelling Out the Performance Appraisal Process

One of the most important things you can do as a manager is to conduct accurate and timely performance appraisals of your employees. Many managers, however, tend to see the performance appraisal process in narrow terms: how can I get this thing done as quickly as possible so I can get back to my real job? (Whatever their 'real' job is as managers.) In their haste to get the appraisal done and behind them, many managers merely consider a few examples of recent performance and base their entire appraisal on them. And because few managers give their employees the kind of meaningful, ongoing performance feedback that they need to do their jobs better, the performance appraisal can become a dreaded event – full of surprises and dismay. Or it can be so sugar-coated that it becomes a meaningless exercise in management. Neither scenario is the right way to evaluate your employees.

TIP Have separate discussions for each of the following:

- Pay rises and bonuses
- Promotions
- Career development
- Ways to improve present performance and develop future performance
- Poor performance

Of course, in practice you can't possibly keep each of the topics totally separate from the rest. But you can prioritise; and you need to spell out to the employee the specific purpose of the present discussion.

REMEMBER The performance appraisal process begins on the day that your employees are hired, continues each and every day that they report to you, and doesn't end until, through transfer, promotion, dismissal or resignation, they move out of your sphere of responsibility.

The performance appraisal process is much broader than just the formal, written part of it. The following steps help you encompass the broader scope of the process. Follow them when you evaluate your employees' performance:

1. **Set goals, expectations and standards – together.**

   Before your employees can achieve your goals, or perform to your expectations, you have to set goals and expectations with them and develop standards to measure their performance. After you've done all this, you have to communicate the goals and expectations *before* you evaluate your employees, not after. In fact, the performance review really starts on the first day of work. Tell your employees immediately how you evaluate them, show them the forms to be used and explain the process.

REMEMBER Ensure that job descriptions, tasks and priorities are unambiguous and clear, and that you and your employees understand and agree to the standards set for them. In this two-way process, ensure that employees have a voice in setting their goals and standards and that you have their agreement. Refer to Chapter 5 in Book 3 for more on setting goals.

2. **Give continuous and specific feedback.**

   Catch your employees doing things right – every day of the week – and tell them about it then and there. And if you catch them doing wrong (nobody's perfect!), let them know about that too. Feedback is much more effective when you give it regularly and often than when you save it up for a special occasion (which can become victimisation if the feedback is constantly negative). The best formal performance appraisals contain the fewest surprises.

   WARNING Constantly bombarding your employees with negative feedback has little to do with getting the performance that you want from them and costs you their respect.

3. **Prepare a formal, written performance appraisal with your employee.**

   Every organisation has different requirements for the formal performance appraisal. Some appraisals are simple, one-page forms that require you to tick a few boxes; others are multi-page extravaganzas that require extensive narrative support. The form often varies by organisation, and by the level of the employee being evaluated. Regardless of your organisation's requirements, the formal performance appraisal should be a summary of the goals and expectations for the appraisal period – events that you've discussed previously (and frequently) with your employees. Support your words with examples and make appraisals meaningful to your employees by keeping your discussion relevant to the goals, expectations and standards that you developed in Step 1.

   TIP As a collaborative process, have the employee complete his own performance appraisal. Then compare your (the manager's) comments with the employee's comments – the differences that you find become topics of discussion and mutual goal setting.

4. **Meet employees personally to discuss the performance appraisal.**

Most employees appreciate the personal touch when you give the appraisal. Set aside some quality time to meet them to discuss their performance appraisal. This doesn't mean five or ten minutes, but at least an hour or maybe more. When you plan performance appraisal meetings, less is definitely not more. Pick a place that's comfortable and free from distractions. Make the meeting positive and upbeat. Even when you have to discuss performance problems, centre discussions on ways that you and your employees can work together to solve them.

TIP The tone of performance appraisals and discussions can often become defensive as you raise negative elements and the employee starts to feel that he'll get a small, or no, pay rise. Start with letting the employee share how his job is going, what's working – and what's not – then share your assessment, starting with the positive.

5. **Set new goals, expectations and standards.**

   The performance appraisal meeting gives you and your employee the opportunity to step back from daily issues for a moment and take a look at the big picture. You both have an opportunity to review and discuss the things that worked well and those that, perhaps, didn't work so well. Based on this assessment, you can then set new goals, expectations and standards for the next review period. The last step of the performance appraisal process becomes the first step, and you start all over again.

The entire performance appraisal process consists of setting goals with your employees, monitoring their performance, coaching them, supporting them, counselling and guiding them, and providing continuous feedback on their performance – both good and bad. If you do these things before you sit down for your annual or semi-annual performance appraisal sessions with your employees, reviews will be a pleasant and positive experience, looking at past accomplishments, instead of a disappointment for both you and them.

REMEMBER When it comes to conducting performance appraisals, managers have plenty of things to remember. Here are a few more:

- Communication with employees should be frequent so that no surprises occur (okay, *fewer* surprises). Give your employees informal feedback on their performance early and often.
- The primary focus of performance appraisals should be on going forward – setting new goals, improving future performance – rather than on looking back.
- Learning and development should always be included as a part of the performance appraisal process (although sometimes a discussion about pay rises can be separate).
- You need to make performance appraisal a priority yourself – a part of your 'real' job – you are,

after all, dependent on the performance of your employees for your own success and effectiveness.

## TURNING THE TABLES

Recently a new kind of performance appraisal has emerged. Instead of the typical downward appraisal where managers review their employees' performance, the *upward appraisal process* requires employees to evaluate their managers' performance. If you think that getting a performance appraisal from your manager is uncomfortable, you haven't seen anything yet. Nothing's quite like the feeling you get when a group of your employees appraise you, giving you direct and honest feedback about the things you do that make it hard for them to do a good job. Ouch!

However, despite the discomfort that you may feel, upward appraisal is invaluable – who better to assess your impact on the organisation than your employees? The system works so well that companies such as Federal Express have institutionalised the upward appraisal and made it part of their corporate culture. Surveys show that many of the world's top companies are using some form of the upward performance appraisal to assess the performance of their managers.

Also popular is the 360-degree evaluation. The *360-degree evaluation process* is when you're appraised from all sides – superiors, subordinates, colleagues and anyone from other departments with whom you happen to be working at the time. Levi Strauss & Co, for example, dictates that all employees are evaluated by their supervisors *and* by their underlings and peers.

The results can be a surprise to the manager who's the subject of the appraisal, who may find that other employees see him as less caring and visionary than he thought. A study by Charles Handy many years ago found that 70 per cent of managers and supervisors who rated themselves as caring and concerned were rated in turn as autocratic and distant by employees.

# *Preparing for the No-Surprises Appraisal*

If you're doing your job as a manager, the appraisal holds no surprises for your employees. Follow the lead of the best managers: keep in touch with your employees and give them continuous feedback on their progress. Then, when you do sit down with them for their formal performance appraisal, the session is a recap of the things that you've already discussed during the appraisal period, instead of an ambush. Keeping up a continuous dialogue lets you use the formal appraisal to focus on the positive things that you and your employees can work on together to get the best possible performance.

REMEMBER Above all, be *prepared* for your appraisals!

Like interviews, many managers leave their preparation for performance appraisal meetings to the last possible minute – often just before the employee is scheduled to meet them. 'Oh, no. Cathy is going to be here in five minutes. Now, what did I do with her file? I know it's here somewhere!' The average manager spends about one hour preparing for an employee review covering a whole year of performance.

To avoid this unprofessional and unproductive situation, follow these tips:

- Set time aside, make an appointment with the employee and stick to it.
- Make a clear statement to the employee – 'The purpose of this performance appraisal is as follows …' – and stick to it.

TIP

Performance appraisal is a year-round job. Whenever you recognise a problem with your employees’ performance, mention it to them, make a note of it and drop it in their files. And do the same whenever your employees do something great. Then, when you’re ready to do your employees’ periodic performance appraisals, you can pull out their files and have plenty of documentation on which to base them. This practice makes the process easier for you, and makes the appraisal more meaningful and productive for your employees.

# Book 4

# Keeping on Top of the Books

# Contents at a Glance

# Chapter 1

# Recording the Financial Facts

**IN THIS CHAPTER**

**Making a financial record**

**Holding onto the records**

**Submitting your accounts**

**Dealing with your accountant**

**Preventing fraud and insuring your cash**

If profit is one of the more exciting and interesting aspect of running your own business, keeping track of exactly how that profit is made is almost universally seen as one of the dullest tasks. The work involved in this area is often either left to the last minute, delegated in its entirety to an accountant or bookkeeper, or outsourced.

Nevertheless, as the boss you have to know everything about everything, and accounting and finance is no exception to that rule. In fact it is one area where there are some hard and fast rules imposed and checked up on by regulatory bodies: the guys who make and oversee rules for governments. You can decide whether or not to advertise your wares, where to advertise and to a large extent the format of your adverts. When it comes to recording financial information, however, there are set procedures and formats.

If you aren't going to keep the financial records yourself, and very few owner-managers do, you're going to have to trust someone else to do it for you. That poses two problems that have the potential to give you a few sleepless nights:

- How will you find and choose someone to do your books, and is the person looking after your numbers honest? Accountants and bookkeepers are no more likely to be honest than anyone else in business, and they certainly have more opportunity than most to be dishonest.
- No matter who keeps your financial records, the buck stops with you. You're considered, indeed required, to be financially literate enough to put your signature to the accounts you file, and any mistakes, penalties and fines will end up at your door.

REMEMBER Even if this chapter doesn't change your mind about the topic's wow factor, you do now know why you can't skip it. The buck really does stop with you.

## *Keeping the Books*

To survive and prosper in business, you need to know how much cash you have, what your profit or loss on sales is, who owes you money and who you owe money to. You need these facts on at least a monthly, weekly or occasionally even a daily basis to survive, let alone grow.

## *Recording financial information*

Although bad luck plays a part in a very small number of business failures, a lack of reliable financial information and bad business judgement plays a part in most. However, businesses have all the information they need to manage and make better business decisions close at hand. Among the bills you have to pay, invoices to raise, petty cash slips to file and bank statements to diagnose, you've enough to give you a true picture of your business's performance.

All you need to do is record and organise that information so that the financial picture becomes clear. The way you record financial information is called *bookkeeping* .

REMEMBER Not only the business owner needs these financial facts. Bankers, shareholders and tax inspectors are unsympathetic audiences to anyone without well-documented facts to back them up. If, for example, HM Revenue and Customs (HMRC) presents a business with a tax demand, the onus then lies with the business person, using her records, to agree or dispute the sum claimed.

In any event, if you plan to trade as a limited company (refer to Chapter 2 in Book 1), the Companies Act 2006 requires you to 'keep adequate records sufficient to show and explain the company's transactions'.

REMEMBER Reasons for keeping proper records:

- To know the cash position of your business precisely and accurately
- To discover how profitable your business really is
- To see which of your activities are profitable and which aren't
- To give bankers and other sources of finance confidence that your business is being well managed and that their money is in good hands
- To allow you to calculate your tax bill accurately
- To help you prepare timely financial forecasts and projections
- To make sure that you both collect and pay money due correctly
- To keep accountancy and audit costs to a minimum
- To meet HMRC's requirement to keep proper records

## *Starting simple with single entry*

If you're doing books by hand and don't have a lot of transactions, the single-entry method is the easiest acceptable way to go.

*Single entry* means that you write down each transaction in your records once, preferably on a ledger sheet. You record the flow of income and expenses through your business by making a running total of money taken in (gross receipts) and money paid out (payments or, as they're sometimes called, *disbursements* ). You should keep receipts and payments and summarise them daily, weekly or monthly, as the business needs require. At the end of the year, you total up the 12 monthly summaries. You're ready for tax time.

You may benefit from separating different types of income and expense into categories – for example, stock, vehicles, telephone – as in Figure 1-1 . This separation lets you see how much you're spending or receiving in each area.

| **Payments** | | | | **Analysis** | | | |
|---|---|---|---|---|---|---|---|
| **Date** | **Name** | **Details** | **Amount £** | **Stocks** | **Vehicles** | **Telephone** | **Other** |
| 4 June | Gibbs | Stock purchase | 310 | 310 | | | |
| 8 June | Gibbs | Stock purchase | 130 | 130 | | | |
| 12 June | ABC Telecoms | Telephone charges | 55.23 | | | 55.23 | |
| 18 June | Colt Rentals | Vehicle hire | 87.26 | | 87.26 | | |
| 22 June | VV Mobiles | Mobile phone | 53.24 | | | 53.24 | |
| 27 June | Gibbs | Stock purchase | 36.28 | 36.28 | | | |
| | | | | | | | |
| Totals | | | 672.01 | 476.28 | 87.26 | 108.47 | |



**FIGURE 1-1:** An example of an analysed cash book.

You need to keep copies of paid and unpaid sales invoices and the same for purchases, as well as your bank statements. You then reconcile (match) bank statements to your cash book to tie everything together.

## Dealing with double entry

If you operate a partnership or trade as a company, you may need a double-entry bookkeeping system from the start.

A *double-entry bookkeeping system* requires two entries for each transaction – hence the name – and every transaction has two effects on the accounts. For example, when you buy an item of stock for sale and pay for it in cash, your cash balance goes down and your amount of stock goes up by the same amount, keeping everything in balance.

## Choosing the right accounting program

With the cost of a basic computerised accounting system starting at barely £100, and a reasonable package costing between £200 and £500, planning to use such a system from the outset is sensible. If you're at all concerned as to whether such software represents value, try out Intuit's software on a free trial basis ( `www.intuit.co.uk/quickbooks-accounting-software/self-employed` ). Thereafter it costs around £8 a month. Or, if you can face having adverts pop up from time to time, Wave, which makes cloud-based, integrated software and tools for small businesses, offers a free-forever accounting package at `www.waveapps.com/accounting` .

Using a computerised accounting system means no more arithmetical errors. As long as you enter the information correctly, the computer adds it up correctly. With a computer, the £53.24 mobile phone expenditure in Figure 1-1 is input as an expense (a debit), and then the computer automatically posts it to the mobile phone account as a credit. In effect, the computer eliminates the extra step or the need to master the difference between debit and credit.

REMEMBER A computerised accounting program is only as good as the data you enter into it. Introduce strict end-of-month controls to make sure that you've counted and valued all stock, dealt with all the month's invoices and so on. Without this, your computer program reflects inaccurate data.

Routine tasks, such as filling in tax and value added tax (VAT) returns, take minutes rather than days with a computer. The system can ensure that your returns are accurate and fully reconciled. With a computerised system, invoices are always accurate. You can see at a glance which customers regularly take too long to pay. You've two main options in your choice of your first accounting system:

- **Manual:** If you think that a manual system is best for your purposes, you can get sheets of analysis paper with printed columns for accounting entries, and put in your own headings as appropriate. Or you can buy off-the-shelf sets of books from any office stationer's outlet. These cost anything from £10 to £20 for a full set of ledgers. Hingston Publishing (hingston-publishing.co.uk/accounts-books) produces small business accounts systems for both VAT and non-VAT registered businesses for about £15.
- **Accounting software:** If you decide to take the plunge and go straight for accounting software, you've a myriad of software providers to choose from that serve the small business market with software for bookkeeping. These are a selection of the more popular packages and providers:
  - **Mamut** (www.visma.co.uk/mamutone/), a product from Visma, offers a range of accounting package systems, starting with its Mamut One Office Accounting costing £407 including VAT and a year's support.
  - **QuickBooks** (www.intuit.co.uk/quickbooks/accounting-software.jsp) offers a range of products from around £8 a month up to £30 a month for a system that can automate the VAT return as well as help with budgeting, purchase orders and stock-holding. The software is cloud-based.
  - **SageOne** (http://shop.sage.co.uk/accountssoftware.aspx) is Sage's entry-level product. It costs £5 a month plus VAT, with more sophisticated desktop-based products available for a one-off purchase price of up to £619 plus VAT.

WARNING If you plan to submit your accounts online, you need an accounting system that meets the requirements of HMRC. A range of Internet-filing-enabled software and forms is available from HMRC and commercial software and service suppliers. You can use these to file company tax returns, including accounts and computations, online. HMRC provides a list of software suppliers at www.hmrc.gov.uk/efiling/ctsoft_dev.htm, but doesn't take responsibility for loss, damage or costs incurred by using the software.

## *Outsourcing bookkeeping*

Accountants and freelance bookkeepers can do all your bookkeeping work – at a price. The rate is anything from £20 per hour upwards.

Bookkeeping services range from a basic write-up of the entries and leave-the-rest-to-you approach, through to providing weekly or monthly accounts, perhaps with pointers as to what may be going wrong. Services even exist that act as a virtual finance director, giving you access to a senior accountant who may sit on your board.

REMEMBER Most bookkeeping services have a computer system into which you have to plug your records, so if you're thinking of going down this route, check out which software you require first.

The bookkeeper's most routine but vital task may be doing the payroll. If you don't get this done on time and correctly, both staff and HMRC, for which you have to collect Pay As You Earn (PAYE), become restless. A weekly payroll service for up to ten employees costs upwards of £85 per month. If you pay everyone monthly, the cost drops to about a third of that figure.

If you go down this route, you probably need someone local, so ask around to find someone who uses a bookkeeper and is satisfied. Alternatively, turn to the phone book, or use Service Start ( `http://uk.servicestart.com` ), which gets up to five price quotes from rated bookkeeping service providers all over the UK.

As with an accountant, make sure that a prospective bookkeeper is adequately qualified. The International Association of Book-keepers (IAB; `www.iab.org.uk` ) and the Institute of Certified Bookkeepers ( `www.bookkeepers.org.uk` ) are the two professional associations concerned.

TIP You can check out the letters that anyone in the accounting profession uses after her name or the bodies she claims to be a member of at the Directory of Essential Accountancy Abbreviations, maintained by the Library and Information Service at the Institute of Chartered Accountants in England and Wales ( `www.icaew.com/en/library/subject-gateways/accounting/abbreviations` ).

# Keeping the Right Paperwork

When handling cash, you can see that a lot of paper changes hands, whether from the cash register, deposits into your current accounts or petty cash withdrawals. Therefore, careful documentation is paramount to control the movement of cash into and out of your business properly. And don't forget about organisation; you need to be able to find that documentation if questions about cash flow arise later.

Monitoring cash flow isn't the only reason why you need to keep loads of paperwork. In order to do your taxes and write off business expenses, you need receipts for those expenses. You also need details about the money you pay to employees, and tax and National Insurance contributions collected for your employees, in order to file the proper reports with HMRC. Setting up a good filing system and knowing what to keep and for how long is very important for any small-business person.

## Creating a filing system

To get started setting up your filing system, you need the following supplies:

- **Filing cabinets:** Pretty self-explanatory – you can't have a filing system with nothing to keep the files in.
- **File folders:** Set up separate files for each of your suppliers, employees and customers who buy on credit, as well as files for backup information on each of your transactions. Many bookkeepers file transaction information using the date the transaction was added to their journal. If the transaction relates to a customer, supplier or employee, they add a duplicate copy of the transaction to the individual files as well.

  REMEMBER Even if you have a computerised accounting system, you need to file paperwork related to the transactions you enter into your computer system. You still need to maintain employee, supplier and customer files in hard copy just in case something goes wrong – for example, if your computer system crashes, you need the originals to restore the data. Back up your computerised accounting system's data regularly to minimise the effects of such a crisis. Daily backups are best; one week is the longest you should ever go without a backup.
- **Ring binders:** These binders are great for things you add to regularly and the binders make adding additional pages easy. Make sure that you number the pages as you add them to the binder, so that you can quickly spot a missing page. How many binders you need depends on how many financial transactions you have each accounting period. You can keep everything in one binder, or you may want to set up a binder for the Chart of Accounts and Nominal Ledger and then a separate binder for each of your active journals. The decision is based on what makes your job easier.
- **Expandable files:** These files are the best way to keep track of current supplier activity and any bills that may be due. Make sure that you have:
  - **An alphabetical file:** Use this file to track all your outstanding purchase orders by supplier. After you fill the order, you can file all details about that order in the supplier's individual file in case questions about the order arise later.
  - **A 12-month file:** Use this file to keep track of bills that you need to pay. Simply place the bill in the slot for the month payment is due. Many businesses also use a 30-day expandable file. At the beginning of the month, the bills are placed in the 30-day expandable file based on the dates that they need to be paid. This approach provides a quick and organised visual reminder for bills that are due.

    TIP If you're using a computerised accounting system, you don't need the expandable files because your accounting system can remind you when bills are due. You can also print an Aged Debtor report, which shows you who owes you money, and an Aged Creditor report, which shows you how much money you owe your suppliers and how many days overdue your invoices are.

- **Backup portable hard drives:** These hard drives can be used to back up your computerised system on a daily basis. Keep the backup hard drive in a fire safe or somewhere that will remain unaffected if a fire destroys the business. (A fire safe is the best way to keep critical financial data safe, and is therefore a must for any business.) If you don't have a fire safe, take the backup off-site each night. You can get a 1TB hard drive for as little as £32.
- **Backup to the cloud:** As well as backing up data to a hard drive, you can back it up away from any of your premises to the cloud. If you're using a cloud-based accounting package, this backup happens automatically. Just Google 'cloud storage' to see the myriad of inexpensive storage providers. Just think: If you had a fire at home or in the office where you had stored your backup, you could lose everything, but a commercial backup provider would keep multiple copies of your backup all over the cloud.

## *Working out what to keep and for how long*

As you can probably imagine, the pile of paperwork you need to hold on to can get very large very quickly. As they see their files getting thicker and thicker, most business people wonder what they can toss, what they really need to keep and how long they need to keep it.

Generally, keep most transaction-related paperwork for as long as HMRC can come and audit your books. For most types of audits, that means six years. But if you fail to file your tax return or file it fraudulently (and hopefully this doesn't apply to you), HMRC may question you about it any time, because no time limitations exist in these cases.

HMRC isn't the only reason to keep records around for longer than one year. You may need proof-of-purchase information for your insurance company if an asset is lost, stolen or destroyed by fire or other accident. Also, you need to hang on to information regarding any business loan until paid off, just in case the bank questions how much you paid. After the loan's paid off, ensure that you keep proof of payment indefinitely in case a question about the loan ever arises. Information about property and other asset holdings needs to be kept around for as long as you hold the asset and for at least six years after the asset is sold. You're legally required to keep information about employees for at least three years after the employee leaves.

Keep the current year's files easily accessible in a designated filing area and keep the most recent past year's files in accessible filing cabinets if you have room. Box up records when they hit the two-year-old mark and put them in storage. Make sure that you date your boxed records with information about what they are, when they were put into storage and when you can destroy them. Many people forget that last detail, and boxes pile up until total desperation sets in and no more room is left. Then someone must take the time to sort through the boxes and figure out what needs to be kept and what can be destroyed – not a fun job.

TIP It's a legal requirement to keep information about all transactions for six years. After that, make a list of things you want to hold on to for longer for other reasons, such as asset holdings and loan information. Check with your solicitor and accountant to get their recommendations on what to keep and for how long.

# Filing Your Accounts

If you're trading as a company, you have to file your accounts with Companies House ( www.companieshouse.gov.uk ) each year.

REMEMBER Unless you're filing your company's first accounts, the time normally allowed for delivering accounts to Companies House is nine months from the end of the relevant accounting period for private companies. If you're filing your company's first accounts and they cover a period of more than 12 months, you must deliver them to the registrar within 21 months of the date of incorporation for private companies. Late filing attracts financial penalties, details of which you can find on the Companies House website.

All companies must prepare full accounts for presentation to their shareholders, but small and medium-sized companies can send abbreviated accounts to the registrar of companies. Abbreviated accounts contain little information that can be of use to a competitor. Nothing is given away on turnover or margins, for example, a luxury denied to larger companies. Small companies' accounts (ones with less than £6.5 million turnover, a balance sheet total of less than £3.26 million, and fewer than 50 employees on average, to be precise) delivered to the registrar must contain:

- An abbreviated balance sheet
- Selected notes to the accounts, including accounting policies, share capital, particulars of creditors payable in more than five years and the basis of any foreign currency transactions
- A special auditor's report (unless exempt from audit)

REMEMBER The rules of disclosure are complex and the preceding is only a brief outline of the requirements. If you're unsure about the information that you have to provide, you should take professional advice.

# Managing Your Accountant

REMEMBER Accountancy is just another business discipline, like selling, research, administration or production. So you need to manage, motivate, reward and appraise your accountant, like any other member of staff. Whoever acts as your company accountant, be she a part-timer from outside or a fellow director, you as the owner must take the lead.

Make sure that your accountant is ahead of the curve on the following key points:

- Your monthly management accounts should be available within a week to ten days of the end of each month. You have the wrong accountant or the wrong accounting system if you can't achieve this standard. If you don't yet have monthly management accounts, make that your accountant's next measurable goal.

- Accounting systems and reports should be simple, free of jargon and supported by clear written explanations of the key issues to consider. For example, if profits are down by 10 per cent, as well as the bald figures an explanation that this reduction was caused by a 5 per cent reduction in sales of product X and a 5 per cent increase in raw material costs gives a clear indication of responsibilities and possible remedies.
- Your accountant should also ensure that your books and records are kept to the standard required by company law. She must also see that your accounting policies meet the required standards and that accounts, VAT returns, and PAYE and tax demands are dealt with in a timely manner.

# Protecting Your Business Against Internal Fraud

Many business people start their operations by carefully hiring people they can trust, thinking: 'We're a family – they'd never steal from me.'

Often a business owner finds out too late that even the most loyal employee may steal from the business if the opportunity arises and the temptation becomes too great – or if the employee gets caught up in a serious personal financial dilemma and needs fast cash. In this section, you find out about the steps you can take to prevent people stealing from your business.

## Facing the reality of financial fraud

The four basic types of financial fraud are:

- **Embezzlement,** which is the illegal use of funds by a person who controls those funds. For example, a bookkeeper may use business money for her own personal needs. Many times, embezzlement stories don't appear in the newspapers because business people are so embarrassed that they choose to keep the affair quiet. They usually settle privately with the embezzler rather than face public scrutiny.
- **Internal theft,** which is the stealing of business assets by employees, such as taking office supplies or products the business sells without paying for them. Internal theft is often the culprit behind stock shrinkage.
- **Payoffs and kickbacks,** which are situations in which employees accept cash or other benefits in exchange for access to the business, often creating a scenario where the business that the employee works for pays more for the goods or products than necessary. That extra money finds its way into the pocket of the employee who helped facilitate the access. For example, say Business A wants to sell its products to Business B. An employee in Business B helps Business A get in the door. Business A prices its product a bit higher and gives the employee of Business B the extra profit in the form of a kickback for helping it out. A payoff is paid before the sale is made, essentially saying 'please'. A kickback is paid after the sale is made, essentially saying 'thank you'. In reality, payoffs and kickbacks are a form of bribery, but few businesses report or litigate this problem (although employees are fired when deals are uncovered).
- **Skimming,** which occurs when employees take money from receipts and don't record the revenue in the books.

Although any of these financial crimes can happen in a small business, the one that hits small businesses the hardest is embezzlement. This crime happens most frequently when one person has access or control over most of the business's financial activities. For example, a single bookkeeper may write cheques, make deposits and balance the monthly bank statement – talk about having your fingers in a very big till.

## *Dividing staff responsibilities*

Your primary protection against financial crime is properly separating staff responsibilities when the flow of business cash is involved. Basically, never have one person handling more than one of the following tasks:

- **Bookkeeping:** Involves reviewing and entering all transactions into the business's books. The bookkeeper makes sure that transactions are accurate, valid, appropriate and have the proper authorisation. For example, if a transaction requires paying a supplier, the bookkeeper makes sure that the charges are accurate and someone with proper authority has approved the payment. The bookkeeper can review documentation of cash receipts and the overnight deposits taken to the bank, but shouldn't actually make the deposit. Also, if the bookkeeper is responsible for handling payments from external parties, such as customers or suppliers, she shouldn't enter those transactions in the books.
- **Authorisation:** Involves being the manager or managers delegated to authorise expenditures for their departments. You may decide that transactions over a certain amount must have two or more authorisations before cheques can be sent to pay a bill. Spell out authorisation levels clearly and make sure that everyone follows them, even the owner or managing director of the business. (Remember, as owner, you set the tone for how the rest of the office operates; when you take shortcuts, you set a bad example and undermine the system you put in place.)
- **Dealing with suppliers:** Involves making sure that you're only paying for goods and services that you actually received. You can do this by only checking invoices against delivery notes/goods received notes to make sure you got the goods you're being charged for. Also check off supplier invoices against their statements to make sure that you aren't missing any invoices.
- **Money-handling:** Involves direct contact with incoming cash or revenue, whether cheque, credit card or credit transactions, as well as outgoing cash flow. People who handle money directly, such as cashiers, shouldn't also prepare and make bank deposits. Likewise, the person writing cheques to pay business bills shouldn't be authorised to sign those cheques; to be safe, have one person prepare the cheques based on authorised documentation and a second person sign those cheques, after reviewing the authorised documentation.

  TIP When setting up your cash-handling systems, try to think like an embezzler to figure out how someone can take advantage of a system.
- **Financial report preparation and analysis:** Involves the actual preparation of the financial reports and any analysis of those reports. Someone who's not involved in the day-to-day entering of transactions in the books needs to prepare the financial reports. For most small businesses, the bookkeeper turns over the raw reports from the computerised accounting system

to an outside accountant, who reviews the materials and prepares the financial reports. In addition, the accountant does a financial analysis of the business activity results for the previous accounting period.

TIP We realise that you may be just starting up a small business and therefore not have enough staff to separate all these duties. Until you do have that capability, make sure that you stay heavily involved in the inflow and outflow of cash in your business. The following tips tell you how:

- **Periodically (once a month) open your business's bank statements and review the transactions.** Someone else can be given the responsibility of reconciling the statement, but you still need to keep an eye on the transactions listed.
- **Periodically look at your business cheque book counterfoils to ensure that no cheques are missing.** A bookkeeper who knows that you periodically check the books is less likely to find an opportunity for theft or embezzlement. If you find that a cheque or page of cheques is missing, act quickly to find out if the cheques were used legitimately. If you can't find the answer, call your bank and put a stop on the missing cheque numbers.
- **Periodically observe your cashiers and managers handling cash to make sure that they're following the rules you've established.** This practice is known as *management by walking around* – the more often you're out there, the less likely you are to be a victim of employee theft and fraud.

## CAUGHT WITH FINGERS IN THE TILL

Alice is a bookkeeper who's been with Business A for a long time. She was promoted to office manager after being with the business for 20 years. She's like a family member to the business owner, who trusts her implicitly. Because he's so busy with other aspects of running the business, he gives her control of the daily grind of cash flow. The beloved office manager handles or supervises all incoming and outgoing cash, reconciles the bank statements, handles payroll, signs all the cheques and files the business's tax returns.

All that control gives her the opportunity, credibility and access to embezzle a lot of money. At first, the trust is well founded, and Alice handles her new responsibilities very well. But after about three years in the role as office manager, she develops a gambling habit and the debts mount up.

Alice decides to pay herself more money. She adds her husband to the payroll and documents the cheques for him as consulting expenses. She draws large cash cheques to buy non-existent office supplies and equipment, and then, worst of all, she files the business's tax returns and pockets the money that should go to paying the tax due. The business owner doesn't find out about the problem until HMRC comes calling, and by then, the office manager has retired and moved away.

This story may sound far-fetched, but you can read about similar embezzlement schemes in the national newspapers.

## *Balancing control costs*

As a small-business person, you're always trying to balance the cost of protecting your cash and assets with the cost of adequately separating those duties. Putting in place too many controls, which end up costing you money, can be a big mistake. For example, you may create stock controls that require salespeople to contact one particular person who has the key to your product warehouse.

This kind of control may prevent employee theft, but can also result in lost sales, because salespeople can’t find the key-holder while dealing with an interested customer. In the end, the customer gets mad, and you lose the sale.

TIP When you put controls in place, talk to your staff both before and after instituting the controls to see how they’re working and to check for any unforeseen problems. Be willing and able to adjust your controls to balance the business needs of selling your products, managing the cash flow and keeping your eye on making a profit. Talk to other business people to see what they do and pick up tips from established best practice. Your external accountant can be a good source of valuable information.

REMEMBER Generally, as you make rules for your internal controls, make sure that the cost of protecting an asset is no more than the asset you’re trying to protect. For example, don’t go overboard to protect office supplies by forcing your staff to wait around for hours to access needed supplies while you and a manager are at a meeting away from the office.

Ask yourself these four questions as you design your internal controls:

- What exactly do I want to prevent or detect – errors, sloppiness, theft, fraud or embezzlement?
- Do I face the problem frequently?
- What do I estimate the loss to be?
- What is the cost to me of implementing the change in procedures to prevent or detect the problem?

You can’t answer all these questions yourself, so consult with your managers and the staff the changes are likely to impact. Get their answers to these questions and listen to their feedback.

TIP When you finish putting together the new internal control rule, ensure that you document why you decided to implement the rule and the information you collected in developing it. After the rule’s been in place for a while, test your assumptions. Make sure that you are in fact detecting the errors, theft, fraud or embezzlement that you hoped and expected to detect. Check the costs of keeping the rule in place by looking at cash outlay, employee time and morale, and the impact on customer service. If you find any problems with your internal controls, take the time to fix them and change the rule, again documenting the process. Detailed documentation ensures that, if two or three years down the road someone questions why she is doing something, you have the answers and are able to determine whether the problem is still valid, as well as whether the rule is still necessary or needs to be changed.

## *Insuring Your Cash through Fidelity Bonds*

Employers can insure themselves against the loss of money through embezzlement by employees. A *fidelity bond* is a form of insurance that companies can take out to protect themselves against financial loss caused by employee theft or dishonesty. If an employee steals from you or one of your customers, the insurance covers the loss.

This type of insurance is a specialist one and can be packaged up with your normal business insurance. The cost varies greatly depending on the type of business you operate and the amount of cash or other assets that are handled by the employees you want to bond. Ask your insurance broker to get an accurate quotation for your business.

# Chapter 2

# Managing Your Tax Position

## IN THIS CHAPTER

**Finding out how much tax you have to pay**

**Looking at ways to cut that bill, legally**

**Seeing how to handle employment taxes**

**Getting through a tax investigation intact**

The government raised £515.3 billion in taxes in 2014/15 in one form of tax or another, equivalent to roughly £11,500 for every adult in the UK. Not only is the amount colossal but now about a zillion ways exist in which tax is raised. Aside from income tax, which only accounts for a quarter of the money raised, you have value added tax (VAT) and national insurance (NI), which most people brush across. Then you have taxes or reliefs from paying tax on fuel, capital gains, capital expenditure, research and development, business rates, excise duty, a climate change levy, air passenger duty, landfill tax, an aggregates levy, small company tax relief, vehicle excise duties and stamp duties, to mention but a few that the successful owner-manager can expect to encounter. Each of these tax categories in turn has a number of its own categories. VAT, for example, is levied at a standard rate, reduced rate, zero rate and exempt from VAT altogether, and the government shifts about the 50 or so product and service categories within each VAT category from time to time. The government has made some 50 major changes to the tax system in the UK since 1979 and a couple of thousand minor ones.

If you think that all, or even most, of the profit you make in your business comes your way, think again. The government takes a sizeable slice of everything you make, in one way or another, and gets very nasty if you try to evade its clutches. You may be starting your first business, but government agencies have had centuries to hone their skills in extracting their pound of flesh. Since 1842, when income tax was reintroduced into Britain, everyone in business has been required to account for their income and profits.

Before you reach for your passport and head offshore, taxing entrepreneurs is a fact of life in almost every country in the world, though both the amounts and methods of assessment vary widely. Surprisingly enough, the tax climate in the UK is relatively benign and people here pay less than most. So although you may have to pay tax, you don't have to pay too much. As a Morgan Stanley advert succinctly puts it, 'You must pay taxes. But there's no law that says you gotta leave a tip.'

What follows is a guide to the taxes you should prepare to face, rather than an accurate statement of the amounts involved. In any normal year many tax rates change, and since the credit crunch the pace of those changes has accelerated sharply. VAT, for example, moved from 17.5 per cent to 15 per cent and then back to 17.5 per cent, and is currently at 20 per cent during the writing of this edition – and all that in the space of a year or so. Add that to the changes that will come in if

Scottish devolution ever comes to pass and their strong case for devolving corporation tax to the Scottish Parliament is upheld, and the next few years could be even more volatile. (Scotland, by the way, is pushing for a lower rate of corporation tax than that applying to the UK as a whole, as indeed is Northern Ireland. Soon, there may be some new tax havens close to home.)

TECHNICAL STUFF A survey of the UK tax system as it stood at November 2014 ( www.ifs.org.uk/bns/bn09.pdf ) by the Institute for Fiscal Studies outlines the amount of tax raised by category and the changes and new taxes introduced since 1979. Not exactly bedtime reading, more a horror story.

TIP You can keep up to date with all the taxes that apply to business in the UK on the Gov.uk website ( www.gov.uk/browse/business/business-tax ).

# Tackling Taxes for Different Types of Businesses

The government treats sole traders, partnerships and limited companies differently for tax purposes, so the following sections look at each in turn.

REMEMBER Managing your tax position is one area in which timely professional advice is essential. Advice is even more important because tax rules can change every year. Good advice can both help to reduce your overall tax bill and increase the value of profits to the business.

## Figuring out sole traders and partnerships

A partnership is treated as a collection of sole traders for tax purposes, and each partner's share of that collective liability has to be worked out. If you're a *sole trader* (in other words, self-employed), your income from every source is brought together and the profit is taxed altogether. Income from business is one of a number of headings on your general tax return form.

In the UK, the key taxes that you need to calculate are:

- Income tax on profits
- Self-employed NI contributions
- VAT based on your trading activity
- Capital gains tax, on the disposal of *fixed assets* such as property at a profit, or when the whole business is sold
- Inheritance tax, paid on death or when certain gifts are made

Neither of the last two taxes is likely to occur on a regular basis, nor do they occur in the first few years in business, so they aren't covered here. When those taxes do come into play, the sums involved are likely to be significant and you should take professional advice from the outset.

### *Adding up income tax*

Under the self-assessment tax system in the UK, you pay taxes for your accounting year in the calendar year in which that accounting year ends. Special rules apply for the first year and the last year of trading to ensure tax is charged fairly.

If your turnover is low – currently in the UK less than the VAT threshold of £83,000 per year – you can summarise your income on three lines: sales, expenses and profit (see this factsheet for details: `www.gov.uk/government/publications/self-assessment-the-three-line-account-what-you-need-to-know`). If your turnover is above the minimum, you have to summarise your accounts to show turnover, gross profit and expenses by account categories, such as vehicle running costs, advertising, telephone and rent.

No matter how you account for your business income, as a sole trader or partnership you get to deduct a personal allowance amount from your profit figure, paying income tax on your profit minus your personal allowance. The personal allowance is the current threshold below which you don't pay tax.

### *Self-employed national insurance*

You calculate self-employed NI based on taxable profits. The percentage you pay depends on what range your profits fall in. Expect to pay around 9 per cent if the number falls in a range from approximately £8,060 to £43,000. Above that figure, you pay 2 per cent. The percentage is paid in addition to the flat-rate Class 2 NI contributions of about £2.80 per week. Note that if you are over 65 for the full tax year, you don't currently have to pay either Class 2 or Class 4 contributions (one of the benefits of being over the retirement age).

REMEMBER All these rates and amounts change in March of every year, but the broad principles remain the same. You can find the latest NI contribution rates on the website of HM Revenue and Customs (HMRC) at `www.hmrc.gov.uk/rates/nic.htm`.

## *Looking at levies on companies*

Companies have a legal identity separate from those who work in them, whether or not those workers also own the company. Everyone working in the business is taxed as an employee. The company is responsible through the Pay As You Earn (PAYE) system for collecting tax and passing it to the tax authorities.

TECHNICAL STUFF Directors' salaries are a business expense, just as with any other wages, and are deducted from the company's revenues in arriving at its taxable profits.

Companies in the UK pay tax in three main ways at rates that can change each year. The current company tax rates are published on the HMRC website (`www.hmrc.gov.uk/rates/corp.htm`):

- **Corporation tax** is paid on the company's profits for the year, as calculated in the tax-adjusted profits. The only main rate of corporation tax in the UK is paid at 20 per cent of taxable profits. Corporation tax is payable nine months after the end of the accounting period.
- **Dividend payment taxes** are levied on the distribution of profit to shareholders. This arrangement gives the appearance of taxing the same profit twice, but through a process of tax credits this double taxation doesn't generally occur. When a shareholder gets a dividend from a company, it comes with a tax credit attached, which means that any shareholder who pays the basic rate of tax won't have to pay any more tax. Higher-rate taxpayers, however, do have a further amount of tax to pay.
- **Capital gains tax** is owed if a company sells an asset, say a business property, at a profit. This capital gain is taxed along the general lines of corporation tax, with lower rates applying to smaller companies.

## Assessing the best legal structure

The most important rule is 'never let the tax tail wag the business dog'. Tax is just one aspect of business life. If you want to keep your business finances private, the public filing of accounts required of companies isn't for you. However, if you want to protect your private assets from creditors if things go wrong, being a sole trader or partner probably isn't the best route to take.

Company profits and losses are locked into the company, so if you've several lines of business using different trading entities, you can't easily settle losses in one area against profits in another. But because sole traders are treated as one entity for all their sources of income, they've more scope for netting off gains and losses.

The whole area of company structure is complicated and depends heavily on what you want to achieve. For example, if you want to maximise your entitlement to make pension contributions, then a strategy that's tax efficient – for example, incorporating (as turning yourself into a limited company is known) – may be a bad idea. Get professional financial advice before you make any decision in this area.

TIP Whiting Partners, a firm of chartered accountants and business advisors, has a useful guide to help you decide, from a tax perspective, which legal structure would be best for you at various levels of annual profits. Check out www.whitingandpartners.co.uk/News/Limited-Company-v-SoleTrader.

# Paying Taxes

Most businesses encounter two taxes at some point; the more successful you are, the sooner you get swept into the taxman's net. Value added tax (VAT) is a tax based on your turnover less your expenses that have carried VAT, and the second – business tax – is based on the profit you make. The HMRC website (www.hmrc.gov.uk) contains all the latest tax rates and details of almost everything you're likely to need to complete your tax returns correctly.

# Valuing VAT

As well as paying tax on profits, every business over a certain size has, in effect, to collect taxes too. VAT is a tax on consumer spending. VAT is a European system, although most countries have significant variations in VAT rates, starting thresholds and the schemes themselves.

TIP HMRC produces a range of leaflets, factsheets and booklets on VAT and other areas of taxation for guidance only ( www.hmrc.gov.uk/leaflets ). For the latest rules and rates go to www.hmrc.gov.uk/businesses . If in doubt (and the language isn't easy to understand), ask your accountant or the local branch of HMRC; after all, they prefer to help you to get it right in the first place than have to sort it out later when you've made a mess of it.

You get no reward for collecting VAT, but you're penalised for making mistakes or for sending returns in late. Read on for the nitty-gritty of what you need to do.

## Registering for VAT

VAT is a complicated tax. The general rule is that all supplies of goods and services are taxable at the standard rate (anything between 5 and 20 per cent is possible) unless the law specifically states they're to be zero rated or exempt.

You can register voluntarily for VAT at any time at the HMRC website ( www.hmrc.gov.uk/vat/start/register/signup-online.htm ), but you must register your business for VAT if your taxable turnover – that is, your sales (not profit) – exceeds £83,000 in any 12-month period or looks as though it may reasonably be expected to do so. This rate is reviewed each year in the budget and changes frequently. (The UK is significantly out of line with many other countries in Europe, where VAT entry rates are much lower.)

In deciding whether your turnover exceeds the limit, you must include your zero-rated sales (things like most unprocessed foodstuffs, books and children's clothing) because they're technically taxable; but the rate of tax is 0 per cent. Leave out exempt items like the provision of health and welfare, finance and land. Currently, you don't have to include business done overseas in your VAT calculations.

REMEMBER It sometimes pays to register even if you don't have to – if you're selling mostly zero-rated items, for example, because you can reclaim VAT that you've paid out on purchases. Also, being registered for VAT may make your business look more professional to your potential customers.

TIP You can find out how and when to register for VAT at the HMRC website ( www.hmrc.gov.uk/vat/start/register/ ).

## Calculating VAT

You may need to extend the simple bookkeeping system described in Chapter 1 of Book 4 to accommodate VAT records. For example, the analysed cash book you use in a simple system needs additional columns to accommodate the pre-VAT sales, the amount of VAT and the total of those two figures.

Calculating the VAT element of any transaction can be confusing. Following these simple steps helps you always get it right:

1. **Take the gross amount of any sum (items you sell or buy) – that is, the total including any VAT – and divide it by 120, if the VAT rate is 20 per cent.**

   If the rate is different, add 100 to the VAT percentage rate and divide your transaction amount, including VAT, by that number.
2. **Multiply the result from Step 1 by 100 to get the pre-VAT total.**
3. **Multiply the result from Step 1 by 20 to arrive at the VAT element of the bill.**

### *Completing the VAT return*

VAT returns are where a computer-based bookkeeping system wins hands down. The accounting package automatically generates VAT returns. All you have to do is enter the current VAT rate. If you get web-enabled software updates, you may not even have to do this.

Basically, VAT inspectors are interested in three figures:

- The amount of VAT you collected on the goods and services you sold.
- The amount of VAT collected from you by those who've sold you goods and services.
- The difference between those two sums. If the difference is positive, that's the amount of VAT due to be paid. If the number is negative, you're entitled to reclaim that amount.

For a business, VAT is a zero-sum game – you don't make money and you don't pay money – the end consumer picks up the tab.

The final two numbers are a check on the reasonableness of the whole sum. You have to show the value of your sales and purchases, minus VAT, for the period in question.

There are some special VAT schemes that apply to special trades. For example, trades like used car sales, auction houses, works of art and collectors' items can take advantage of a margin scheme. They charge VAT on the difference between what they paid for the item and what it was sold at, rather than the full selling price. Under this scheme you charge VAT at 16.67 per cent (one-sixth) on the difference. You can find out more by looking at `www.gov.uk/vat-margin-schemes/overview`.

The person registered for VAT has to sign the VAT return. Remember that a named person is responsible for VAT – a limited company is treated as a person in this instance. Not only are you acting as an unpaid tax collector, but you also face penalties for filing your return late or incorrectly. You have to keep your VAT records for six years and periodically you can expect a visit from a VAT inspector.

### Sending in VAT returns

Each quarter, or each year if you take that option, you have to complete a return that shows your purchases and the VAT you paid on them, and your sales and the VAT you collected on them. The VAT paid and collected are offset against each other and the balance sent to HMRC. If you paid more VAT in any quarter than you collected, you get a refund.

To help smaller businesses (annual turnover less than £150,000) that may struggle with the more traditional VAT return, HMRC has introduced the Flat Rate Scheme (FRS), which enables eligible businesses to calculate their VAT payment as a percentage of their total turnover. You still have to put VAT on your sales invoices, but you don't have to do the input and output tax return to settle up your VAT. Your VAT liability is agreed as a percentage of all your sales. This percentage is allocated by HMRC based on the type of trade your business carries out. You can find out more about the FRS at www.hmrc.gov.uk/vat/start/schemes/flat-rate.htm.

REMEMBER Virtually all VAT-registered businesses must submit their VAT returns online and pay any VAT due electronically. The very few exceptions include businesses going into insolvency and those businesses run by practising members of a religious society whose beliefs prevent them from using computers. You can find out all about completing your VAT return online and paying the tax due electronically at www.gov.uk/vat-returns.

### Choosing cash or income accounting

Generally, VAT is levied on invoiced sales, so in theory and often in practice occasions can arise when you have to pay VAT on sums you haven't collected yourself. This unhappy state of affairs can happen if you send out an invoice at the end of the quarter and your customer hasn't paid by the time you have to make the VAT return. If this situation proves a major problem, you can usually elect to pay VAT on a cash basis, rather than the strictly more correct income recognition basis that's triggered when you send out your invoices.

TIP You can find out whether you're eligible to operate a cash VAT scheme at www.hmrc.gov.uk/vat/start/schemes/cash.htm.

## Minimising tax on profit

You have no reason to arrange your financial affairs in such a way that you pay the most tax! While staying within the law by a safe margin, you can explore ways to *avoid* as opposed to *evade* tax liabilities. This avoidance is a complex area and one subject to frequent change. The tax authorities try most years to close loopholes in the tax system, while highly paid tax accountants and lawyers try even harder to find new ways around the rules.

TIP Here are some of the areas to keep in mind when assessing your tax liability:

- Make sure that you include all allowable business expenses. Especially when you've recently set up in business, you may not be fully aware of all the expenses that you can claim. Discuss this with your accountant and check out HMRC's website (www.gov.uk/expenses-if-youre-self-employed) for more information.
- If your business creates any products or services that have intellectual property rights, you may be eligible to claim research and development credits, which can amount to 230 per cent of the actual expenditure. This is available only to limited companies and is quite complex so you will need help. Have a look at www.gov.uk/guidance/corporation-tax-research-and-development-rd-relief.
- If you've made losses in any tax period, under certain circumstances you may carry them forward to offset future taxable profits or backward against past profits.
- You can defer paying capital gains tax if you plan to buy another asset with the proceeds. This arrangement is known as *rollover relief* and you can use it normally up to three years after the taxable event. Check out this website for the latest position on this and other capital gains tax reliefs: www.gov.uk/business-asset-rollover-relief.
- Pension contributions reduce your taxable profits. You may even be able to set up a pension scheme that allows you some say over how those funds are used. For example, your pension fund can be used to finance your business premises. The pension fund in effect becomes your landlord. The company then pays rent, an allowable business expense, into your pension fund, which grows tax free.
- If you do intend to buy capital assets for your business, bring forward your spending plans to maximise the use of the *writing-down allowance*, which is the portion of the cost of the asset you can set against tax in any year. For example, if you propose to buy a computer or a very low-emission motor vehicle, you may be allowed to charge 100 per cent of the cost in the year you make the purchase. And if you know in March that you intend to buy a new computer later that year, by making the purchase before 5 April you can take the writing-down allowance in that tax year. If you delay until after that date, you have to wait until the following tax year to get the benefit of a lower tax bill. Find out more on this subject at www.gov.uk/capital-allowances.
- Identify non-cash benefits that you and others working for you can take instead of taxable salary. For example, a share option scheme may achieve the same, or better, level of reward, with less tax payable.
- Examine the pros and cons of taking your money out of a limited company by way of dividends or salary. These routes are taxed differently and may provide scope for tax reduction.
- If your spouse has no other income from employment, they can earn a sum equivalent to their annual tax-free allowance (currently about £10,800) by working for your business. HMRC is currently looking hard at the taxation of civil partnerships and companies, so check with your accountant to confirm what is allowed.
- If you incurred any pre-trading expenses at any stage over the seven years before you started up in business, you can probably treat them as if you incurred them after trading started. Such expenses can include market research, designing and testing your product or service, or capital

items such as a computer bought before you started trading and then brought into the assets of your business.
- You may be able to treat the full purchase price of business assets you bought through hire purchase in your capital allowances calculation.

This list is indicative rather than comprehensive. Taxation is a field in which timely professional advice can produce substantial benefits in the form of lower tax bills.

TIP Tax Cafe ( www.taxcafe.co.uk/business-tax.html ) publishes a range of regularly updated business tax advice guides aimed at anyone wanting to find out how to pay less tax legally.

# Handling Employment Taxes

Not only must you pay tax on your business profits and collect VAT from suppliers for onward transmission to an ever-hungry exchequer, but you also have to look after your employees' tax affairs too. As an employer you have a legal responsibility to ensure that an employee's taxes are paid, and you can end up picking up the tab yourself if the employee fails to. So ensure that you collect tax from your employees' pay before paying them.

Employers must send a Full Payment Submission (FPS) to tell HMRC about payments to your employees and what deductions have been made on or before the employees' payday.

The law requires that employers *must* provide their staff with itemised pay statements, known as payslips. These payslips must show

- Gross pay
- Net pay
- Any deductions (stating the amounts of each item and the reason the deductions are made)

WARNING As an employer, you've a legal obligation to operate PAYE on the payments you make to your employees if their earnings reach the NI lower earnings limit (LEL). The HMRC website has details on the basics of employment taxes and related matters ( www.gov.uk/guidance/rates-and-thresholds-for-employers-2015-to-2016 ).

# Surviving a Tax Investigation

If your books are in good order and you honestly report your income and expenses, you should have little trouble from the authorities. However, serious penalties exist for tax misdemeanours, and you're required to keep your accounts for six years. So if at any point tax authorities become suspicious, they can dig into the past even after they've agreed your figures – back six years if they suspect you've been careless, and back 20 years if they believe you've intentionally filed false accounts.

WARNING If you’re found to have underpaid tax, you have to pay any tax you owe, plus interest, as well as a penalty of up to 100 per cent of the tax owed. These penalties are big business for HMRC: in the 2014/15 tax year, HMRC claimed £295 million in yield from the deterrent effect of its additional 1,000 prosecutions; despite this, they estimate that losses to tax fraud still amount to £16 billion each year.

A tax investigation can be triggered for a variety of reasons, ranging from the banal to the frankly terrifying. A number of businesses are put under the spotlight each year, and you may just be pulled out of the hat. Or you may be in an industry that for one reason or another is being investigated generally. However, the more likely reason is that your accounts have shown major and unexplained changes (unusually high expenses, for example) or that you’ve been noticed for having a lifestyle inconsistent with the profits you’re reporting. This revelation can come about through a diligent tax inspector, an envious neighbour, a disgruntled former spouse or employee, or indiscreet gossip in the pub.

REMEMBER However the investigation is triggered, you need professional advice from your accountant immediately. And it would certainly be prudent to protect yourself from any problems by getting insurance against a tax, VAT or NI investigation.

TIP Joining the Federation of Small Business gives you immediate professional support and essential protection for tax matters (www.fsb.org.uk/tax-protection). This professional support will only help you defend the HMRC investigation; it does not cover you for any subsequent fines and reclaimed tax. Membership starts at £120 a year, plus a £30 joining fee, plus VAT. Also check out The Tax Donut, which has useful advice on dealing with a tax enquiry (www.taxdonut.co.uk/tax/tax-problems-and-investigations/tax-investigations).

# Chapter 3

# How Investors Read a Financial Report

**IN THIS CHAPTER**

**Using ratios to understand profit performance**

**Discovering financial information**

**Paying attention to what the auditor has to say**

**Scanning footnotes and identifying the important ones**

In reading financial reports, directors, managers, business owners and your investors, both actual and potential, need to know how to navigate through the financial statements to find the vital signs of progress and problems. The financial statement ratios explained in this chapter point the way – these ratios are signposts on the financial information highway. You can also keep abreast of business affairs by reading financial newspapers and investment magazines, and investment newsletters are very popular. These sources of financial information refer to the ratios discussed in this chapter, on the premise that you know what the ratios mean. Most managers or individual investors in public companies don't have the time or expertise to study a financial report thoroughly enough to make decisions based on the report, so they rely on stockbrokers, investment advisers and publishers of credit ratings (like Standard & Poor's) for interpretations of financial reports. The fact is that the folks who prepare financial reports have this kind of expert audience in mind; they don't include explanations or mark passages with icons to help *you* understand the report.

You may have your own accountant or investment adviser on tap, and so perhaps you're wondering why you should bother reading this chapter if you rely on others to interpret financial reports anyway? Well, the more you understand the factors that go into interpreting a financial report, the better prepared you are to evaluate the commentary and advice of stock analysts and other investment experts. If you can at least nod intelligently while your stockbroker talks about a business's P/E and EPS, you'll look like a savvy investor – and may get more favourable treatment. (P/E and EPS, by the way, are two of the key ratios explained in this chapter.)

This chapter gives you the basics for comparing companies' financial reports, including the points of difference between private and public companies, the important ratios that you should know about, and the warning signs to look out for on audit reports.

## *Analysing Financial Reports with Ratios*

Financial reports have lots of numbers in them. (Duh!) The significance of many of these numbers is not clear unless they're compared with other numbers in the financial statements to determine the relative size of one number to another number. One very useful way of interpreting financial reports is to compute *ratios* – that is, to divide a particular number in the financial report by another. Financial report ratios are also useful because they enable you to compare a business's current performance with its past performance or with another business's performance, regardless of whether sales revenue or net income was bigger or smaller for the other years or the other business. In other words, using ratios cancels out size differences.

The following sections explain the financial statement ratios that you're most likely to run into. Here's a general overview of why these ratios are important:

- **Gross margin ratio and profit ratios:** You use these ratios to measure a business's profit performance with respect to its sales revenue. Sales revenue is the starting point for making profit; these ratios measure the percentage of total sales revenue that is left over as profit.
- **Earnings per share (EPS), price/earnings (P/E) ratio and dividend yield:** These three ratios revolve around the market price of shares, and anyone who invests in publicly owned businesses should be intimately familiar with them. As an investor, your main concern is the return you receive on your invested capital. Return on capital consists of two elements:
    - Periodic *cash dividends* distributed by the business
    - Increase (or decrease) in the *market price* of the shares

  Dividends and market prices depend on earnings – and there you have the relationship among these three ratios and why they're so important to you, the investor. Major newspapers report P/E ratios and dividend yields in their stock market activity tables; stockbrokers' investment reports focus mainly on forecasts of EPS and dividend yield.
- **Book value per share and return on equity (ROE):** Shares for private businesses have no ready market price, so investors in these businesses use the ROE ratio, which is based on the value of their ownership equity reported in the balance sheet, to measure investment performance. Without a market price for the shares of a private business, the P/E ratio cannot be determined. EPS can easily be determined for a private business but does not have to be reported in its profit and loss account.
- **Current ratio:** This ratio indicates whether a business should have enough cash to pay its liabilities.

See Figures 3-1 (profit and loss account) and 3-2 (balance sheet) for a business example. Notice that a cash flow statement is not presented here – mainly because no ratios are calculated from data in the cash flow statement. The footnotes to the company's financial statements are not presented here, but the use of footnotes is discussed in the following sections.

(Amounts in thousands, except per share amounts)

**Profit and Loss Account for Year**

| | |
|---|---|
| Sales Revenue | £ 52,000 |
| Cost of Goods Sold Expense | 31,200 |
| Gross Margin | £ 20,800 |
| Sales, Administration, and General Expenses | 15,600 |
| Depreciation Expense | 1,650 |
| Earnings Before Interest and Tax | £ 3,550 |
| Interest Expense | 750 |
| Earnings Before Tax | £ 2,800 |
| Corporation Tax Expense | 900 |
| Net Income | £ 1,900 |
| Earnings Per Share | £ 2.39 |



**FIGURE 3-1:** A sample profit and loss account.

## *Gross margin ratio*

Making bottom-line profit begins with making sales and earning enough gross margin from those sales, as explained in Chapter 3 in Book 2. In other words, a business must set its sales prices high enough over product costs to yield satisfactory gross margins on its products, because the business has to worry about many more expenses of making sales and running the business, plus interest expense and income tax expense. You calculate the *gross margin ratio* as follows:

Gross margin ÷ sales revenue = gross margin ratio

So a business with a £20.8 million gross margin and £52 million in sales revenue (refer to Figure 3-1 ) ends up with a 40 per cent gross margin ratio. Now, if the business had only been able to earn a 41 per cent gross margin, that one additional point (one point is 1 per cent) would have caused a jump in its gross margin of £520,000 (1 per cent × $52 million sales revenue) – which would have trickled down to earnings before income tax. Earnings before income tax would have been 19 per cent higher (a $520,000 bump in gross margin ÷ $2.8 million income before income tax) . Never underestimate the impact of even a small improvement in the gross margin ratio. An established business saying states that every extra pound earned at the gross margin level drops down to the bottom line.

WARNING Outside investors know only the information disclosed in the external financial report that the business releases. They can’t do much more than compare the gross margin for the two- or three-yearly profit and loss accounts included in the annual financial report. Although publicly owned businesses are required to include a management discussion and analysis (MD&A) section that should comment on any significant change in the gross margin ratio, corporate managers have wide latitude in deciding what exactly to discuss and how much detail to go into. You definitely should read the MD&A section, but it may not provide all the answers you’re looking for. You have to search further in stockbroker releases, in articles in the financial press or at the next professional business meeting you attend.

Managers focus on *contribution margin per unit* and *total contribution margin* to control and improve business profit performance. Contribution margin equals sales revenue minus product costs and other variable operating expenses of the business. Contribution margin is profit before the company’s total fixed costs for the period are deducted. Changes in the contribution margins per unit of the products sold by a business and changes in its total fixed costs are extremely important to know when it comes to managing profit.

However, businesses don’t disclose contribution margin information in their *external* financial reports – they wouldn’t even think of doing so. This information is considered to be proprietary in nature; it should be kept confidential and out of the hands of its competitors. In short, investors do not have access to information about the business’s contribution margin. Neither accounting standards nor the Stock Exchange requires that such information be disclosed. The external profit and loss account discloses gross margin and operating profit, or earnings before interest and income tax expenses. However, the expenses between these two profit lines in the profit and loss account are not separated between variable and fixed (refer to Figure 3-1 ).

## Profit ratio

Business is motivated by profit, so the *profit ratio* is very important, to say the least. The profit ratio indicates how much net income was earned on each £100 of sales revenue:

Net income ÷ sales revenue = profit ratio

For example, the business in Figure 3-1 earned £1.9 million net income from its £52 million sales revenue, so its profit ratio is 3.65 per cent, meaning that the business earned £3.65 net income for each £100 of sales revenue.

A seemingly small change in the profit ratio can have a big impact on the bottom line. Suppose that this business had earned a profit ratio of 5 per cent instead of 3.65 per cent. That increase in the profit ratio translates into a £700,000 increase in bottom-line profit (net income) on the same sales revenue.

Profit ratios vary widely from industry to industry. A 5–10 per cent profit ratio is common in most industries, although some high-volume retailers, such as supermarkets, are satisfied with profit ratios around 1 per cent or 2 per cent.

TECHNICAL STUFF

You can turn any ratio upside down and come up with a new way of looking at the same information. If you flip the profit ratio over to be sales revenue divided by net income, the result is the amount of sales revenue needed to make £1 profit. Using the same example, £52 million sales revenue ÷ £1.9 million net income = 27.37 to 1 upside-down profit ratio, which means that this business needs £27.37 in sales to make £1 profit. So you can say that net income is 3.65 per cent of sales revenue, or you can say that sales revenue is 27.37 times net income – but the standard profit ratio is expressed as net income divided by sales revenue.

## Earnings per share

Publicly owned businesses, according to generally accepted accounting principles (GAAP), must report *earnings per share (EPS)* below the net income line in their profit and loss accounts – giving EPS a certain distinction among the ratios. Why is EPS considered so important? Because it gives investors a means of determining the amount the business earned on their share investments: EPS tells you how much net income the business earned for each share you own. EPS is also important for assessing whether the company is earning enough to protect future dividend payments. The essential equation for EPS is as follows:

Net income ÷ total number of capital stock shares = EPS

For the example in Figures 3-1 and 3-2 , the company's £1.9 million net income is divided by the 795,000 shares of stock the business has issued to compute its £2.39 EPS.

(Amounts in thousands)

**Balance Sheet at End of Year**

| | | |
|---|---|---|
| **Assets** | | |
| Cash | £ 3,500 | |
| Debtors | 5,000 | |
| Stock | 7,800 | |
| Prepaid Expenses | 900 | |
| Current Assets | | £ 17,200 |
| Fixed Assets | £ 19,500 | |
| Accumulated Depreciation | (6,825) | 12,675 |
| Total Assets | | £ 29,875 |
| **Liabilities** | | |
| Creditors | £ 1,500 | |
| Accrued Expenses Payable | 2,400 | |
| Tax Payable | 75 | |
| Overdraft | 4,000 | |
| Current Liabilities | | £ 7,975 |
| Long-term Loans | | 6,000 |
| **Owners' Equity** | | |
| Share Capital (795,000 shares) | £ 4,000 | |
| Retained Earnings | 11,900 | 15,900 |
| Total Liabilities and Owners' Equity | | £ 29,875 |



**FIGURE 3-2:** A sample balance sheet.

## Price/earnings ratio

The *price/earnings (P/E) ratio* is another ratio that's of particular interest to investors in public businesses. The P/E ratio gives you an idea of how much you're paying in the current price for the shares for each pound of earnings, or net income being earned by the business. Remember that earnings prop up the market value of shares, not the book value of the shares that's reported on the balance sheet. (Read on for the 'Book value per share ' section.)

The P/E ratio is, in one sense, a reality check on just how high the current market price is in relation to the underlying profit that the business is earning. Extraordinarily high P/E ratios are justified only when investors think that the company's EPS has a lot of upside potential in the future.

The P/E ratio is calculated as follows:

Current market price of stock ÷ most recent trailing 12 months diluted EPS = P/E ratio

If the business has a simple capital structure and does not report a diluted EPS, its basic EPS is used for calculating its P/E ratio. (See the preceding section 'Earnings per share '.)

## Dividend yield

The *dividend yield* tells investors how much *cash flow income* they're receiving on their investment. (The dividend is the cash flow income part of investment return; the other part is the gain or loss in the market value of the investment over the year.)

Suppose that a stock of a public company that is selling for £60 paid £1.20 cash dividends per share over the last year. You calculate dividend yield as follows:

£1.20 annual cash dividend per share ÷ £60 current market price of stock = 2 per cent dividend yield

You use dividend yield to compare how your stock investment is doing to how it would be doing if you'd put that money in corporate or Treasury bonds, gilt edged stock (UK government borrowings) or other debt securities that pay interest. The average interest rate of high-grade debt securities has recently been three to four times the dividend yields on most public companies; in theory, market price appreciation of the shares over time makes up for that gap. Of course, shareholders take the risk that the market value will not increase enough to make their total return on investment rate higher than a benchmark interest rate. (At the time of writing this yield gap, as it is known, has shrunk to nothing and is causing an agonising reappraisal of the value of equities in relation to debt, as an investment medium.)

## Book value per share

*Book value per share* is one measure, but it's certainly not the only amount, used for determining the value of a privately owned business's shares. The asset values that a business records in its books (also known as its *accounts* ) are *not* the amounts that a business could get if it put its assets up for sale. Book values of some assets are generally lower than what the cost would be for replacing the assets if a disaster (such as a flood or a fire) wiped out the business's stock or equipment. Recording current market values in the books is really not a practical option. Until a seller and a buyer meet and haggle over price, trying to determine the market price for a privately owned business's shares is awfully hard.

You can calculate book value per share for publicly owned businesses, too. However, market value is readily available, so shareholders (and investment advisers and managers) don't put much weight on book value per share. EPS is the main factor that affects the market prices of stock shares of public companies – not the book value per share. We should add that some investing strategies, known as *value investing* , search out companies that have a high book value per share compared to their going market prices. But by and large, book value per share plays a secondary role in the market values of stock shares issued by public companies.

Although book value per share is generally not a good indicator of the market value of a private business's shares, you do run into this ratio, at least as a starting point for haggling over a selling price. Here's how to calculate book value per share:

Total owners' equity ÷ total number of stock shares = book value per share

The business shown in Figure 3-2 has issued 795,000 shares: its £15.9 million total owners' equity divided by its 795,000 shares gives a book value per share of £20. If the business sold off its assets exactly for their book values and paid all its liabilities, it would end up with £15.9 million left for the shareholders, and it could therefore distribute £20 per share. But the company won't go out of business, liquidate its assets and pay off its liabilities, so book value per share is a theoretical value. It's not totally irrelevant, but it's not all that definitive, either.

## Return on equity ratio

The *return on equity (ROE) ratio* tells you how much profit a business earned in comparison to the book value of shareholders' equity. This ratio is useful for privately owned businesses, which have no way of determining the current value of owners' equity (at least not until the business is actually sold). ROE is also calculated for public companies, but, just like book value per share, it plays a secondary role and is not the dominant factor driving market prices (earnings are). Here's how you calculate this key ratio:

Net income ÷ owners' equity = ROE

REMEMBER The owners' equity figure is at book value, which is reported in the company's balance sheet.

The business whose profit and loss account and balance sheet are shown in Figures 3-1 and 3-2 earned £1.9 million net income for the year just ended and has £15.9 million owners' equity. Therefore, its ROE is 11.95 per cent (£1.9 million net income ÷ £15.9 million owners' equity = 11.95 per cent) . ROE is net income expressed as a percentage of the amount of total owners' equity of the business, which is one of the two sources of capital to the business, the other being borrowed money (or *interest-bearing debt* ). (A business also has non-interest-bearing operating liabilities, such as creditors.) The cost of debt capital (interest) is deducted as an expense to determine net income. So net income 'belongs' to the owners; it increases their equity in the business, so it makes sense to express net income as the percentage of improvement in the owners' equity.

## Using combined ratios

No one would use a single ratio to decide whether one vehicle was a better or worse buy than another. Miles per gallon (MPG), miles per hour (MPH), annual depreciation percentage and residual value proportion are just a handful of the ratios that would need to be reviewed. So it is with a business: a combination of ratios can be used to form an opinion on the financial state of affairs at any one time.

TIP The best known of these combination ratios is the Altman Z-Score ( www.creditguru.com/CalcAltZ.shtml ) that uses a combined set of five financial ratios derived from eight variables from a company's financial statements linked to some statistical techniques to predict a company's probability of failure. Entering the figures into the onscreen template at this website produces a score and an explanatory narrative giving a view on the business's financial strengths and weaknesses.

## Appreciating the limits of ratios

A danger with ratios is to believe that because you have a precise number that there is a definite right figure to aim for. For example, there is natural feeling with financial ratios to think that high figures are good ones, and an upward trend represents the right direction. This theory is, to some extent, encouraged by the personal feeling of wealth that having a lot of cash engenders.

Unfortunately, there's no general rule on which way is right for financial ratios. In some cases, a high figure is good; in others, a low figure is best. Indeed, you even get circumstances in which ratios of the same value aren't as good as each other. Look at the two working capital statements in Table 3-1 .

**TABLE 3-1 Difficult Comparisons**

| | | *Example 1* | | *Example 2* |
|---|---|---|---|---|
| **Current Assets** | | | | |
| Stock | 10,000 | | | 22,990 |
| Debtors | 13,000 | | | 100 |
| Cash | 100 | 23,100 | 10 | 23,100 |
| **Less Current Liabilities** | | | | |
| Overdraft | 5,000 | | 90 | |
| Creditors | 1,690 | 6,690 | 6,600 | 6,690 |
| **Working Capital** | | 16,410 | | 16,410 |
| **Current Ratio** | | 3.4:1 | | 3.4:1 |

The amount of working capital in each example is the same, £16,410, as are the current assets and current liabilities, at £23,100 and £6,690 respectively. It follows that any ratio using these factors would also be the same. For example, the current ratios in these two examples are both identical, 3.4:1, but in the first case there's a reasonable chance that some cash will come in from debtors, certainly enough to meet the modest creditor position. In the second example, there's no possibility of useful amounts of cash coming in from trading, with debtors at only £100, while creditors at the relatively substantial figure of £6,600 will pose a real threat to financial stability.

So in this case, although the current ratios are identical, the situations being compared are not. In fact, as a general rule, a higher working capital ratio is regarded as a move in the wrong direction. The more money a business has tied up in working capital, the more difficult it is to make a satisfactory return on capital employed (ROCE), simply because the larger the denominator, the lower the ROCE.

In some cases, the right direction is more obvious. A high ROCE is usually better than a low one, but even this situation can be a danger signal, warning that higher risks are being taken. And not all high profit ratios are good: sometimes a higher profit margin can lead to reduced sales volume and so lead to a lower ROCE.

# Finding Financial Facts

Understanding how to calculate financial ratios and how to interpret the resulting data is all fine and dandy, but before you can do anything useful you need to get a copy of the accounts in the first place. Seeing the accounts for your own business shouldn't be too much of a problem. If you're the boss, the accounts should be on your desk right now; if you're not the boss, try snuggling up to the accounts department. If they're too coy to let you have today's figures, the latest audited accounts are in the public domain anyway, filed away at Companies House ( www.companieshouse.gov.uk ), as required by law.

## Public company accounts

Most companies make their glossy annual financial reports available to download from their websites, which you can find by typing the company name into an Internet search engine. You need to have Adobe Acrobat Reader on your computer to open the files. No problem, though: Adobe Acrobat Reader is free and you can easily download the program from Adobe's website ( https://get.adobe.com/reader/?loc=uk ). The software enables you to search for key words in the annual report – a handy feature indeed for tracking down the sections of the report you're most interested in.

TIP Yahoo has direct online links to several thousand public company reports and accounts and performance ratios at http://uk.finance.yahoo.com (enter the name of the company you're looking for in the box on the left of the screen, under Investing. It will appear after you have put in about three letters; click and follow the threads). Paying this site a visit saves you the time and trouble of hunting down company websites.

Public company annual financial reports are available to the general public on the London Stock Exchange (LSE) website ( www.londonstockexchange.com ). You can find reports for US companies on the Securities Exchange Commission's (SEC's) EDGAR database at the SEC website ( www.sec.gov/edgar/quickedgar.htm ).

## Private company accounts

Finding financial information on private companies is often a time-consuming and frustrating job. Not for nothing do these companies call themselves ‘private’. Businesses, and particularly smaller businesses, can be very secretive about their finances and have plenty of tricks to hide information from prying eyes. Many smaller businesses can elect to file abbreviated accounts with Companies House that provide only the barest details. The accounts of very small companies don’t need to be audited, so the objective reliability of the scant data given may be questionable. Having said that, tens of thousands of private companies file full and generally reliable accounts.

TIP The Gov.uk website (www.gov.uk/get-information-about-a-company) is the most useful source of information on private companies and, better still, it’s free. You can monitor any company, including your own, to find out when it files new information by registering at this link.

Information you can find includes:

- Company information, such as registered address and date of incorporation
- Current and resigned officers
- Insolvency information
- Mortgage charge data
- Previous company names

## Scoring credit

If all you want is a quick handle on whether a company is likely to be around long enough to pay its bills, including a dividend to shareholders, then a whole heap of information exists about credit status for both individual sole traders and companies of varying complexity. Expect to pay anywhere from £5 for basic information up to £200 for a very comprehensive picture of a company’s credit status. This information helps you avoid trading unknowingly with individuals or businesses that pose a credit risk.

Experian (www.experian.co.uk/business-express/protecting-you-from-financial-risk/credit-reports.html), Dun & Bradstreet (https://creditreports.dnb.com/m/home) and Creditgate.com (www.creditgate.com) are the major agencies compiling and selling credit histories and small-business information. Between them they offer a comprehensive range of credit reports instantly available online that include advice about credit limits.

## Using FAME (Financial Analysis Made Easy)

FAME (Financial Analysis Made Easy) is a powerful database that contains information on 9 million companies in the UK and Ireland. Typically, the following information is included:

- Details on directors and managers
- Financial strength metrics including credit scores and ratings and CCJs (County Court Judgements) – CCJs reveal where a company has been successfully sued in the courts for outstanding debts
- Shareholders and subsidiaries and corporate structures and families

- Deals and rumours about mergers and acquisitions
- Industry descriptions, Standard Industrial Classification (SIC) codes and research
- News
- Original accounts and documents as filed at Companies House and the Companies Registration Office in Ireland

You can compare each company's detailed financials with its peer group based on its activity codes, and the software lets you search for companies that comply with your own criteria, combining as many conditions as you like. FAME is available in business libraries and on CD from the publishers, who also offer a free trial ( www.bvdinfo.com/Products/Company-Information/National/FAME.aspx ).

# *Introducing the Audit Report*

The value of analysing a financial report depends directly and entirely on the accuracy of the report's numbers. Top management wants to present the best possible picture of the business in its financial report (which is understandable, of course). The managers have a vested interest in the profit performance and financial condition of the business.

Independent auditors are like umpires in the financial reporting process. The auditor comes in, does an audit of the business's accounting system and procedures, and gives a report that is attached to the company's financial statements. You should check the audit report included with the financial report. Publicly owned businesses are required to have their annual financial reports audited by an independent accountancy firm, and many privately owned businesses have audits done too, because they know that an audit report adds credibility to the financial report.

What if a private business's financial report doesn't include an audit report? Well, you have to trust that the business prepared accurate financial statements that follow GAAP and that the footnotes to the financial statements provide adequate disclosure.

Unfortunately, the audit report gets short shrift in financial statement analysis, maybe because it's so full of technical terminology and accountant doublespeak. But even though audit reports are a tough read, anyone who reads and analyses financial reports should definitely read the audit report.

WARNING The auditor judges whether the business used accounting methods and procedures in accordance with accepted accounting principles. In most cases, the auditor's report confirms that everything is hunky-dory, and you can rely on the financial report. However, sometimes an auditor waves a yellow flag – and in extreme cases, a red flag. Here are the two most important warnings to watch out for in an audit report:

- The business's capability to continue normal operations is in doubt because of what are known as *financial exigencies* , which may mean a low cash balance, unpaid overdue liabilities or major lawsuits that the business doesn't have the cash to cover.
- One or more of the methods used in the report is not in line with the prevailing accounting body

rules, leading the auditor to conclude that the numbers reported are misleading or that disclosure is inadequate.

Although auditor warnings don't necessarily mean that a business is going down the tubes, they should turn on that light bulb in your head and make you more cautious and sceptical about the financial report. The auditor is questioning the very information on which the business's value is based, and you can't take that kind of thing lightly.

In very small businesses, it's likely that the accounts will not be independently audited and their accounts come with a rather alarming caveat, running something like this: *These accounts have been prepared on the basis of information provided by the owners and have not been independently verified* . A full audit is an expensive process, and few businesses that don't have to will go to the expense and trouble to find out what they probably already know anyway.

REMEMBER Just because a business has a clean audit report doesn't mean that the financial report is completely accurate and above board. Keep in mind that the accounting rules are pretty flexible, leaving a company's accountants with room for interpretation and creativity that's just short of *cooking the books* (deliberately defrauding and misleading readers of the financial report).

# Digging Deeper into the Audit Report

An auditor does two basic things: *examines evidence* and *gives an opinion* about the financial statements. The lion's share of audit time is spent on examining evidence supporting the transactions and accounts of the business. A very small part of the total audit time is spent on writing the auditor's report, in which the auditor expresses an opinion of the financial statements and footnotes.

This list gives you an idea of what the auditor does 'in the field' – that is, on the premises of the business being audited:

- Evaluates the design and operating dependability of the business's accounting system and procedures.
- Evaluates and tests the business's internal accounting controls that are established to deter and detect errors and fraud.
- Identifies and critically examines the business's accounting methods – especially whether the methods conform to generally accepted accounting rules, which are the touchstones for all businesses.
- Inspects documentary and physical evidence for the business's revenues, expenses, assets, liabilities and owners' equities – for example, the auditor counts products held in stock, observes the condition of those products and confirms checking account balances directly with the banks.

The purpose of all the audit work (examining evidence) is to provide a convincing basis for expressing an opinion of the business's financial statements, attesting that the company's financial statements and footnotes (as well as any directly supporting tables and schedules) can be relied on – or not, in some cases. The auditor puts that opinion in the auditor's report.

The auditor's report is the only visible part of the audit process to financial statement readers – the tip of the iceberg. All the readers see is the auditor's one-page report (which is based on the evidence examined during the audit process, of course). For example, PricewaterhouseCoopers LLP may spend thousands of hours auditing Sainsbury's, but the only thing that the shareholders see is the final, one-page audit report.

## Seeing what's in an auditor's report

The audit report, which is included in the financial report near the financial statements, serves two useful purposes:

- It reassures investors and creditors that the financial report can be relied upon or calls attention to any serious departures from established financial reporting standards and principles.
- It prevents (in the large majority of cases, anyway) businesses from issuing sloppy or fraudulent financial reports. Knowing that your report will be subject to an independent audit really keeps you on your toes!

The large majority of audit reports on financial statements give the business a clean bill of health, or a *clean opinion* . At the other end of the spectrum, the auditor may state that the financial statements are misleading and should not be relied upon. This negative audit report is called an *adverse opinion* . That's the big stick that auditors carry: they have the power to give a company's financial statements an adverse opinion, and no business wants that. Notice that we say here that the audit firms 'have the power' to give an adverse opinion. In fact, the threat of an adverse opinion almost always motivates a business to give way to the auditor and change its accounting or disclosure in order to avoid getting the kiss of death of an adverse opinion. An adverse audit opinion, if it were actually given, states that the financial statements of the business are misleading, and by implication fraudulent. The LSE and the SEC do not tolerate adverse opinions; they would stop trading in the company's shares if the company received an adverse opinion from its auditor.

Between the two extremes of a clean opinion and an adverse opinion, an auditor's report may point out a flaw in the company's financial statements – but not a fatal flaw that would require an adverse opinion. These are called *qualified opinions* .

## True and fair, a clean opinion

If the auditor finds no serious problems, the audit firm states that the accounts give a true and fair view of the state of affairs of the company. In the US, the auditor gives the financial report an *unqualified opinion* , which is the correct technical name, but most people call it a *clean opinion* . This expression has started to make its way into UK accounting parlance as the auditing business becomes more international. The clean-opinion audit report runs to about 100 words and three paragraphs, with enough defensive, legal language to make even a seasoned accountant blush. This is a clean, or unqualified, opinion in the standard three-paragraph format:

In our opinion:

- *the financial statements give a true and fair view of the state of affairs of the* *company and the Group at 22 February 2016 and of the profit and cash flows of the Group for the year then ended;*

- *the financial statements have been properly prepared in accordance with the Companies Act 2006; and*
- *those parts of the Directors' remuneration report required by Part 3 of Schedule 7A to the Companies Act 2006 have been properly prepared in accordance with the Companies Act 2006.*

## Wondering whether audits always catch fraud

Business managers and investors should understand one thing: having an audit of a business's financial statements does not guarantee that all fraud, embezzlement, theft and dishonesty will be detected. Audits have to be cost-effective; auditors can't examine every transaction that occurred during the year. Instead, auditors carefully evaluate businesses' internal controls and rely on sampling – they examine only a relatively small portion of transactions closely and in depth. The sample may not include the transactions that would tip off the auditor that something is wrong, however. Perpetrators of fraud and embezzlement are usually clever in concealing their wrongdoing and often prepare fake evidence to cover their tracks.

# Frolicking through the Footnotes

Reading the footnotes in annual financial reports is no picnic. The investment pros have to read them because, in providing consultation to their clients, they are required to comply with due diligence standards; or, because of their legal duties and responsibilities of managing other peoples' money.

We suggest you do a quick read-through of the footnotes and identify the ones that seem to have the most significance. Generally, the most important footnotes are those dealing with the following matters:

- **Share options awarded by the business to its executives:** The additional shares issued under share options dilute (thin out) the earnings per share of the business, which in turn puts downside pressure on the market value of its shares, everything else being the same.
- **Pending legal actions, litigation and investigations by government agencies:** These intrusions into the normal affairs of the business can have enormous consequences.
- **Segment information for the business:** Most public businesses have to report information for the major segments of the organisation – sales and operating profit by territories or product lines. This gives a better glimpse of the different parts making up the whole business. (However, segment information may be reported elsewhere in an annual financial report than in the footnotes.)

These are just three of the many important pieces of information you should look for in footnotes. But you have to stay alert for other critical matters that a business may disclose in its footnotes, so scan each and every footnote for potentially important information. Finding a footnote that discusses a major lawsuit against the business, for example, may make the shares too risky for your portfolio.

# Book 5

# Marketing and Advertising Your Wares

# Contents at a Glance

# Chapter 1

# Taking a Closer Look at Customers

**IN THIS CHAPTER**

- **Finding out who your customers are**
- **Understanding why your customers buy (and why they may not buy again!)**
- **Discovering how your customers make choices**
- **Keeping the big picture in mind**
- **Handling business customers**

The most crucial part of business planning involves taking a long, hard look at customers – those you enjoy having, those you would love to land and those you would just as soon give away to some unsuspecting competitor. The stakes are high. How well you know your customers ultimately determines how successful you are. But figuring out what makes customers tick can be downright frustrating. If you've tried it before, you may be tempted to throw up your hands and leave the entire mess to the so-called experts – marketing gurus, consultants or perhaps astrologers. Don't. This chapter shows you how to better acquaint yourself with your customers so that you can offer them more value and serve them more profitably than anyone else out there.

In this chapter, you get a closer look at why customers buy your products and services in the first place by exploring their needs and motives. You discover how they make choices in the marketplace by examining customer perceptions and their decision-making process. Finally, you take a quick look at your customers that are actually other businesses.

## *Checking Out Who Your Customers Are*

A fresh look at customers starts with the ones you enjoy seeing – those who regularly purchase goods or services from you. But sometimes, knowing what something is *not* can be just as important as knowing what it *is* . You can discover as much about your own business and best customers by observing the other kinds of customers out there – the customers who are difficult, the customers who are gone and the customers whom you never had.

### *The good customer*

Good customers are the ones who bring a smile to your face, the ones you like serving, the ones who appreciate you, the ones who keep you in business. They are the customers you want to keep coming back time and again. To keep all those good customers happy, however, you may need to know more than the fact that Tom likes Chinese food, Mary has a weakness for chocolates and Harry loves red ties.

Why? Isn't simply knowing individual customers on some personal basis enough? Well, not quite. What happens if you have hundreds or even thousands of small customers, as a shop does, or if your staff turnover is high as in most parts of the catering industry?

In such cases, there's no substitute for a good database system for tracking your relationship with clients and then making appropriate product or service offers. For example, supermarkets now analyse customer purchases and make targeted special offers based on their understanding of the customer profile. This all helps to make customers feel special and loved. Your business can measure and describe its customers in several ways:

- Track *where* your customers are, breaking them down by country, region, city or postcode.
- Figure out *who* your customers are, including their age, gender, occupation, income and ethnic origin.
- Find out more about *how* they live – their hobbies, favourite sports teams, restaurant choices and holiday destinations, for example.

You're probably a step ahead of us here and have already noticed that many of these criteria result in groups of customers that look alike. When marketing gurus divide customers into specific groups, they call them *market segments* . (Find out more about viewing your sales by market segment in Chapter 6 of Book 1.)

TIP

When it comes to understanding customers, one good strategy is to find out what other businesses try to find out about their customers. Keep track of the questions that other companies ask you. Richer Sounds stores (a chain of hi-fi and home cinema retailers), for example, routinely ask for your postcode when you step up to the till. And you often find a list of personal questions on product registration forms, warranty cards and customer service mailings. Some companies even offer a small reward if you tell them something – anything – about yourself. But go easy here. Companies can lose a lot of goodwill when customers grow suspicious about – or just annoyed by – all the questions that they're being asked. Forbes, the business and financial news journal famed for its definitive list of the world's billionaires, reported in 2016 that 72 per cent of consumers said that surveys interfere with the experience of a website. They went on to note that response rates have dropped over the past 20 years, from about 20 per cent to barely 2 per cent today. They concluded that most surveys annoy customers and don't gather useful information anyway.

## The bad customer

'A bad customer? Isn't that a contradiction in terms?' you ask. 'How can there be such a thing as a bad customer, especially for a customer-oriented company?' Keep in mind that your initial reaction doesn't always tell the whole story. Remember that *you* don't really define the business that you're in, your *customers* do. They place a series of demands on your company and then evaluate how well it performs against those demands.

Good customers do the following:

- Ask you to do things that you do well
- Place value on the things that you do and are willing to pay for them
- Challenge you to improve your skills, expand your knowledge and focus your resources

- Take you in new directions that are consistent with your strategy and planning

Bad customers represent the flip side. They do the following:

- Ask you to do things that you aren't equipped to do well
- Distract you, causing you to veer away from your strategy and your business plan
- Purchase in such small quantities that the cost of doing business with them far outweighs any revenue that they generate
- Require so much service and attention that you can't focus your efforts on more valuable (and profitable) customers
- Remain dissatisfied with what you do, despite all your best efforts
- Fail to pay on time – or to pay at all!

The pundits have come up with a principle that you can apply here: the *80/20 principle* . In this case, the rule says that if you survey all your customers, 20 per cent of them account for about 80 per cent of your business. These 20 per cent are your good customers. You obviously want to keep them – and keep them happy! But look at the other 80 per cent of your customers, and you may discover a few whom you'd rather hand over to the competition.

When you analyse what you do for that 80 per cent of customers and what they do for you, these customers are often more trouble than they're worth. Their shoe styles are never in stock, and their special orders are always returned. Maybe their finances are a mess, which makes them late in paying. Still, the lure of additional revenue and more customers – or the belief that you should never say no to any customer – often keeps you involved with this group. You would be better off without these customers, though, and leaving your competitors to handle such bad business impairs their ability to compete with you for good business.

To handle bad customers, follow these steps:

1. **Figure out who they are, and establish if you can make a profit out of doing business with them.**
2. **Convert them into good customers by exploring ways of turning loss-making customers into profitable ones.**

   For example, by putting up prices, introducing minimum order sizes or minimum drop quantities, or encouraging them to order online.
3. **Alternatively, hand them over to someone else.**

   If they don't accept the changes to your service that you introduce to ensure they make you money, they'll soon move on to other suppliers.

WARNING A note of caution: some of this year's bad customers may become next year's good customers. Ensure you only divest yourself of *permanently* bad customers.

### The other guy's customer

You may think that focusing on customers whom you've never had points to another sort of failure on your part, but actually, these people present an opportunity. The fact that you haven't been able to serve this group gives you a challenge: to find out what your market really thinks is important. Your competitors' customers are telling you what you are not. This information is extremely useful, especially when you're working on the big picture in the early stages of business planning by defining who you are and who you want to serve.

Unfortunately, getting information out of your competitors' customers is often an expensive proposition. You don't know them, and you don't have an ongoing relationship with them. Market research firms, of course, are always eager to work with you. These companies are willing to bring together focus groups and talk to consumers about all sorts of things that relate to your products in comparison to the competition. The catch, of course, is that their services don't come cheap.

Fortunately, you don't have to be quite this formal about the information-gathering process, at least in the initial stages. As long as you can get selected people to provide sincere answers, you may be able to approximate the results of a focus-group study on your own.

TIP Getting to know your competitors' customers is often difficult, but not impossible:

- Spend some time where customers gather. Use trade shows, user groups and industry conferences to make informal contacts and begin a dialogue with your non-customers.
- Ask pointed questions of people who choose competing products. Did they take the time to see what was available on the market? Have they even heard of your product or service? If they have, did they actually take the time to look at it? If not, why not? If so, what were their impressions?
- Really listen to what they have to say, no matter how painful it is. Don't get defensive when people say negative things about your company or your products.

## Discovering Why Your Customers Buy

Perhaps the most difficult – and useful – question that you can answer about your customers is why they buy what they buy. What actually compels them to seek out your products or services in the marketplace? What's important to them? What are they really looking for?

### Understanding needs

Why do people buy things in the first place? Psychologist types tell us that *needs fulfilment* is really at the heart of all consumer behaviour (see Figure 1-1 , based on the social psychologist Abraham Maslow's famous 'Hierarchy of Needs' model). Everybody has needs and wants. When a need is discovered, it creates the motivation that drives human activity.

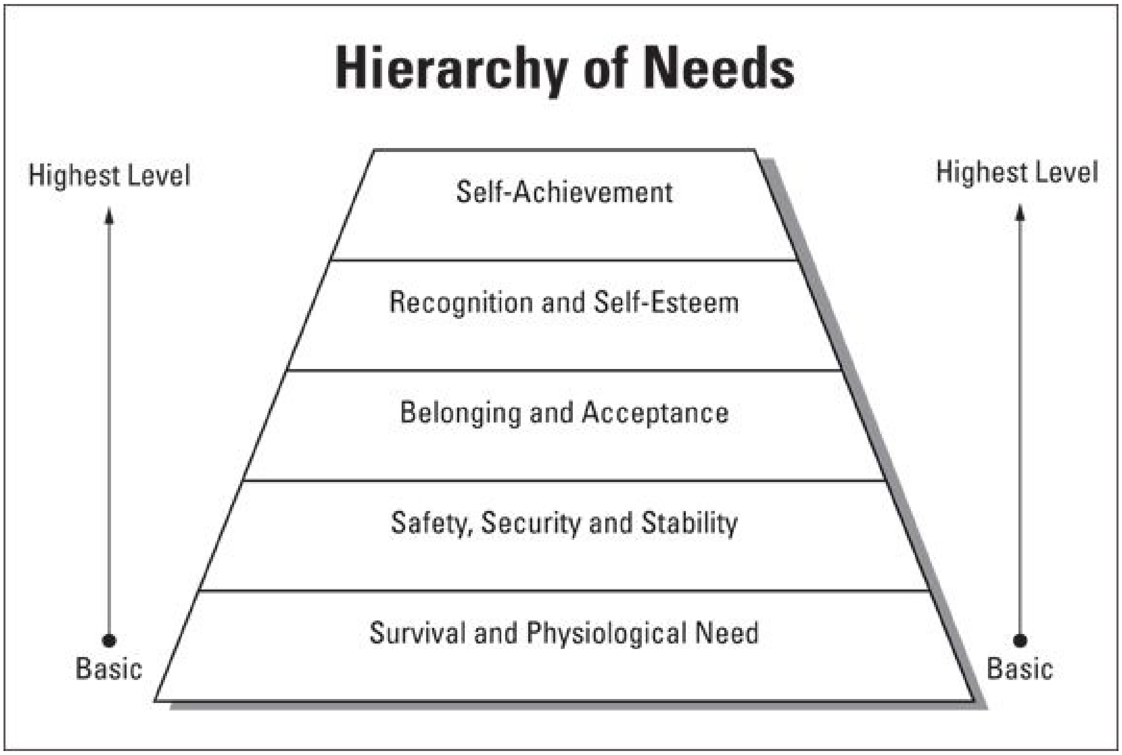




**FIGURE 1-1:** A basic overview of people's needs.

These needs operate at five levels in the hierarchy:

- Survival, at the most basic level, results in the universal need for grocery shops, carpenters and tailors.
- The urge for safety, security and stability generates the need for bank accounts, disability health insurance and home alarm systems.
- The desire for belonging and acceptance creates the need for designer-label polo shirts, members-only clubs and participation in expensive diet programmes.
- The urge to be recognised and held in esteem establishes the need for company banquets, fast cars and award plaques.
- The desire for self-achievement and fulfilment results in the need for adventure holidays, quiz shows and correspondence courses.

DHL, for example, is really in the reliability business. Many of its customers are businesses that want the assurance – absolutely, positively – that their precious shipments will be delivered early the next day or even the same day. These customers are so motivated by this need that they are willing to pay a substantial premium over other alternatives, simply for absolute reliability and their own peace of mind.

## *Determining motives*

*Motives* are needs that have been awakened and activated, so to speak. Motives send people scurrying into the marketplace, searching for products or services that can fulfil a particular need. Motives aren't always what they seem to be:

- Greetings card companies, for example, don't just sell cute little jingles printed on glossy paper at exorbitant prices. The prices are justified because the companies are actually selling small insurance policies against their customers' fear of feeling guilty. Perhaps fear of guilt (over a missed birthday or a forgotten anniversary) is really what propels the buyer into the greetings card market.

- Recent MBA graduates have been asked to rank the things that are most important to them when they decide among various job offers. When asked point-blank, a substantial majority rank quality of life, community and schools at the top of the list and place starting salary somewhere in the middle. A more careful survey and analysis of the MBA selection criteria, however, usually settles upon compensation as being the single most important variable in accepting a new position fresh out of university.
- Most of us have a need to be accepted and liked by other people. This powerful motivation creates great market opportunities for the likes of beauty salons, gyms and breath-mint companies.

Although motives obviously apply to individual consumers, they work equally well in the context of business or corporate behaviour. When a particular manufacturing company contracts with a private health and medical insurance company, such as BUPA, for example, is the company motivated to improve the health of its employees? Or is it motivated to reduce the cost of its health insurance premiums so that it can better compete with foreign companies (fulfilling its own need to survive)? If you run BUPA, how you answer this question has a major impact on your internal management of costs versus the overall quality of the health care that you provide.

REMEMBER Your job, of course, is to dig beneath the obvious customer responses and consumption patterns to determine what the buyers' real motives are in purchasing goods and services in your own market. When you understand what's actually driving customer behaviour, you're in a much better position to talk about your own product in terms that customers will respond to.

# *Finding Out How Your Customers Make Choices*

How do customers make choices in the marketplace? The most important thing to remember is that customers decide to buy things based on their own view of the world – their own perceptions of reality. Few customers buy without thinking. Instead, they bring their perceptions of the world into a decision-making process that (ideally) leads them to purchase your product or service instead of other options.

## *Perceptions are reality*

Customer perceptions represent the market's world view and include not only what your customers think of your products and services, but also how they see your company and view your competitors.

As customers turn to the marketplace, they confront a mind-boggling array of competing products. Many variables influence your customers as they evaluate their choices: advertising, endorsements, reviews and salesmanship, not to mention their own gut reactions. You need to know how customers respond to all these stimuli if you ultimately want to earn and keep their business.

Have you ever wondered, for example, why so few yellow jumpers are available in the men's departments of clothing shops? Market research consistently shows that a majority of men believe that the colour yellow suggests weakness. Subconsciously, men feel that they may be perceived as being wimps if they have anything to do with the colour. So the yellow-jumper option isn't too popular.

Or have you noticed that Madonna doesn't do many endorsements? Okay, it's not as though she needs the extra income. But companies may feel that her image is just too controversial, resulting in negative perceptions and the risk that potential buyers will be driven away.

REMEMBER Never lose sight of the marketer's motto:

> Customer perceptions are the market reality.

People buy goods and services based on what they perceive to be true, not necessarily on what you know to be the facts. To be successful in the marketplace you have to develop a clear insight into customer perceptions, understanding how buyers react to products and services in your market before you complete your own business plans.

## *The five steps to adoption*

Marketing gurus often refer to the customer's *decision-making process* as the *DMP* (the acronym makes the term sound more official). In many markets, the DMP involves a series of well-defined steps that are dubbed the *consumer adoption process* . (Okay, we'll call it the *CAP* .) In this case, of course, *adoption* refers to a newly formed relationship with a product, not a child.

By understanding the steps that consumers often go through, you're better able to take advantage of your customers' behaviour and build strategies that help them complete the adoption process. The process involves five major steps, which are described in Table 1-1 .

### TABLE 1-1 The Consumer's Five-Step Adoption Process

| ***Primary Steps*** | ***Description of Consumer*** | ***Your Task*** |
|---|---|---|
| Awareness | Aware of a product or service but lacking detailed knowledge | Develop a strategy that educates and excites potential customers |
| Interest | Curious because of publicity and seeking more information | Provide more detailed product information and continue to build momentum |
| Evaluation | Deciding whether to test the product or service | Make the product-evaluation process as easy and rewarding as possible |
| Trial | Using the product or service on a test basis | Make the trial as simple and risk-free as you can |
| Adoption | Deciding to become a regular user | Develop strategies to retain good customers |

Suppose that you're in a start-up firm with a top-notch consumer-software title. You're afraid, however, that customers are reluctant to give the program a try, for fear the software will be difficult to learn or incompatible with their computers. (Keep in mind that people act on their perceptions of reality rather than on the reality itself!) To move potential customers past the evaluation and into the trial step of the adoption process, you may want to consider setting up a free new-user hotline and offering a money-back, no-questions-asked guarantee.

## Remembering the Big Picture

Remember that old saying about not seeing the wood for the trees? Well, when you first start to think about your customers, you don't want to fall into a similar trap. It's sometimes tempting to see only the small number of individual customers whom you know, and focus on their personal habits, likes and dislikes. Even when you begin to look at more general customer trends, including why your customers buy and how they make choices, getting buried in the details can be awfully easy.

WARNING Don't take the bait! Don't view your customers and your own business activities too narrowly. Look instead at the larger wood – those general customer behaviours and basic needs that define your market.

If you think about your business only in terms of your existing products, for example, you risk losing sight of customer needs that you've overlooked – needs that a competitor is no doubt going to satisfy at some point. You also create a short-sighted view of your own strategic choices that can result in missed market opportunities and woefully inadequate business plans.

Unfortunately, companies (and even entire industries) still lose sight of the big picture all the time. Markets are viewed too narrowly, and customer needs are neglected – a classic management blunder. Consider these examples, two from the business world and one from politics:

- Companies that make home-improvement tools often view their business in terms of product components – the making and selling of 6mm drill bits, for example. But when you think about it, nobody really wants or needs 6mm drill bits (not even your dentist). What customers are *really* looking for are 6mm holes. That basic need creates the potential opportunity for any number of possible solutions.
- Glasses manufacturers – the companies that make the frames and lenses – continue to see themselves as being in the glasses-fashion business. But the customers, frustrated by not being able to read a menu closer than three feet away when they've forgotten their glasses, simply want to see better. The manufacturers are now learning a hard lesson with the advent of laser technologies that promise to improve vision by reshaping the cornea – no vision problems, no need for glasses, no more business.
- Bill Clinton had a little sign tacked up on the back wall of his 1992 US presidential campaign headquarters that read 'It's the economy, Stupid!' Campaign manager James Carville posted the sign because he wanted everyone to focus not so much on the product – Mr Clinton – as on the marketplace and customer needs.

  In this case, of course, the marketplace was the election itself, and the customers were the voting public. At the time, workers in the United States were suffering through a steep recession, worried about foreign competition and petrified about the 'new world economy'. As a shrewd campaign strategist, Carville knew that the road to success lay in getting beyond the candidates themselves and appealing to the voters' innermost needs – those universal, underlying issues that would ultimately sway decision making in the polling booth.

As a business planner, you have to do the same as in these examples: focus on being market-driven when you approach your customers.

Charles Revson revolutionised the cosmetics industry when he quipped, 'In the factory, we make cosmetics; in the store, we sell hope.' As the founder of Revlon, he understood that he was offering his customers something far more important than chemistry: the prospect of youth, beauty and sex appeal.

REMEMBER The key point here is simple: if you don't know what your customers really want, you can't possibly fulfil their needs in an effective way.

Put yourself in your customer's shoes:

- Take a hard look at one of your own products or services, and honestly ask yourself, 'Why would *I* need this thing?'
- Ask the same question of several people who use your product or service.
- Try to imagine a world without your product or service. What would you substitute for it?

Answering questions such as these goes a long way towards fostering creativity, generating new strategies and providing expanded market opportunities.

# Dealing with Business Customers

Although this chapter has mentioned companies that sell principally to other companies (as opposed to those that sell primarily to individual consumers), some of you in this so-called *business-to-business (B2B) market* may think that you're being ignored. But you're not – honest! In this section, you find details on how companies, institutions and government agencies act when they themselves are the customers. What makes the business buyer different? Many things.

## Secondhand demand

Demand for goods and services in B2B markets is almost always *derived demand* . In other words, businesses purchase only those goods and services that they can use to better serve their own customers.

Steel, for example, is a product that no end-user buys. When was the last time you had the urge to go out and get your hands on some flat-rolled sheeting? Steel purchasers tend to be car manufacturers, construction firms, appliance companies and the like. After these businesses have used the steel to make their own products (cars, office blocks and refrigerators), someone else comes into the picture as a potential customer.

What are the implications for the steel sellers? If a steelmaker cuts its prices across the board, for example, should it expect a huge increase in orders? Not necessarily. Steel buyers will increase their purchases only if they think that they can sell more of the things that *they* make, and their own sales may be affected by many factors beyond the underlying steel price. How many of us went out to buy a car the last time steel prices were reduced by 10 per cent?

*Inelastic demand* is a term that number crunchers use when they talk about demand for a particular product that doesn't stretch or change automatically when the price of the product changes.

TIP If you offer products or services in the B2B market, make sure that you take the time to think through what your planning decisions mean to your business buyers. And that means thinking about your customers' customers as well. Consider these questions:

- Will a price reduction on your part result in increased sales for your customers – and your company?
- Will your customers (and their customers) benefit if you offer them additional bells and whistles while raising their costs?
- Are your customers looking for continuity and price stability?

## Decision making as a formal affair

Purchase decisions in the business-to-business marketplace tend to be more formal, rational and professional than in most consumer markets. Many people from different parts of the target company are often involved in the DMP (check out the earlier section 'The five steps to adoption ' to find out more about the DMP). One division in the company may recommend your product or service, another may acquire it, yet another may pay for it, and all of them do the work for a separate customer centre that actually uses that product. Taken together, these divisions form the *decision-making unit* (or DMU) – another marketing term foisted off on us nice people by marketing gurus.

Table 1-2 describes three ways in which a business DMU may behave when it's thinking about buying a product or service.

**TABLE 1-2 How Businesses Behave When They Buy**

| ***Buying Behaviour*** | ***Description of the Customer's DMP*** |
|---|---|
| Business as usual | Continues to order more of the product or service, perhaps even automating the process so that inventories don't fall below certain levels. |
| Yes, but … | Asks for changes in the existing sales arrangement, modifying one or more purchase terms (such as pricing, financing, quantities and options) and including various people who are part of the DMU. |
| Opportunity knocks | Purchases a product or service for the first time, perhaps after putting out an invitation to tender (ITT) to several possible suppliers and making a deliberate, complete decision involving all parties in the DMU. |

## Forces to be reckoned with

In working with business customers, you most likely have to deal with several powerful customer forces that you rarely encounter in consumer markets. If your business-to-business strategies are going to succeed over time, you must factor these forces into your business plans. Consider the following questions:

- What’s the state of the customer’s business?
    - Is it booming, mature or dying?
    - Is it facing increased competition or enjoying record profits?
    - Is it outsourcing business or creating new opportunities?
    - Does it threaten to become a competitor?
- How does the customer’s company operate?
    - Does the customer purchase centrally, or does it have buyers scattered around the company?
    - Does it require several levels of approval before a decision is made?
    - Do senior executives (who may or may not know a lot about the product) make the ultimate purchase decisions?
- Who’s important to whom?
    - Do the customer’s key decision-makers tend to be engineers or marketing people?
    - Does the customer use both small and large suppliers?
    - Does it have a policy of requiring more than one supplier in critical areas?

TIP As you begin to develop strategies for your business customers, take the time to investigate the forces that are unique in business-to-business markets. Try the following:

- Get out into the field and talk to potential business buyers.
- Read about customers’ organisations and their industries.
- Attend the conferences and conventions that your customers attend, and find out about the critical events and forces that shape their thinking.

All these activities take time and resources, of course, but your investment will be rewarded many times over when you incorporate what you find out into your business-to-business planning.

# Chapter 2

# Considering Your Business Mission, Vision and Objectives

**IN THIS CHAPTER**

**Pinpointing your concept**

**Stating your mission**

**Looking at vision**

**Tending to goals and objectives**

To be successful in the market place, you need to have a clear picture of exactly what you want to do and who you're doing it for. In other words, you need a vision and a mission.

Say you want to start your own airline. That idea in itself doesn't make a business. What destinations you'll fly to, what type of planes you'll use, how you'll sell your tickets and to whom you'll sell them are all burning issues that set what are known as the *parameters* of your business. You can think of parameter-setting as a process that narrows down the big universe that starting your own airline begins with, until perhaps you train your focus on flying tourists to and from New York (which is where Virgin began).

Defining the parameters of your vision involves getting to know more about your future customers and more about what you plan to do to woo and win them. Every business needs a winning concept, a clear mission, an inspirational vision, and achievable objectives and goals – no rocket science in that.

In this chapter, you find out how to refine your vision and compose a mission statement that you can adjust to suit your goals throughout the life of your business.

## *Developing Your Concept*

When you know the basic concept of what you're selling and to whom, you should refine that by examining the features of the product (or service) and the benefits that customers get when they purchase. *Features* are what a product has or is, and *benefits* are what the product (or service) does for the customer. For example, cameras and even film or memory sticks aren't the end product that customers want: they're looking for good pictures. Finally, include proof that you can deliver these benefits.

REMEMBER You need to decide on your business concept, and you really need to get a good handle on it before you can go much further with your business plans.

# *Composing Your Mission Statement*

A *mission statement* explains in clear, concise terms what the business does. To devise a worthy mission statement, focus your attention on your strengths and the value you provide to your customers.

Your mission should be narrow enough to give direction and guidance to everyone in the business. This concentration is the key to business success because only by focusing on specific needs can a small business differentiate itself from its larger competitors. Nothing kills off a business faster than trying to do too many different things too soon. Also, your mission should address a large enough market to allow your business to grow and realise its potential.

Mission statements mustn't be too bland or too general. Anyone reading the statement should be able to tell what your company aims to achieve in the next three years and how it aims to do so.

Your mission statement should explain what business you're in or plan to enter. It should include answers to some or all the following questions:

- Market/customer needs: who are we satisfying/delighting?
- What product/service are we offering that meets those needs?
- What are our capabilities (consider both particular skills and knowledge, and resources)?
- What market opportunities exist for our product or service, and what threats exist from competitors (and others)?
- What do we want to achieve both now and in the future?

Above all, mission statements should be realistic, achievable and brief. You certainly don't need to take a long weekend in a country hotel with key staff and management consultants poring over flip charts to develop your mission statement. If you can't distil the essence of what you plan to do in a simple, direct sentence or two, then you'd better hold back on the launch party – and definitely don't order champagne and balloons.

Run through the following checklist periodically to make sure that your mission statement is still on track:

- Is your mission statement current? (You may need to look at the mission statement you wrote before you carried out lots of market research or sold anything much to see whether it's still valid.)
- Does the mission statement accurately reflect what you do?
- Would this mission statement stand out in a crowd?
- Can a 14-year-old understand it? (That is the standard of the average tabloid reader.)
- Does your mission statement provide a clear guide to action?
- Does it tell you what businesses you're *not* in?

TIP Write down your company's mission statement from memory. Have your oldest employee and your newest employee do the same, and then compare the three. Use the differences to refine the mission statement or employee training.

REMEMBER Ultimately, your mission statement reflects the unique quality of your business that makes people want to buy from you. That uniqueness may be contained in the product or service, but is more likely to be woven into the fabric of the way you do business. Try telephoning any three car-hire firms, or walking into three restaurants. The chances are that it's not their products but their people and systems that make them stand out.

What the mission statement does is get everyone pulling hard in the same direction. The direction may change slightly over time, but everyone still pulls the same way and the company moves forward, rather than standing still or declining.

TIP You can see a cross section of example mission statements at http://www.leadership-tools.com/example-of-mission-statement.html .

# Seeing the Vision Thing

Vision isn't the same as mission. You can think of *mission* as providing direction for the medium term along a line that most people can follow. *Vision* is about stretching the organisation's reach beyond its grasp. Generally, few people concerned with the company can now see how the vision is to be achieved, but all concerned agree that it will be great if it can be. When your vision becomes reality, it may be time for a new challenge, or perhaps even a new business.

Microsoft founder Bill Gates had a vision of a computer in every home at a time when few offices had one. As a mission statement 15 years ago, this vision may have raised a wry smile. After all, only a few decades before IBM had estimated the entire world demand for its computers as seven! Now, Gates's vision has been all but reached.

You need to create the vision with the people who work with you in order to be sure of their wholehearted commitment. You can't get that commitment if the only people who buy into the vision are you, your partner and the management consultant who sold it to you.

As with the mission, only when everyone knows and shares the business's vision is it likely to be achieved. All parts of the organisation are so connected to each other, to the market and to the customer in such a complex series of relationships that the management team can't hope to achieve anything much without everyone's input. Rather, in the way that markets work better with perfect information, businesses work better when everyone knows and believes in the vision.

# Setting Objectives and Goals

Missions and visions are vital, but they aren't much good without clear objectives, which are the major measurable tasks for the business and operating goals for individuals. For example, you need an idea of how big you want the business to be – in other words, what your share of the market is likely to be.

Forecasting sales is certainly not easy, especially before you've even started trading. But if you don't set a goal at the start and instead just wait to see how things develop, one of two problems is likely to occur: you don't sell enough to cover your fixed costs and so lose money and perhaps go out of business, or you sell too much and run out of cash while you wait for your customers to pay up (in other words, you over-trade).

Obviously, before you can set a market share and sales objective, you need to know the size of your market. (See Chapter 6 in Book 1 for information on how to research the market.)

The size you want your business to be is more a matter of judgement than forecast. You make a judgement tempered by the resources you have available to achieve those objectives, and by some idea of what's reasonable and achievable and what isn't. The amount of money you can persuade outsiders to pump into your business also limits your ambition.

TIP Set near-term objectives covering the next 18 months or so, and longer-term objectives covering up to an additional three or so years.

REMEMBER You can set objectives in any number of areas, but the most vital areas are *profits* , the money you have left after everyone has been paid; *margins* , the profit made per item sold; *return on capital employed* , the profit made for every pound invested; *value added per employee* , the profit made per person employed; *sales volume and value in pounds* , the output; and your *percentage share of the market* , known universally as 'market share'. (See Chapter 3 in Book 2 and Chapter 3 in Book 4 for more on these and other ways to measure profit.)

You also need to ensure that any objectives set meet these criteria:

- **Accepted:** This means that whoever you set a goal for must commit to the task. Silence isn't a sufficient response. So, for example, sales staff should sign off acceptance of targets and production staff should confirm that they accept output goals.
- **Achievable:** If a goal is way beyond any reasonable chance of being achieved, when you fail to get there all concerned, yourself included, are going to be demotivated.
- **Allocated:** You should leave no objective hanging, without assigning a named person or persons the task of achieving all or part of the task in question.
- **Challenging:** Objectives need to stretch but not break.
- **Measurable:** Remember that old saying: 'What gets measured gets done'? Certainly, if you can't measure something, setting goals in that area is pointless.
- **Time-scaled:** Not great English, but an objective without a date by which it is to be achieved is meaningless. Saying you must get sales of £100,000 a month may be challenging if you're in your first month in business, but altogether too laid-back for year five.

  For example, Pizza Express set out its goals in June 2011 as aiming to nearly double its number of outlets from 318 to 700 by 2020. By 2016 it had over 440 outlets, so it was over 60 per cent of the way towards achieving its goal.

# Chapter 3

# Marketing and Selling Your Wares

**IN THIS CHAPTER**

**Understanding the marketing mix and how to use it**

**Deciding the advertising message**

**Choosing the media**

**Reviewing selling options**

**Examining legal issues**

Entering the market with your product or service involves deciding on what mix of marketing ingredients to use. In cooking, the same ingredients used in different ways can result in really different products. The same is true in business, where the 'ingredients' are product (or service), promotion, price, place, people, physical evidence and process. A change in the way you put these elements together can produce an offering tailored to meet the needs of a specific market. For example, a hardback book isn't much more expensive to produce than a paperback. However, with a bit of clever publicity, bringing the hardback out a few months before the paperback edition with a higher price tag, the publisher can create an air of exclusivity that satisfies a particular group of customers.

In this chapter, you find out how to get news about your business to all the people who can help you achieve sales, how to set the right selling price and – if you're selling a physical product – how to get it to your customer. Those of you who are old hands at marketing are familiar with the 4Ps (product, promotion, price and place), which were originally seen as covering the whole of subject of marketing. You see here the new 3Ps (people, physical evidence and process). Together all of them are now referred to as the 7Ps.

How you apply the 7Ps, as with every other aspect of business, has to be legal, so in this chapter you discover the laws you're likely to encounter and how not to break them.

## *Making Up the Marketing Mix*

The key to successful promotion lies in knowing exactly what you want people to do. A few elements can make or break the successful marketing of your business. The elements you need to consider that go to make up the marketing mix are:

- The *product or service* is what people use, but they buy the underlying benefits it confers on them. For example, when someone buys a camera he may be considering whether he should buy SLR or digital, what lens it has, even what film it takes in the case of more traditional snappers – but these end products aren't what customers want. What they're looking for is good pictures.
- *Promotion* is the means by which you tell your market(s) about your products or services.

Promotion includes such elements as your website, leaflets, advertising and even basic items such as business cards and letterheads.

- *Pricing* strategies can range from charging what the market may bear, right through to *marginal cost* (just enough to cover direct costs and a small contribution to overheads). Knowing your costs is important, but this element is only one in the pricing decision. You also have to take account of the market place, your competition and your product position (for example, if you offer a luxury item, your place in the market is different to that of someone who sells necessities).
- *Place* is a general term to cover everything from where you locate your business to how you get your product or service to market. Poor distribution often explains sluggish sales growth. If your type of product gets to market through several channels but you use only one of them, then no amount of price changes or extra promotion makes much difference.
- *People* are the interface between your business and the customer. They answer phones, respond to emails, serve at tables and collect money. Their behaviours reflect on how a customer sees your product. People need motivating, managing and rewarding. Occasionally they need to be disciplined or even dismissed. This aspect of business is so vital that the whole of Book 3 is devoted to the subject.
- *Physical evidence* refers to the environment in which customers see or experience your product or service.
- *Process* is how the product or service is delivered, and your processes can be varied or improved so as to give your business a competitive edge.

# Defining Your Product or Service Parameters

To be successful in any market place, you need to have a clear picture of exactly what you want to do and for whom you're doing it. In other words, you need a vision and a mission. (Chapter 2 in Book 5 offers advice on developing your mission statement.)

To market your product effectively, you have to make decisions about factors such as product range and depth before you're ready to enter the market. Having decided to open a corner shop, for example, you still have to decide whether to focus on food only, or to carry household items and perhaps newspapers and flowers too. You also need to decide whether to carry more than one brand and size of each product.

If the key advantages of your corner shop are its location, opening hours, delivery service and friendly staff, all at competitive prices, then perhaps you don't need a wide or deep product range.

# Using Advertising to Tell Your Story

You can't be confident that your customers share your zeal for your business proposition, so you need to convince them that they need what you're offering. The way to convince them is to tell potential customers about what you're selling by advertising your wares.

The skill of advertising lies in reducing the global population to your target audience and reaching as many of them as you can at an economic cost. You first analyse the benefits or virtues of your product, isolate the features and translate them into customer benefits. Who has a need for your product? Define exactly who your potential customers are.

Question all the time. Then, the advertising process is to set objectives for your campaign, decide on a budget, design the message, pick the medium to reach your target audience and determine how you're going to evaluate the success of your advertising.

When you understand the basics, which are covered in the following sections, you should also be able to analyse advertisements better, break them down into their elements and avoid the all-too-common mistakes that advertisers make every day.

REMEMBER Advertising by itself doesn't sell. It doesn't shift a bad product (or at least not more than once) or create new markets. Sales literature, order forms, a sales force, stocks, distributors and a strategy must back up your advertising.

## *Considering the customer's point of view*

People buy a product or service for what it can do for them. Customers look for the benefits. As the seller, your mission is to answer the question 'What's in it for me?' from your potential customer's point of view.

Every time you compose a sales letter, write an advertisement or plan a trade show, you must get to the heart of the matter. Why should customers purchase your product or service? What benefit may it bring them?

You need to view all your marketing efforts from the prospect's point of view, not just your own. When you know what you're selling and to whom, you can match the features of the product (or service) to the benefits the customers can get when they purchase. A *feature* is what a product has or is, and *benefits* are what the product does for the customer. Finally, include proof that the product or service can deliver these benefits. Table 3-1 shows an analysis of features, benefits and proofs.

**TABLE 3-1 Listing Features and Benefits**

| *Feature* | *Benefit* | *Proof* |
|---|---|---|
| We use a unique hardening process for our machine. | Our tools last longer and that saves you money. | We have a patent on the process; independent tests carried out by the Cambridge Institute of Technology show our product lasts longest. |
| Our shops stay open later than others in the area. | You get more choice of when to shop. | Come and see. |
| Our computer system is fault tolerant using parallel processing. | You have no downtime for defects or system expansion. | Our written specification guarantees this – come and talk to satisfied customers operating in your field. |

You can employ this format to examine the features, benefits and proofs for your own products or services and use the information to devise your ads. Remember, the customer pays for the benefits and the seller for the features. So the benefits provide the copy for most of your future advertising and promotional efforts.

Try this format out on your business idea. Keep at it until you really have a good handle on what makes your customers tick. To make the process work best, you need to talk to real prospective customers in your target market.

## Making an exhibition of yourself

One way to gather useful market research data on customers and competitors is to attend exhibitions. Exhibitions are also a useful way of seeing whether a demand for what you have to offer is likely to exist, because hundreds of key decision-makers are gathered in one place for you to make a pitch to.

Equinox, a designer furniture company, took part in a national exhibition at London's Earls Court while on an enterprise programme at Cranfield Business School. A grant paid for half the cost of its £1,200 stand and the £5,000 of firm orders it received more than covered the rest of the cost. More importantly, the founder felt more confident in his product and he took away 40 contacts to follow up later.

You can find out when exhibitions relevant to your business take place by searching on the UK Trade & Investment website. This government organisation is responsible for all trade promotion and development work (www.events.ukti.gov.uk). If you want to exhibit or attend a show overseas, TSNN (www.tsnn.com) operates a widely consulted event database containing data on more than 15,000 trade shows, exhibitions, public events and conferences worldwide. You need to register (free) for full access to the database.

TIP You may be able to get financial help from your trade association to attend an overseas exhibition. For example, the UK Fashion and Textile Association has grants available for eligible UK-based companies for key shows in Paris, Berlin, Florence and New York, covering menswear, womenswear, lingerie and childrenswear (go to the website www.ukft.org and select Business and then Export).

TIP Check out the government's support service for exporters – Business Is Great (www.greatbusiness.gov.uk/ukti/) – and its Business Support Helpline (0300 456 3565) for advice, inspiration and help to get started in exporting.

## Setting advertising objectives

You're wasting your time advertising your product or service unless it leads to the opportunity for a sale in a significant number of instances. Ask yourself what potential customers have to do to enable you to make these sales. Do you want them to visit your showroom, phone you, write to your office, return a card or send an order in the post? Do you expect them to order now, or to remember you at some future date when they've a need for your services?

The more specifically you identify the response you want, the better you can tailor your promotional effort to achieve your objective, and the more clearly you can assess the effectiveness of your promotion.

The more general your advertising objective is – for example, to 'improve your image' or 'to keep your name in front of the public' – the more likely it is to be an ineffective way of spending your money.

## Deciding the budget

People commonly use two methods to calculate their advertising budget numbers:

- **What can we afford?** This approach accepts that cash is usually a scarce commodity and advertising has to take its place alongside a range of competing demands.
- **Cost/benefit:** This approach comes into its own when you've clear and specific promotional goals. If you've spare capacity in your factory or want to sell more out of your shop, you can work out how much it costs you to increase your production and sales, and how much you may benefit from those extra sales. You then figure out how much advertising money it's going to take to get you the extra business.

Suppose you expect a £1,000 advertisement to generate 100 enquiries for your product. If your experience tells you that on average 10 per cent of enquiries result in orders, and your profit margin is £200 per product, then you can expect an extra £2,000 profit. That benefit is much greater than the £1,000 cost of the advertisement, so the investment seems worthwhile.

In practice, you should use both these methods to decide how much to spend on promoting your products.

## Defining the message

To define your message, you must look at your business and its products from the customer's standpoint and be able to answer the question, 'Why should I buy your product?' The best way is to consider the answer in two stages:

1. **'Why should I buy your *product or service* ?'**

   The answer comes naturally when you look carefully at customers' motives for buying and the benefits they get from the product.
2. **'Why should I buy *your* product or service?'**

   The only logical and satisfactory answer is: 'Because it's better and so it's different.'

   The difference can arise in two ways:

   - You, the seller, are different. To achieve this, you establish a particular niche for your business.
   - Your product or service is different. Each product or service should have a unique selling point, based on fact.

Your promotional message must be built around the strength(s) of your product or service and must consist of facts about the company and about the product or service.

The stress here is on the word *fact* . Although many types of fact may surround you and your products, your customers are interested only in two – the facts that influence their buying decisions, and the facts of how your business and its products stand out from the competition.

The assumption is that everyone buys for obvious, logical reasons only, but of course innumerable examples show that people don't. Does a woman buy a new dress only when an old one is worn out? Do bosses have desks that are bigger than their subordinates' because they have more papers to put on them?

# Choosing the media

Broadly, your advertising choices are *above-the-line* media, which is jargon for the Internet, newspapers, magazines, television, radio and other broadcast media, and *below-the-line* activities, such as brochures, leaflets, visiting cards, stationery, letterheads and the way you answer the phone.

## Above-the-line advertising

The printed word (the Internet, newspapers and magazines) probably takes most of your above-the-line advertising budget. Print is the accepted medium to reach the majority of customers. Most people read a newspaper, especially on Sunday, and magazines cater for every imaginable interest and range from parish magazines to Sunday supplements. News and articles are also increasingly available on the Internet (as online versions of conventional papers) or via blogs.

You must advertise where your buyers and consumers are likely to see your message. Your market research (refer to Chapter 6 in Book 1 and Chapter 1 in Book 5) tells you where your likely prospects lie. Before making your decision about which paper or journal to advertise in, you need to get readership and circulation numbers and the publication's reader profile.

You can get this information directly from the journal or paper, which you should be able to access through your local business library. The Audit Bureau of Circulations (`www.abc.org.uk`) audits website traffic, among other media, and Rajar (Radio Joint Audience Research) independently compiles radio audience statistics every quarter, providing an industry benchmark (`www.rajar.co.uk`). Blog Catalog (`www.blogcatalog.com`) operates social network and blog indexing services that can help you filter through the myriad of social media and home in on the ones that operate in your business sector. (See also Chapter 7 in Book 5, where the whole social networking scene is covered.)

## Below-the-line advertising

When considering below-the-line advertising, identify what business gurus call *moments of truth* – contact points between you, your product or service, and your customer. Those moments offer you a chance to shine and make a great impression. You can spot the difference immediately when you get a really helpful person on the phone or serving you in a shop. The same is true of product literature that's actually helpful, a fairly rare event in itself.

Some of the most effective promotional ideas are the simplest; for example, a business card with a map on the reverse showing how to find you, or thank-you cards instead of letters on which you can show your company's recently completed designs.

# Choosing the frequency

Think carefully about the timing of your advertising in relation to the kind of media you're considering. The copy dates of some monthly publications are two months before publication;

trade exhibitions often occur only once or twice a year. This scarcity poses problems if you're waiting on a shipment or uncertain about a product change. Daily or weekly publications allow much prompter changes. The ultimate kinds of media are probably the Internet, which can be updated minute by minute, and radio, where messages can be slotted in on the same day. Yearbooks, diaries and phone directories require a lot of forward notice.

## Writing a leaflet

Whether or not you actually use a leaflet as part of your advertising strategy, it's always worth writing one. The process forces you to think about what you have to tell potential customers about your product or service and, most importantly, what you want them to do next when they know of your existence. So if you want them to buy now, you need to give prices, availability, delivery times and so forth.

A leaflet doesn't have to be big – both sides of a sheet of A4 paper is as much as you can hope to get most readers to plough through, even if you're peddling the elixir of life. As well as carrying text, leaflets are a great way to get across more complex messages that a picture or diagram delivers best.

The leaflet content needs to be:

- Clear, in straightforward English, simply laid out and easy to read
- Concise, using as few words as possible, and jargon free
- Correct, because spelling mistakes and incorrect information destroy confidence in you and your product or service
- Complete, providing all the information needed for the reader to progress to the next stage in the buying process

TIP Flyerzone (`www.flyerzone.co.uk/catalogue/designs`) has hundreds of ready-made designer templates for hundreds of different types of business from bars to wedding services. You can use their free online template to create your own leaflet, flyer or poster.

## Using the Internet for viral marketing

The Internet is now central to the marketing process for most businesses. Even where customers don't buy online, most consumers and all business buyers check out products and services using the Internet to check price, quality and competitive offers. Increasingly, products that used to have a physical presence are disappearing from the shelf. Music, software, film and now even books are available in 'soft' form to try or buy and download online. (This whole subject is so vital to a small firm's ability to compete that this book dedicates two whole chapters to the subject; flick to Chapter 6 in Book 5, which covers doing business online, and Chapter 7 in Book 5, which looks at social media.)

*Viral marketing* is a term that describes the ability of the Internet to accelerate interest and awareness in a product by rapid word-of-mouth communications. Take a look at recent communications networks and how they work.

The simplest are the ‘one-to-one’ broadcast systems, such as television and radio. In these systems, the overall value of the network rises in a simple relationship to the size of the audience; the bigger the audience, the more valuable your network. Mathematically, the value rises with N, where N represents the size of the audience. This relationship is known as Sarnoff’s Law, after a pioneer of radio and television broadcasting.

Next in order of value comes the telephone network, a ‘many-to-many’ system where everyone can get in touch with anyone else. Here the mathematics are subtly different. With N people connected, every individual has the opportunity to connect with $N-1$ other people (you exclude yourself). So the total number of possible connections for N individuals is $N(N-1)$, or $N^2-N$ . This relationship is known as Metcalf’s Law, after Bob Metcalf, an inventor of computer networking. The size of a network under Metcalf’s Law rises sharply as the value of N rises, much more so than with simple one-to-one networks.

TECHNICAL STUFF

The Internet, however, has added a further twist. As well as talking to each other, Internet users have the opportunity to form groups in a way they can’t easily do on the telephone. Any Internet user can join discussion groups, auction groups, community sites and so on. The mathematics now becomes interesting. As David Reed, formerly of Lotus Development Corporation, demonstrated, if you’ve N people in a network, they can in theory form $2^N-N-1$ different groups (a relationship known as Reed’s Law). You can check this formula by considering a small N, of say three people, A, B and C. They can form three different groups of two people, AB, AC and CB, and one group of three people, ABC, making a total of four groups as predicted by the formula. As the value on N increases, the size of the network explodes.

The birth of viral marketing, using the power of Reed’s Law to the full, has been attributed to the founder of Hotmail, who insisted that every email sent by a Hotmail user should incorporate the message: ‘Get your free web-based email at Hotmail.’ By clicking on this line of text, the recipient would be transported to the Hotmail home page. Although this email sent by the company itself wouldn’t have had much effect, at the foot of an email sent by a business colleague or friend it made a powerful impact. The very act of sending a Hotmail message constituted an endorsement of the product and so the current customer was selling to future customers on the company’s behalf just by communicating with them. The recipient of a Hotmail message discovered that the product works, but also that someone he respected or liked was a user.

You only have to see how quickly a harmful computer virus can spread in hours and days, to cover the whole world, to see the potential of viral marketing. For a small firm, this technique has the added advantage of being inexpensive and easy to execute. Just look at a few major sites on the Internet to get ideas. Book e-tailors all have links for you to email a friend about a book you’ve ‘stumbled’ across on their site. Travel sites encourage you to email any of their special offers that you don’t plan to take up to a friend. However, the beauty and limitation of viral marketing is that it works only when you’re talking about a good product. People don’t recommend something they don’t like using themselves.

## Providing opportunities to see

The more opportunities you give potential customers to see your name or your product, the greater the chance of them remembering you, which is why direct mail letters usually involve more than one piece of literature. The theory is that the recipient looks at each piece before discarding it. The recipient may only give it a brief scan, but each scan gives the seller another chance to hook a customer. So, rather than using different advertising messages, try getting the same or a similar message to one customer group several times.

One claimed benefit of breakfast television is that it can get your message out before the shops open. In business-to-business sales, trade buyers are deluged with calendars, diaries, pen sets and message pads in the hope that when the buyer is making a decision, the promotional materials are still close at hand and have an influence on that decision.

## Figuring your bang-for-the-buck ratio

You should undertake advertising only where you can realistically measure the results. Everything else is self-indulgent. The formula to keep in mind is:

$$\text{Effectiveness} = \text{Total cost of the advertising activity concerned} \div \text{Results}$$
$$(\text{in measurable units such as customers, new orders or enquiries})$$

A glance at the advertising analysis in Table 3-2 shows how one organisation went about measuring and comparing the effectiveness of different advertising methods. Table 3-2 shows the advertising results for a small business course run in London. At first glance, the Sunday paper produced the most enquiries. Although it cost the most, at £340, the cost per enquiry was only slightly more than the other media used. But the objective of this advertising wasn't simply to create interest; it was intended to sell places on the course. In fact, only 10 of the 75 enquiries converted into orders – an advertising cost of £34 per head. On this basis, the Sunday paper was between 2.5 and 3.5 times more expensive than any other medium.

**TABLE 3-2 Measuring Advertising Effect**

| *Media Used* | *Enquiries* | *Cost of Advertising (£)* | *Cost per Enquiry (£)* | *No. of Customers* | *Advertising Cost per Customer (£)* |
|---|---|---|---|---|---|
| Sunday paper | 75 | 340 | 4.50 | 10 | 34 |
| Daily paper | 55 | 234 | 4.25 | 17 | 14 |
| Posters | 30 | 125 | 4.20 | 10 | 12 |
| Local weekly paper | 10 | 40 | 4.00 | 4 | 10 |
| Personal recommendation | 20 | N/A | N/A | 19 | N/A |

# Getting into the News

Getting your business into the news is one of the most cost-effective ways to get your message in front of both actual and potential customers. People see papers, TV and journals, online and off-line, as being unbiased, and so they've a greater impact on their audiences than pure adverts.

TIP It goes without saying that what you're looking for is favourable news, but if you do have bad news coming through, check out this website: www.aboutpublicrelations.net/crisis.htm.

The surest way to get in the news is to write a press release. Better still, write lots of them. To be successful, a press release needs to get attention immediately and be quick and easy to digest. Studying and copying the style of the particular journals (or other media) you want your press release to appear in can make publication more likely.

The introduction is the most vital part. Ask yourself, 'Will what I write make the reader want to read on?' Avoid detail and sidetracks. The paragraphs should have bite and flow. Keep the sentences reasonably short. State the main point of the story or information early on. Follow these suggestions for a successful press release:

- Type the release on a sheet of A4 paper headed 'Press Release' or 'Press Information' and email it to the News Editor, News Desk or a named journalist.
- Use double spacing and wide margins to allow for editorial changes and printing instructions, respectively. Use one side of the paper only.
- Date the release and include a headline to identify it. This must persuade the editor to read on. If it doesn't attract interest, it'll be quickly 'spiked'. Editors are looking for topicality, originality, personality and, sometimes, humour.
- Tell your story in three paragraphs. The substance should come in the first one. The first paragraph must say who, what, why, when and where, and succeeding paragraphs can fill in the detail. If space is short, a sub-editor deletes from the bottom, and papers are always looking for fillers – short items that they can drop into gaps. Even if the paper cuts the bulk of the story, at least it may print the main facts.
- Include at least one direct quotation or comment, always from a named individual and ideally from someone of standing or relevance.
- Keep the press release simple and write for the readership. The general public prefers images or descriptions to technical facts. For example, you can describe a new car lock as being able to keep out a professional thief for 30 minutes for a story in the general press. For the trade press, the same story may be better supported by facts about the number of levers, codes and so forth that are involved in beefing up the lock's security system.
- Finish with a contact for more information. Give phone numbers for work and home and a mobile number, as well as your email and website addresses. Doing so helps a journalist looking for more detail – if a gap occurs suddenly and you're available for further information, your story may be more attractive.
- Submit the release before the paper or journal's deadline. All the media work to strict deadlines. Many local papers sold on a Friday are printed on a Tuesday or Wednesday morning. A release that fails to make it by then probably gets ignored. The national dailies, of course, have more flexibility and often have several editions. At the other end of the scale, many colour supplements and monthly journals have a cut-off date six weeks in advance.
- Steer away from selling your firm and product, and write news. Anything else is advertising and may be discarded. You're not writing an advertisement; you're telling a story to interest readers.

- A good picture is worth a thousand words, as the adage goes. Certainly, from a journalist's point of view, your picture is worth half a page of text he doesn't have to write himself.

### Deciding who to contact

REMEMBER The target audience for your press release is the professional *editor* – the person who decides what to print. With British editors receiving an average of 80–90 press releases per week, make sure that you're publicising your latest newsworthy item and that your press release is free of puffery and jargon.

Do your research to find not only the right newspapers or journals, but also the right journalists. Read their columns, or listen to or watch their programmes, and become familiar with their style and approach to news stories. Your goal is to write a press release that's so close to a journalist's own style that he has almost no additional work to do to make your news usable.

### Following through

You get better results if you follow up your press release with a quick phone call. Journalists get bogged down and distracted like everyone else, so don't be too surprised if your masterpiece sinks to the bottom of a pile of prospective stories before the day is out. That phone call, or even an email if you can't get through, is often enough to keep up interest and get your story through the first sifting.

When you start getting results, you want to keep the effort going. But even if you aren't successful at first, don't be disappointed or disheartened. Keep plugging away. Try to find a story regularly for the local press and get to know your local journalists and editors. Always be truthful, helpful and available. If a media contact rings you and you're in a meeting, make sure that you ring back.

Some companies seem to get a piece in the paper every week. The stories published aren't always earth-shattering news, but the continuous drip of press coverage eventually makes an impact. For example, Virgin Airways was boosted immeasurably by successful press coverage. Few of the millions of words of copy written about Richard Branson or Virgin have been paid for.

## Using Blogs and Social Networks

Consumers increasingly get influenced by their peers' views as to what to buy and do. This process of disseminating information was at one time the exclusive domain of mainstream advertising and of comment in the press or on the news. The Internet has changed the game, and now everyone can find out from consumers how good or bad a product or service is.

Blogs, Facebook, Foursquare, Twitter and a host of other social networks are now an important way to get your message across. In some cases – such as when marketing to the under 25s – they're the *only* way. Often systematic processes are in place; TripAdvisor's information on hotel users' experiences is a good example, where users rate on a points scale different aspects of a hotel experience – such as accommodation, service and value for money. This information allows potential customers to see whether the particular aspect or aspects they're looking for in a hotel are likely to be delivered.

TIP You need to build these social network routes into your marketing plans. The latest edition of *Social Media Marketing For Dummies* (Wiley) contains everything you need to know about this vital topic. Also check out Chapter 7 in Book 5 on this subject.

# Selling for Business Success

More direct than advertising or publicity, selling is at the heart of every business. Whatever kind of selling your business involves, from moving goods over a counter to negotiating complex contracts, you need to understand the whole selling process and be involved with every aspect of it.

## Telling the difference between selling and marketing

Marketing involves the whole process of deciding what to sell, who to sell it to and how. The theory is that a brilliant marketing strategy should all but eliminate the need for selling. After all, selling is mostly concerned with shoe-horning customers into products that they don’t really want, isn’t it? Absolutely not! The more effort you put into targeting the right product or service to the right market, the less arduous the selling process is, but you still have a selling job to do.

The primary job of the sales operation is to act as a bridge or conduit between the product and the customer. Across that gulf flows information as well as products and services. You need to tell customers about your great new ideas and how your product or service performs better than anything they’ve seen to date.

REMEMBER Most businesses need selling and marketing activities in equal measure to get their message across effectively and get goods and services into their markets.

## Selling yourself

One of the most important operational issues to address is your personal selling style. If you’ve sold products or services before, you may have developed a successful selling style already. If not, you need to develop one that’s appropriate for your customers and comfortable for you. Regardless of your experience, assessing your selling style helps define and reinforce your business goals.

Check that you and your salespeople always see things from the customer’s point of view. Review the sales styles of your salespeople to see how they can improve. Consider whether your own and your salespeople’s selling styles are *consultative* , where you win the customer over to your point of view, or *hard* , where you try forcing the customer to take your product or service.

In assessing your selling style, consider the following:

- Always have a specific objective for any selling activity, together with a fall-back position. For example, your aim may be to get an order, but you may settle for the chance to tender for a customer's business. If you don't have objectives, much of your sales activity may be wasted on courtesy calls that never reach the asking-for-an-order stage.

- The right person to sell to is the one who makes the buying decision. You may have to start farther down the chain, but you should always know who you finally have to convince.
- Set up the situation so you can listen to the customer. You can best do this by asking open questions that look for long answers as opposed to closed questions that solicit a 'yes or no' response. When the customer has revealed what his needs really are, confirm them back to him.
- Explain your product or service in terms of the customer's needs and requirements.
- Deal with objections without hostility or irritation. Objections are a sign that the customer is interested enough in what you have to say to at least discuss your proposition. After you've overcome the customer's objections and established a broad body of agreement, you can try to close the deal.
- Your approach to closing can be one of a number of ways:
    - The *assumptive close* takes the tack that because you and the customer are so much in agreement, an order is the next logical step.
    - If the position is less clear, you can go for the *balance sheet close* , which involves going through the pros and cons and then arriving at a larger number of pros. So again, the most logical way forward is for the customer to order.
    - If circumstances allow, you can use the *special situation* closing technique. This may be appropriate if a product is in scarce supply or on special offer for a limited period.
- If you're unsuccessful, start the selling process again using your fall-back objective as the goal.

## *Outsourcing selling*

Hiring sales people can prove to be too costly for a new or small business. A lower-cost and perhaps less-risky sales route is via agents. Good agents should have existing contacts in your field, know buyers personally and have detailed knowledge of your product's market. Unlike someone you recruit, a hired agent should be off to a flying start from day one.

The big difference is that agents are paid purely on commission – if they don't sell, they don't earn. The commission amount varies, but is rarely less than 7 per cent of the selling price, though 25 per cent isn't unknown.

You can find an agent as follows:

- Advertise in your specialist trade press or newspapers such as the *Daily Telegraph* and *Exchange and Mart* .
- Use the search facility on the website of the Manufacturers' Agents' Association ( www.themaa.co.uk ), whose membership consists entirely of commission agents selling in all fields of business. The fee is £175 plus £35 VAT to contact up to 20 agents in one search.
- Check out Internationally United Commercial Agents and Brokers ( www.iucab.com ), which has details on around 470,000 commercial agents in Europe and North and South America.
- Look in trade directories that list other agents' associations.
- Approach outlets where you want to sell (this method is the most reliable one). They know the honest, competent and regular agents who call on them. Draw up a shortlist and invite those agents to apply to you.

REMEMBER When interviewing potential sales agents, you should find out:

- What other companies do they work with and products do they already sell? You want them to sell related but not competing products or services to yours.
- What's their knowledge of the trade and geographical area that you cover? Sound them out for specific knowledge of your target market.
- Who are their contacts?
- What's their proven selling record? Find out who their biggest customers are and talk to them directly.
- Do they appear honest, reliable and fit to represent your business? Take up references and talk to their customers.

Finding professional representation is a challenge, so your product has to be first class and your growth prospects good, with plenty of promotional material and back-up support.

When you do find someone to represent your product, draw up an agreement to cover the main points, including geographical area, commission rates, when commission is payable, customers you want to continue dealing with yourself, training and support given, prohibition of competing agencies and periods of notice required to terminate. Also build in an initial trial period after which both parties can agree to part amicably.

### Measuring results

Sales results can take time to appear. In the meantime, you need to make sure that you (or your agent) are doing things that eventually lead to successful sales. You should measure the following:

- Activities:
  - Sales appointments made
  - Sales calls made per day, per week and per month (monitor trends, because last quarter's sales calls give you a good feel for this quarter's sales results)
  - Quotations given
- Results:
  - New accounts opened
  - Old accounts lost
  - Average order size

## Settling on a Price

Pricing is another element of the marketing mix, and it represents the biggest decision you have to make about your business and the one that has the biggest impact on company profitability. You need to keep pricing constantly under review.

To get a better appreciation of the factors that may have an influence on what you charge, keep these factors in mind. (The accounting aspect of pricing is covered in Chapter 3 of Book 2.)

## Caring about business conditions

Obviously, the overall conditions in the market place have a bearing on your pricing policy. In boom conditions, where products are so popular that they're virtually being rationed, you can expect the overall level of prices for some products to rise disproportionately. And conditions can vary so much from place to place that they've a major impact on pricing. For example, one business starter produced her beauty treatment price list based on prices near to her home in Surrey. However, she planned to move to Cornwall to start her business, where prices were 50 per cent lower, reflecting lower rates of pay in the county. So although she got a boost by selling her Surrey home for much more than she paid for a house in Cornwall, that gain was offset by having to charge much lower prices for her services.

Seasonal factors can also contribute to changes in the general level of prices. A turkey, for example, costs less on the afternoon of Christmas Eve than it does at the start of Christmas week.

## Working to your capacity

Your capacity to produce your product or service, bearing in mind market conditions, influences the price you set. Typically, a new venture has limited capacity at the start. A valid entry strategy may be to price high enough to just fill your capacity, rather than so low as to swamp you.

Take the example of a housewife who started a home ironing service at £5.50 per hour's ironing, in line with competition, but because she had only 20 hours a week to work in, she rapidly ran out of time. It took six months to get her price up to £7 an hour and her demand down to 20 hours per week. Then she was able to recruit some assistance and had a high enough margin to pay outworkers and make a bit of profit herself.

## Understanding consumer perceptions

A major consideration when setting your prices is customers' perception of the value of your product or service. Their opinion of value may have little or no relation to its cost, and they may be ignorant of the price that the competition charges, especially if your product or service is a new one.

## Skimming versus penetrating

The overall image that you want to portray in the market place influences the prices you charge. A high-quality image calls for higher pricing, naturally. However, within that pricing policy you've two options: set a high price, which just *skims* the market by being attractive only to a small population of wealthier customers; or go for a low price to *penetrate* the market, appealing to the mass of customers.

Businesses often adopt skim pricing for new products with little or no competition that are aimed at affluent buyers (who are willing to pay more to be the trendsetters for a new product). After the innovators have been creamed off the market, you can drop the price to penetrate to lower layers of demand.

The danger with this strategy is that high prices attract the interest of new competitors. If you've a product that's easy to copy and impossible to patent, you may be better off setting the price low to discourage competitors and to spread your product throughout the market quickly.

### Avoiding setting prices too low

WARNING The most frequent mistake that companies make when setting a selling price for the first time is to pitch it too low. Through failing to understand all the costs associated with making and marketing your product or through yielding to the temptation to undercut the competition at the outset, you set your price so low that you risk killing your company.

## Pondering Place and Distribution

Place is the aspect of the marketing mix that makes you review exactly how you get your products or services to your customers.

If you're a retailer, restaurateur or garage proprietor, for example, then your customers come to you. Your physical location is probably the key to success. If your business is in the manufacturing field, you're more likely to go out and find customers. In this case, your channels of distribution are the vital link.

Even if you're already in business and plan to stay in the same location, you may benefit from taking the opportunity to review that decision. If you're looking for additional funds to expand your business, your location is undoubtedly an area that prospective financiers will want to explore.

### Choosing a location

From your market research data, you should be able to come up with a list of criteria that are important to your choice of location. The factors you need to weigh up when deciding where to locate include:

- If you need a skilled or specialist workforce, is it readily available?
- Are the necessary back-up services available, such as computer support, equipment repairs and maintenance?
- How readily available are raw materials, components and other supplies?
- How does the cost of premises, rates and utilities compare with other areas?
- How accessible is the site by road, rail and air?
- Are there any changes in the pipeline that may adversely affect trade? Examples include a new motorway bypassing the town, changes in transport services and the closure of a large factory.
- Are there competing businesses in the immediate neighbourhood? Are these competitors likely to have a beneficial or detrimental effect?
- Is the location conducive to the creation of a favourable market image? For instance, a high-fashion designer may lack credibility trading from an area famous for its heavy industry and infamous for its dirt and pollution.
- Is the area generally regarded as low or high growth? Is the area favourable to businesses?
- Can you and your key employees get to the area easily and quickly?

TIP You may even have spotted a role model – a successful competitor, perhaps in another town, who appears to have got the location spot on. You can use its location criteria as a guide to developing your own.

Using these criteria, you can quickly screen out most unsuitable areas. You may have to visit other locations several times, at different hours of the day and on different days of the week, before screening them out too.

## *Working from home*

Few dedicated statistics exist on the number of people operating home-based enterprises as distinct from those setting up in dedicated premises. In February 2015 the UK government produced the Report on Small Firms ( www.gov.uk/government/uploads/system/uploads/attachment_data/file/402897/Lord_Young_s web_version_final.pdf ). It found that in 2013 there were 2.9 million home-based businesses, which was an increase of nearly 500,000 since 2010. Even those not working from home now often start out from there, like Simon Nixon, who founded the price comparison site MoneySuperMarket.com ( www.moneysupermarket.com ).

Starting a business from home gives you a number of distinct advantages over those plumping for premises straight away. Here are three big advantages that a home-based business has over its peers that give it an edge:

- **Lower costs:** Starting from home saves most of the £35,000 start-up costs that the average business incurs even before it takes its first order. The chances are that you've nearly everything you need to start up your business already somewhere around your home. You can press into service a garage, loft, spare bedroom or garden shed for a whole host of business-related tasks from holding stock to being a dedicated office space away from the normal hustle of home life. Your computer, however old, is almost definitely just fine, unless you're starting a business at the cutting edge of design or on the Internet.
- **More time:** Money can buy lots of things, but time isn't one of them. However close to your business premises you are, you'll spend an hour or more a day travelling to and from it. If your shop, restaurant or office is only a couple of miles away, however, maybe you won't believe that proposition. How on earth is it possible to take an hour to travel just a mile? Well, an immutable law says that the closer your home is to your business premises, the more often you travel between the two. Ergo, if you're 20 miles away, you go once a day, covering 40 miles, and if you're only 5 miles away, you come home for lunch and return once or twice more each week to collect things you've forgotten. Whatever the distance, the average weekly travel time is about the same. Working from home gives you back all that wasted time spent travelling, and you can invest the time in your business.
- **Less stress:** Commuting to work on a daily basis is stressful. In any vibrant and successful economic area, road works, accidents, delays and traffic jams are pretty much the norm. Few people are fortunate enough to work in a car-free area or where parking is never a problem. Even if you can find such a paradise, the chances are it would be useless as a business proposition. Depopulated areas are equally devoid of customers, suppliers and people to employ.

## Selecting a distribution channel

When you know where you want to locate, selecting a distribution channel involves researching methods and deciding on the best way to get your product to your customers.

Moving a product through a distribution channel calls for two sorts of selling activity. *Push* is the name given to selling your product in, for example, a shop. *Pull* is the effort that you carry out on the shop's behalf to help it sell your product. Your advertising strategy or a merchandising activity may cause the pull. You need to know how much push and pull are needed for the channel you're considering. If you aren't geared up to help retailers sell your product, and they need that help, this channel may be a poor choice for you.

The way in which you have to move your product to your end customers is an important factor to weigh up when choosing a channel. As well as such factors as the cost of carriage, you also have to decide on packaging materials. As a rough rule, the more stages in the distribution channel, the more robust and expensive your packaging has to be.

REMEMBER Not all channels of distribution settle their bills promptly. For example, mail-order customers pay in advance, but retailers can take up to 90 days or more to pay. You need to take account of this settlement period in your cash-flow forecast.

Consider these factors when choosing channels of distribution for your particular business:

- **Does the channel meet your customers' needs?** You have to find out how your customers expect their product or service to be delivered to them and whether they need that particular route.
- **Will the product itself survive?** Fresh vegetables, for example, need to move quickly from where they're grown to where they're consumed.
- **Can you sell enough this way?** 'Enough' is how much you want to sell.
- **Is the channel compatible with your image?** If you're selling a luxury product, door-to-door selling may spoil the impression you're trying to create in the rest of your marketing effort.
- **How do your competitors distribute?** If they've been around for a while and are obviously successful, you may benefit from looking at how your competitors distribute and then using that knowledge to your advantage.
- **Is the channel cost-effective?** A small manufacturer may not find it cost-effective to supply retailers in a particular area because the direct 'drop' size – that is, the load per order – is too small to be worthwhile.
- **Is the mark-up enough?** If your product can't bear at least a 100 per cent mark-up, then you're unlikely to be able to sell it through department stores. Your distribution channel has to be able to make a profit from selling your product too.

# Considering the Newer 3Ps

The original marketing mix had just 4Ps – product, price, place and promotion. However, this mix has since been extended to 7Ps, with *people* , *process* and *physical evidence* added to accommodate the increasing emphasis on customers. The originators of the extra 3Ps had in mind the unique problems in marketing intangible services; however, as almost every product has a major service element, the 7Ps have been adopted into the mainstream marketing mix analysis (refer to the earlier section 'Making Up the Marketing Mix ').

## People

Marketing managers often believe that the most important aspects of marketing lie in areas such as creating sensational advertising campaigns, launching innovative and well-designed products or creating brand identity. Not to denigrate these factors in any way, but the single most prevalent reason for a marketing strategy failing lies in its implementation and, by extension, the *people* who carry out marketing tasks. It's the selection of people to implement strategy and the way in which they're organised that contributes the most to your business's success. Unfortunately, people – both individually and collectively – are infinitely variable in their likely responses to situations, making their behaviour hard to predict.

The famous German military strategist Moltke originated a useful statement that applies here, which can be summarised as 'No campaign plan survives first contact with the enemy' (if the word 'enemy' is replaced by 'organisation'). However, by understanding and applying some basic principles and concepts in the areas of leadership, motivation and team-building, you can improve an organisation's chances of achieving its objectives. Aspects of leadership and team-building are covered in Chapter 6 of Book 6.

Sometimes something as basic as getting your employees to more properly reflect your customer base can change your business proposition as dramatically as a shift in price, promotion, product or place. In 1989, B&Q, the largest home improvement and garden centre retailer in the UK and Europe and the third largest in the world, made a major change to the profile of its workforce. In response to customer comments that they wanted to be served by someone who had lived in their own home and knew something about home improvements, B&Q set each of its 330 UK stores the objective to employ a workforce that reflects the make-up of the local community, but with an emphasis on employing people over 50. This initiative delivered 18 per cent higher profits, with one-sixth of the previous level of staff turnover. Not only are the shareholders happy, the employees are too. The company is one of only eight organisations globally to have won Gallup's Great Workplace Award for three years in a row, scoring 4.24 out of five, a near 'world class' achievement.

## Physical evidence

The physical environment needs to be attractive and appropriate, particularly for retail businesses. So for McDonald's, a play area is a plus – but this would perhaps be inappropriate for a bank. Services are largely intangible when you think about marketing them. However, customers tend to rely on physical cues to help them evaluate a product before they buy it.

REMEMBER To make a service tangible to the customer, marketers develop what is called *physical evidence* to replace these physical cues in a service. The role of the marketer is to design and implement such tangible evidence, varying it as appropriate in the marketing mix.

For example, ambience can be used to help customers experience the service on offer. In a club loud music and flashing lights are the order of the day, while in a spa candles and scent can be used to deliver a calm, therapeutic environment. The marketer's task is to make ambience support and enhance the service being sold.

### Process

How you deliver your product or service (the *process* ) is another element in the marketing mix that you can vary or improve so as to give your business a competitive edge. Complicated ordering systems, confusing websites and unhelpful returns policies can work against your business. For example, customers going on a package holiday will expect a streamlined process to ensure a satisfactory trip – they'll expect to find and book the holiday on a website, get their e-tickets by email, check in and retrieve their baggage without lengthy queues, experience a smooth transit from the airport to the hotel, and receive a swift resolution to any problems.

Process is now such a critical element in the marketing mix that it has attracted a whole new business discipline, *business process reengineering (BPR)* . This reengineering process involves a fundamental rethink and radical redesign of business processes to achieve dramatic improvements in critical, contemporary measures of performance such as cost, quality, service and speed.

TECHNICAL STUFF

The term 'reengineering' was first introduced in July/August 1990 in the *Harvard Business Review* article 'Reengineering Work: Don't Automate, Obliterate'. The article's author was Michael Hammer, a former computer science professor at the Massachusetts Institute of Technology. Hammer then went on to develop the concept further in a book, *Reengineering the Corporation* (published by HarperCollins), written jointly with James Champy.

IBM, for example, embarked on reengineering in 1992. Its goal was to become more customer-centred. At the time, the company had 12 customer relationship processes, including 'solutions delivery' – a fully priced contract between IBM and the customer for a complete IT system, covering hardware, software, technical support and consulting services, as well as outsourced products. The redesigned process moved the responsibility for pricing to the frontline sales team, using a specially developed 'pricing tool' piece of software. This removed the two-month delay that formerly occurred when pricing was referred to IBM's headquarters, during which time IBM was in danger of losing customers (especially where time was a critical buying benefit).

Organisations including the Small Business Administration (SBA; the US government's body for helping new and small businesses), Walmart and Ford Motor Company have used BPR with success.

## Looking at Legal Issues in Marketing

Nothing in business escapes the legal eye of the law, and marketing is no exception. If anything, marketing is likely to produce more grey areas from a legal point of view than most other aspects. You have patent and copyright issues to consider, for example.

A number of vital aspects of your business distinguish it from similar firms operating in or near to your area of operations. Having invested time, energy and money in acquiring these distinguishing factors, you need to take steps to preserve any benefits they provide you with. Intellectual property, often known as IP, is the generic title covering the area of law that allows people to own their creativity and innovation in the same way that they can own physical property. The owner of IP can control and be rewarded for its use, and this control encourages further innovation and creativity.

TIP The following four organisations can help direct you to most sources of help and advice across the entire IP field. They also have helpful literature and explanatory leaflets and guidance notes on applying for IP protection:

- Intellectual Property Office (www.ipo.gov.uk)
- European Patent Office (www.epo.org)
- US Patent and Trademark Office (www.uspto.gov)
- World Intellectual Property Organization (www.wipo.int)

The following sections cover the most common types of IP.

WARNING Protecting your IP in the UK may not be of much help in a global world. This lack of protection can be a problem, particularly when it comes to patents where disclosure is part of the application process. Your details and those of your idea will be included in the government's searchable patents journal when it publishes your application. Both are available to the public on its website and can be found using most standard search engines. The Intellectual Property Office provides guidance on getting worldwide protection for your IP at www.ipo.gov.uk/types/patent/p-manage/p-abroad/p-worldwide.htm.

## Naming your business

The main consideration in choosing a business name is its commercial usefulness. You want one that lets people know as much as possible about what your company does. So choose a name that conveys the right image and message.

Whichever business name you choose, it has to be legally acceptable and abide by the rules of the Business Names Act 1985. Detailed information on this subject is available from the Business Names section at the Companies House website. Go to www.companieshouse.gov.uk and click on Guidance and then Incorporation and Names.

## Looking at logos

You don't have to have a logo for your business, but it can build greater customer awareness. A *logo* may be a word, typeface, colour or shape. The McDonald's name is a logo because of its distinct and stylistic writing.

Choose your logo carefully. It should be easily recognisable, fairly simple in design and able to be reproduced on everything associated with your business. As far as the law is concerned, a logo is a form of trademark (see 'Registering a trademark ', later in this chapter).

## *Protecting patents*

*Patents* can be regarded as contracts between inventors and the state. The state agrees with the inventor that if he's prepared to publish details of his invention in a set form and if it appears that he's made a real advance, the state then grants him a monopoly on his invention for 20 years. The inventor can use the monopoly period to manufacture and sell the innovation; competitors can read the published specifications and glean ideas for their research, or they can approach the inventor and offer to help to develop the idea under licence.

If you want to apply for a patent, you mustn't disclose your idea in non-confidential circumstances. If you do, your invention is already 'published' in the eyes of the law, and this fact can invalidate your application. Ideally, you write down the confidentiality of the disclosure you make in a confidentiality agreement, which the person to whom you're making the disclosure signs. The other way is to get your patent application on file before you start talking to anyone about your idea. You can talk to a chartered patent agent in complete confidence because they work under strict rules of confidentiality.

The process of filing an application and publishing and granting the patent takes two and a half years. The associated costs can be high: subject matter searches cost upwards of £500, validity searches from £1,000 and infringement searches from £1,500. The relevant forms and details of how to patent are available from the Patent Office at `www.ipo.gov.uk` .

## *Registering a trademark*

A *trademark* is the symbol by which the goods of a particular manufacturer or trader can be identified. It can be a word, a signature, a monogram, a picture, a logo or a combination of these.

To qualify for registration, the trademark must be distinctive, must not be deceptive and must not be capable of confusion with marks already registered. Excluded are national flags, royal crests and insignia of the armed forces. A trademark can apply only to tangible goods, not services (although pressure is mounting for this ruling to be changed). To register a trademark, you or your agent should first conduct preliminary searches at the trademarks section of the Intellectual Property Office ( `www.gov.uk/topic/intellectual-property/trade-marks` ) to check that no conflicting marks are already in existence. You then apply for registration on the official trademark form and pay a fee (currently £200, or £170 if you apply online). Registration is initially for ten years. After this time, you can renew for further periods of ten years at a time, with no upper time limit.

If you've been using an unregistered trademark for some time and it can be construed that customers closely associate it with your product, the trademark has acquired a 'reputation' that gives it some protection legally, but registration makes it much simpler for the owner to have recourse against anyone who infringes the trademark.

## *Detailing your design*

You can register the shape, design or decorative features of a commercial product if it's new, original, never published before or – if already known – never before applied to the product you have in mind. Protection is intended to apply to industrial articles to be produced in quantities of more than 50.

REMEMBER Design registration applies only to features that appeal to the eye – not to the way the article functions.

To register a design in the UK, you apply to the Intellectual Property Office ( www.gov.uk/topic/intellectual-property/designs ) and send a specimen or photograph of the design plus a registration fee (currently £60 plus £40 for each additional design). To protect your design outside the UK, you generally have to make separate applications for registration in each country in which you want protection.

## Controlling a copyright

*Copyright* gives protection against the unlicensed copying of original artistic and creative works – articles, books, paintings, films, plays, songs, music and even engineering drawings. To claim copyright, the item in question should carry the symbol © with the author's name and date. No other action is required to take out copyright, if that copyright is relevant to your business. For further information, you can access the copyright section of the Intellectual Property Office website ( www.gov.uk/topic/intellectual-property/copyright ).

REMEMBER Copyright doesn't last forever. Its duration depends on the type of copyright involved and can be anything from 25 to 70 years after the creator's death.

## Abiding by fair business rules

The whole way in which businesses and markets operate is the subject of keen government interest. Don't, for example, gang up with others in your market to create a *cartel* , in which you all agree not to lower your prices or to compete with each other too vigorously. Any such action may be brought to the attention of the Competition and Markets Authority ( www.gov.uk/government/organisations/competition-and-markets-authority ), whose job is to make markets work well for consumers. Markets work well when businesses are in open, fair and vigorous competition with each other for the consumer's custom.

The Competition and Markets Authority:

- Ensures that consumer legislation and regulations are properly enforced
- Takes action against unfair traders
- Encourages codes of practice and standards
- Offers a range of information to help consumers understand their rights and make good choices
- Liaises closely with other regulatory bodies that also have enforcement powers

## Setting terms of trade

All business is governed by terms of trade, which are in turn affected by contractual relationships.

Almost everything done in business, whether it's the supply of raw materials, the sale of goods and services or the hire of machinery, is executed under contract law. This is true whether the contract is in writing or verbal – or even merely implied. As the seller you set out your own terms of trade for selling to your customers, but sometimes your buyer has their own terms of trade for buying from suppliers (that's you), which can override your terms of trade.

REMEMBER Only contracts for the sale of land, hire purchase and some insurance contracts have to be in writing to be enforceable. To make life more complicated, a contract can be part written and part oral. So statements made at the time of signing a written contract can legally form part of that contract. For a contract to exist, three events must take place:

- An offer
- An acceptance
- A consideration – some form of payment

When selling via the Internet or mail order, the contract starts when the supplier 'posts' an acceptance letter, a confirmation or the goods themselves – whichever comes first.

Goods purchased via the Internet or mail order are covered by the the Consumer Contracts Regulations 2013, which came into force on 13 June 2014, under which customers have seven working days after they've received the goods to change their minds and return them. They don't need a reason and can get a full refund.

TIP You can find out more about consumer rights at the Research Institute for Consumer Affairs (http://rica.org.uk/content/consumer-rights).

You must give customers

- Information about the company they're dealing with, such as the business name, registered and trading addresses, and directors' names
- Written confirmation of the order – by fax, letter or email
- A full refund if the goods don't arrive by the date agreed in the original order; if no date was agreed, they must be delivered within 30 days
- Information about cancellation rights
- Protection against credit card fraud

You have to meet certain standards by law for the supply of goods and services. Over and above these, you need your own terms and conditions to avoid entering into 'contracts' you didn't intend. You need help to devise these terms. The following four basic propositions govern your conditions:

- The conditions must be brought to the other party's attention before he makes the contract.
- The last terms and conditions specified before acceptance of an offer apply.

- If any ambiguity or uncertainty exists in the contract terms, they're interpreted against the person who inserted them.
- The terms may be interpreted as unreasonably unenforceable, in breach of various Acts of Parliament.

TIP The Trading Standards Institute ( www.gov.uk/find-local-trading-standards-office ) can provide useful information on most aspects of trading relationships.

## *Describing your goods*

You can't make whatever claim you like for the performance of your goods or services. If you state or imply a certain standard of performance for what you're selling, your customers have a legally enforceable right to expect that to happen. So if you state that your new slimming method not only makes people lose weight but also makes them happier, richer and more successful, you'd better deliver on all those promises.

WARNING The Trade Descriptions Act 1968 and related legislation make it an offence for a trader to describe goods falsely. The Act covers everything from the declared mileage of second-hand cars to the country of manufacture of a pair of jeans.

The Trading Standards Institute operates at county level throughout the UK to ensure that trading laws are met. You can contact your branch by phone or via the website ( www.gov.uk/find-local-trading-standards-office ).

## *Dealing with payment problems*

Unless you're able to insist on payment before you send your product or supply your service, getting paid isn't always as simple as sending a bill and waiting for the cheque. Customers may dispute the bill, fairly or unfairly.

A government service gives you an opportunity to collect money when you find a regular court too expensive. True, for particularly small cases the process isn't always cost effective, and occasionally you have problems collecting on your judgement. But the Small Claims Court, as this service is sometimes referred to, should still be part of your business's collection strategy. (See www.gov.uk/make-court-claim-for-money/overview for more info.) The Ministry of Justice also offers a mediation service, providing members of the public and businesses with a simple, low-cost method of resolving a wide range of civil disputes out of court. Costs range from £50 to £425, plus VAT, for disputes over amounts between £5,000 and £50,000. For details visit www.civilmediation.justice.gov.uk .

One other route to less painful debt recovery (or problem resolution) is to go to arbitration. That's where an independent person listens to both sides of the case and makes a decision based more on common sense, fairness and practicalities than merely on the law. Arbitration is a cheaper, quicker and less intimidating process. You can find out all about the process and locate an arbitrator from the Chartered Institute of Arbitrators ( www.ciarb.org ).

# Chapter 4

# Creating and Placing Ads

**IN THIS CHAPTER**

**Writing copy and choosing strong visual elements for your print ad**

**Understanding print media terms and rates**

**Running your ad in newspapers and magazines**

**Getting seen and heard in other ways**

**Advertising on billboards, signs, posters and sandwich boards**

The year 2011 was a tipping point, when more people got their information from the Internet than from newspapers – and when online advertising got most of the ad revenue as well. But research by JWT, the global media firm, shows that over 50 per cent of millennials (people born in the early 1980s to around 2000) would prefer for print to remain a significant factor in their lives, even in the face of ever-increasing digitisation. The same study states that more than eight out of ten American adults would rather read magazines in hard copy than online.

In the same vein, only a few years ago e-readers were set to wipe printed books off the map; however, in October 2015 Waterstones, the UK's largest bricks-and-mortar book retailer, removed Amazon's Kindle e-books from its stores, replacing them with print books due to 'pitiful sales'.

So, you'd better know your customers before you abandon traditional advertising altogether (turn to Chapter 1 in Book 5 for help in defining your customers). If you're advertising to an older age group, putting ink on newspaper is still an essential way to get your word out.

If your target audience is younger – especially the 18–24 age group – you may want to consider ruling out traditional newspapers in favour of messages delivered via web-connected devices and TV. Even then, plenty in this chapter is for you because the younger audience is a primary target for out-of-home ads and ads in highly targeted publications where your message can catch them while they're flicking through one of the thousands of special-interest magazines.

## *Deciding on Your Budget*

How much money you spend on marketing depends on the type of business you have and the marketing tools you employ. Everyone wants a magic formula, but there isn't one, especially today when so much marketing happens online rather than through paid advertising. The following examples indicate this diversity in business types and marketing budget requirements:

- Mature businesses in established markets with low growth goals can get away with low marketing investments of as little as 2–5 per cent of sales. Companies that target high growth must invest far more.
- Businesses whose sales come primarily from subcontracting can spend almost no cash on

marketing, while businesses that need to win the attention of a broad cross-section of retail customers must budget enough to gain visibility through paid media ads, online communications and promotions.
- Businesses with customers who are active online and in social media networks can establish communication and ongoing interaction with little or no cash investment, though don't fool yourself into believing that social media and online marketing is free. At the least, you need to allocate time, which may translate to money if you hire staff or outside resources to establish and manage a truly effective online presence.

Only a decade ago, marketing success – especially for business-to-consumer marketers – relied heavily on how much money a business could invest in efforts to push its message into the marketplace. Today, success results not from merely pushing marketing messages but from forming two-way interactions with customers, both personally and through the Internet.

Cash no longer makes or breaks marketing effectiveness. Today's marketers need to budget both money and time to communicate with *and* listen to customers – interacting, responding and developing two-way relationships as a result.

TIP As you determine how much to allocate for marketing, consider the following:

- **The nature of your business and your market:** Businesses that market to other businesses tend to allocate a lower percentage of sales to marketing than businesses that market to a wide range or number of consumers. The difference is the proverbial rifle versus shotgun. The business-to-business marketer can set its sights and reach its customers directly, whereas the business-to-consumer marketer must reach a broader audience, usually involving costly investments of time and money.
- **The maturity of your business:** Start-up businesses need to invest more heavily than established businesses, in part to cover extraordinary one-time costs that existing businesses have behind them and in part to accelerate communications to gain first-time prospect awareness.
- **The size of your market area:** Businesses that serve customers who are primarily located within a short drive or walk from the business location can target marketing communications into a concise market area. As a result, they can probably allocate a lower investment than businesses that have to build awareness and interest in regional, national or even international markets.
- **Your competition:** Businesses with a monopoly have to enhance their marketing efforts if several competitors suddenly open nearby. And businesses that are the underdog and want to take on the leaders must invest accordingly.
- **Your objective and task:** The most important consideration in setting your budget is to understand your growth goals. The more aggressive they are, the more time and money you need to budget for marketing. For example, if you're planning to launch a new product or open a new location, you need to increase your marketing efforts to gain awareness, interest and action and to fund the training, marketing support and additional advertising required to make your plan possible.

# Writing and Designing Your Ads

In the best print ads, the headline, copy and graphics work together to capture attention, inspire the target market, promote the product's benefits, prompt the desired consumer action *and* advance the brand of the business that placed the ad.

Whether you create ads yourself with help from someone experienced in the fields of copywriting, design and ad production or you turn to pros who create ads for a living, use this section to understand the key steps in the print ad production process. From writing headlines and copy to making design decisions to preparing materials for reproduction by print media outlets, the upcoming pages highlight what you need to know.

## Packing power into headlines

A *headline* is a print ad's major introductory statement. This statement is the large-type sentence or question that aims to stop readers in their tracks, target the right prospects and pull them inside the ad to read more.

Four out of every five people who see your ad read only the headline. Here's where the rest of the readers go:

- One reader sees your headline and moves on because she doesn't have time to study the details at the moment.
- A second reader sees the headline and rules herself out as a prospective customer because she doesn't want or need your product or service or because she can't afford what you're offering at this time.
- A third one finds your headline all that's needed to reinforce an existing (hopefully positive) opinion.
- A fourth one (should you be so lucky) finds the headline powerful enough to trigger the desired consumer action.
- A fifth one is stopped by your headline and inspired to dive into the ad copy to find out more. Oh lucky day!

### Knowing the attributes of a good headline

Your headline has to pack marketing power. The headline is your only chance to communicate with 80 per cent of your prospects, and your hook for baiting the other 20 per cent into your ad. If a headline doesn't grab and inspire, your body copy doesn't stand a chance. Here's what your headline needs to do:

- Flag your prospect's attention by saying, in essence, 'Stop! This message concerns you.'
- Appeal to your target prospect individually and immediately.
- Promote an answer or solution to a problem.
- Convey a meaningful benefit.
- Advance your brand image.

As if the preceding weren't already a heavy load, the headline has to accomplish those things in words that people can read and grasp in five seconds. But even within that limitation, you've a little creative elbow room:

- Headlines can be short or long, as long as they're irresistibly compelling.
- They can sit at the top, in the middle or along the bottom of the page.
- They can be a single word, a phrase, a complete sentence or a question.

### *Crafting your headline*

Whether you write your headlines yourself or call on the talents of a professional copywriter or advertising agency, follow these tips:

- **Lead with your most powerful point.** Too many ads use a clever come-on for a headline and then divulge the benefit somewhere toward the end of the copy, where few people see it. Reverse the sequence. Create a headline that conveys a benefit or asks a question that can stop people in their tracks. Then use your copy to fulfil the interest you pique.
- **Turn features into benefits.** If you say that your product works at double the speed of competing products, you've stated a feature. If you say that the consumer can save the equivalent of two days of annual leave, you've stated a benefit. If you add that the consumer gets an extra free bonus with every purchase, you've fuel-injected the message.
- **Make your headline easy to read at a glance.** Choose a very legible typeface and think twice before using all capital letters, which are harder to read and, as a result, easier to overlook.
- **Don't end your headline with a full stop.** The last thing you want is to encourage the reader to stop at the end of the headline.
- **Be believable.** An old line about advertising goes, *If it sounds too good to be true, it probably is* . Beyond that, media ad departments screen ads and reject ones that advance deceptive messages.

### *Adding power to your headline language*

As you take a critical look at the language you use to develop your headlines, consider the following advice:

- **Positive statements carry power.** Figure out the pain your customers want to eliminate and use your headline to promote a solution. For example, if your customers want to save time, tell them how your product allows them to work less. Offer an answer to their nagging problems.
- **Use compelling language.** After you settle on a headline, see whether you can push more impact into the words. For example, if your headline says *stomach* , ask yourself whether *guts* would pack more punch.
- **Find words that prompt mental images.** Instead of saying *reduce fear* , paint a picture by saying something like *eliminate white knuckles* .
- **Replace technical terms with words that most people understand.** Keep your headline simple, clear and free of jargon.
- **Use the word *you* .** *You* is the most magnetic word in advertising. Every time you get ready to write *we* , turn the spotlight to the consumer by using *you* .
- **Tell *how* .** People are attracted to the feeling of interaction conveyed by the word *how* . Write a headline that includes *how to* … or *how you* … to draw prospects into your ad copy.
- **Use power words.** A widely cited study by the psychology department at Yale University found that the most powerful English words include *you* , *results* , *health* , *guarantee* , *discover* , *love* ,

*proven* , *safety* , *save* and *new* .

## Writing convincing copy

*Copy* is the term for the words that fill the body of an ad. Good copy talks directly to the reader. Its point is to connect and persuade. Instead of following the standard rules of grammar, copy is usually written to sound like how people talk. Copy is conversational yet crisp and, above all, convincing.

The first sentence of your ad copy has to do only one thing: make the reader want to continue to the second sentence. The second sentence needs to lure the prospect on to the third sentence. And so good ad copy goes, carrying consumers through your ad, building credibility and trust and convincing readers of the merit of your message until, finally, the ad makes an irresistible offer and tells the prospect exactly how to respond.

As you lead prospects through your ad, aim to accomplish the following points:

- **Tell your basic story.** Provide enough information to convey what you're offering, the benefits that a buyer can count on and information that backs your claim.
- **Sweeten your offer.** Add a guarantee, special financing terms, trade-in opportunities, a promotional price or package, special options, a free or limited-time trial, or other incentives to increase consumer responsiveness.
- **Convey urgency.** Consider limited-time offers, promotions that reward only the first 100 respondents, or statements such as *while stocks last* .
- **Explain what to do next.** Don't assume that prospects know how to reach you or how to find your business, whether in person or online. Explain when and how to respond.

TIP As you review your copy, imagine that your prospect is saying, 'Well, let me think about it; right now I'm just shopping.' Then add statements of value, action inducements or other ideas to overcome prospect hesitation. But for each statement you add, look for one to delete. The cleaner you can keep your ad, the better. Flick through a magazine or newspaper to see for yourself. Does your eye linger on the ads crammed full of text or those with strong headlines, bold graphics and short blocks of copy?

If your ad includes prices, refer to Chapter 3 in Book 2 and Chapter 3 in Book 5 for advice on setting selling prices.

## Making design decisions

Advertisers, ad agencies and media outlets have spent enormous amounts of time and money to determine what does and doesn't work in the design of print advertisements. No pat formula exists – life in the marketing world isn't quite that easy – but when readers are asked which ads they remember positively, the following design traits emerge.

### Add visual appeal

Whenever you can, include an attention-getting visual element in your ads by following these tips:

- **Use art.** Ads with stopping power nearly always have a photograph, an illustration (a drawing, cartoon or other art) or both. The art may present the product, show the product in use or relate to the product by reflecting its characteristics through what's known as *borrowed interest* , delivered by art that serves as a metaphor for the product.

  For example, a restaurant ad may feature art of the entryway (the product), a photo of diners (the product in use) or an illustration of a sprig of rosemary or a bundle of herbs (borrowed interest reflecting the natural elegance of the restaurant and its recipes).
- **Let your visual *show* what your ad is about.** You don't have to be literal. An ad for housekeeping services could feature a mop, broom and vacuum cleaner. The ad may be more effective, however, if it communicates the benefit of more free time by showing a person in a bubble bath, feet propped up on the rim, open magazine in hand, in an immaculately clean setting.

Commissioning original photos or artwork ensures that your ads feature one-of-a-kind images. Another option that's often more affordable (though usually non-exclusive) is to purchase rights to use what are called *stock images* , which you can locate through an online search for 'stock photos and images'.

TIP As you invest in artwork, consider buying rights to feature the image not only in ads but also in direct mail, on your website and in other venues that together leverage the image into a campaign symbol for your business.

### Keep it simple

TIP Streamline your design to help readers focus on your ad's important points. Here are two ways to keep your ad design uncluttered:

- **Frame the ad with open space.** Isolate your ad from those around it while providing the visual relief toward which the reader's eye naturally gravitates.
- **Make the ad easy to follow.** If you imagine a big letter 'Z' placed over your ad space, you get a good idea of the path of most readers' eyes as they view ads. Design your ad accordingly, so readers grasp your message and see your name and logo before exiting your ad space. If your ad lacks an obvious focal point, or if two design elements compete for dominance, the reader is likely to pass over the ad altogether.

You do see ads that break these basic rules, but unless your ad is in the hands of an accomplished designer, you're wise to keep its design clean and simple.

### Design every ad to advance your brand

Small businesses have small budgets. Don't reduce your investment's impact by changing the look of your ads from season to season or, worse, from week to week. Here are a few ways to advance your brand:

- **Find an ad look and stick with it.** Settle on a recognisable format that readers can link to your name and brand. A consistent ad design gains you marketplace awareness and impact, and it saves you time and money by eliminating the need to redesign every new ad.
- **Prominently present your name.** Huge advertisers can get away with postage stamp–sized presentations of their logos because their products and ad looks are so familiar. Small business budgets don't allow for that level of awareness, so make your name apparent in every ad.
- **When in doubt, leave it out.** This adage is good advice for do-it-yourself ad designers (and all other designers, too). As you consider tossing in an additional type font, different type size, ornamental border or any other design element, remind yourself that good design is usually the result of subtraction – not addition.

## KNOWING YOUR TYPE

Choosing the right type is an art that makes a tremendous difference in how your ad looks and, more important, how easy your message is to read. As you work on ad designs, you may find the following terminology helpful.

A *typeface* is a particular design for a set of letters and characters. For example, Garamond, Helvetica and Times New Roman are typefaces.

A *type family* is the full range of weights and styles available in a typeface. For example, you can stay within the Helvetica family and select bold, italic and light versions in a great number of sizes.

A *font* is the term used for a full set of characters (letters, numbers and symbols) in a particular typeface and size. For example, different fonts include 10-point Garamond, 10-point Garamond bold, and 10-point Garamond italic.

Limit the number of typefaces and sizes that you use in an ad, unless you're intentionally trying to achieve a jam-packed or cluttered look (which may be the aim of a carnival promoter or a retailer announcing a giant warehouse clearance event). Additionally, follow this advice:

- **Headlines** need to be attention-grabbing, so designers usually choose typefaces that are capable of standing out while also communicating clearly. Choose *sans serif* typefaces, which have no decorative lines at the ends of the straight strokes in the characters. Probably the most popular sans serif typeface is clean-cut Helvetica.
- **Body copy** needs to be easy to read, so designers often opt for *serif* typefaces such as Garamond, Century Schoolbook or Times New Roman because they have flourishes (serifs) that serve as connectors to lead the eye easily from one letter to the next. Avoid any font that's overly stylish or hard to read, avoid combining more than two type fonts in an ad and definitely avoid using type in sizes too small for ageing eyes.

## *Translating ad production terminology*

Even if you pay the pros to produce your ads, it helps to know the language of print ad design and production:

- **Ad proof:** This copy of your ad is the last thing you see before the presses run. When you review ad proofs, look closely at type set in all capital letters, which is where many typos slip through. Read your phone number twice and double-check your address. See that mandatory information (copyright lines, trademarks, photo credits and so on) is in place. Then hand the proof to the best proofreader in your organisation for a second review before you initial your approval.

- **Display advertising:** Print ads that combine a headline, copy, art elements and the advertiser's logo in a unique design are called *display* ads. All-word ads are called *classified* or *directory* ads.
- **Four-colour:** This term is the one traditionally used to describe full-colour printing, because (flash back to junior school art class) you can create all colours from the primary colours of blue, red and yellow (or, in printer terms, cyan, magenta and yellow). Before digital production, full-colour printing involved separating a photo into these three colours and then reproducing it by laying one ink over the next until the image matches the original. Black (the fourth 'colour') is used for type and other details.
- **Spot colour:** This term describes colour used to highlight an otherwise black-and-white ad.

# Making Sense of Print Media Rates

Publications that accept print ads have a *rate card* that specifies pricing, deadlines and production requirements. Here are definitions of key terms:

- **Bulk or volume rate:** A reduced rate offered to businesses that commit to placing a certain amount of advertising over a contract period. Increased volume results in decreased rates.
- **Cash discount:** A discount for prompt payment. Reduce the cost of your media charges by up to 2 per cent by settling your bills quickly.
- **Closing date or deadline:** The date by which you must submit ad material to a publication if your ad is to appear in a certain issue.
- **Column inch:** A column inch is 1 column wide by 1 inch high. Most newspapers measure ad space in column inches, though once in a while you see ad rates quoted in *agate lines* , which equal $\frac{1}{14}$ of an inch. Just multiply by 14 to arrive at the price per column inch.
- **Combination rate:** A discounted rate offered to advertisers who buy space in two or more publications owned by the same publisher or by affiliates in a syndication or publishing group.
- **Cost per thousand (CPM):** The cost of using a particular medium to reach a thousand households or individuals. (The 'M' stands for the Roman numeral designation for one thousand.) CPM also allows you to compare the relative cost of various media options.

  The CPM formula: $\text{Media rate} \div \text{circulation or audience} \times 1{,}000 = \text{CPM}$ .

  If a full-page newspaper ad costs £2,200 and the circulation is 18,000, the CPM is £122.22 ( $£2{,}200 \div 18{,}000 \times 1{,}000 = £122.22$ ).
- **Earned rate:** The rate that you pay after all discounts are applied.
- **Flat rate:** The cost of advertising with no discounts.
- **Frequency discount:** A reduced rate offered to advertisers that run an ad a number of times within a given period.
- **Local or retail rate:** A reduced newspaper ad rate offered to local or retail businesses. If you place ads in an out-of-town paper but sell your product through or in connection with a local business, see whether the business can place your ad or whether you can receive the local rate by mentioning the local business in your ad.

- **Make-good:** A no-charge repeat of your ad, which you can request if your ad ran with a publisher error or omission.
- **Open rate:** The highest price you pay for placing a particular ad one time with no discounts. Also called the *one-time rate* and the *basic rate* .
- **Pick-up rate:** A discounted price that many newspapers offer for ads that are rerun with no changes within a five- or seven-day period.
- **Short rate:** The amount you owe to the publisher if you don't earn the rate for which you're contracted. If you sign a contract to run a certain amount of advertising but over the contract period you run less advertising than anticipated, you owe the publisher the difference between the contract rate and the rate you actually earned.

# *Placing Newspaper and Magazine Ads*

More opinions exist about what works in newspaper and magazine advertising than there are newspapers and magazines, and that adds up to a lot of differing ideas. Some advisers tell you to avoid the Sunday edition, the start of the month or the day that the supermarket store ads appear because those days are crammed with ads and your ad can get lost in the chaos. Others counter with the fact that those big and busy issues are crammed with ads because they're the best-read of the week. Some people tell you to place clever, small-space ads with high frequency, and others advocate dominating with big-format ads, even if you can afford to run them only on a few carefully chosen dates.

Most of the advice you hear is absolutely right – but only some of the time. So how do you proceed?

- **Know your target prospect** so that you can make an educated guess about which days and sections of the paper that person is likely to read.
- **Know your objectives** (see Chapter 2 in Book 5) so that you can select and time your ad placements accordingly.
- **Know how advertising works** so that you can prepare a schedule that takes advantage of media discounts. That's what the upcoming sections are about.

## *Scheduling your placements*

Myths are rampant about which days get the highest readership. The fact is, from Monday to Friday, the number of people who open their papers varies only a few percentage points, with Tuesday's paper outpulling the others because in most markets it carries the food ads. While magazines are typically monthly or weekly, the day your ad will be seen is nearly impossible to predict with great accuracy. If you want your ad to generate results, heed these tips:

- **Place your ad on the day that makes sense for your market and message.** Here are a few examples:
    - If your target prospect is an avid price shopper, don't miss the issues full of supermarket ads.
    - If your target is a sports fanatic, advertise in Monday's sports section, where your prospect is reading the weekend recaps.

    - If you’re promoting weekend dining or entertainment, advertise in the Thursday and Friday papers and in entertainment sections – unless you’re trying to influence prospects in out-of-town markets, in which case you’d better run your ad Tuesday and Wednesday to allow time to make weekend travel plans.
    - If your ad features an immediate call to action (*Call now for a free estimate* ), don’t choose the weekend papers if you’re not open to handle the responses.
- **Advertising in the Sunday paper usually costs more – and delivers more.** The number of single-copy sales is 10 to 40 per cent higher on Sundays than on weekdays. What’s more, readers spend up to three times as long with the Sunday paper as they do with weekday papers, and Sunday’s paper tends to have a longer shelf life. Even if your newspaper charges a premium for Sunday ad placements, calculate the cost per thousand (refer to the earlier section ‘Making Sense of Print Media Rates ’) and you’re likely to find that the cost of reaching readers is cheaper on Sunday than on any other day.

## Using small-budget, small-size ads

Even though more readers note full-page ads than half-page ads, and more note half-page ads than quarter-page ads, small-budget, small-size ads still pull their weight. They’re the only way to go if you don’t have the budget to run larger ads multiple times, because a one-time ad is incapable of building the awareness or recognition you need your marketing efforts to achieve.

TIP Though partial-page ads pull fewer readers, the number of readers doesn’t drop as fast as the cost of the space. For example, though a full-page ad pulls about 40 per cent more readers than a quarter-page ad, the quarter-page ad costs roughly a quarter of the price. As you work out a small-budget ad plan with your advertising salesperson, here’s some general advice to follow:

- **If you have to choose, opt for placement frequency over ad size.** Plan the largest ad that you can afford to run multiple times and don’t worry if the most you can afford is only a partial page.
- **Match your ad size to your message.** If you’re opening a major new location, go for the biggest ad you can afford. But if you’re promoting a £5.99 product, a big, splashy ad is likely overkill.
- **Aim to dominate the page.** Even partial-page ads can have a page-dominating effect. Span the width of the page with a 1⁄3-page horizontal ad. Or run a half-page vertical ad, which echoes the shape of a full-page ad and dominates the page as a result. Long, skinny, one-column ads that run all the way down the page also draw attention, especially if they’re placed along the paper’s outer edge.
- **If you’re not the biggest, be the most consistent.** Ask your newspaper representative about a top-of-mind awareness (TOMA) programme that offers outrageous discounts in return for running your ad – however tiny – several times a week, 52 weeks a year.

## Requesting your ad placement

*Right-hand page, as far forward as possible* is repeated like a mantra by print advertisers. But you won't find any solid proof that an ad on the right page of an open publication does any better than one on the left page, and the same can be said for other hallowed rules about ad placement. In fact, research shows that newspaper ads placed above the fold pull no more readers than those placed below the fold, and ads next to editorial content pull the same as those next to other ads. An ad's success depends on its content, not on its placement.

Create a strong ad, and *then* decide whether you'll reach your prospects if your ad runs anywhere in the paper (called a *run of paper* or *ROP* placement) or whether you need to request – and possibly pay extra for – a *preferred position* . The following advice helps you make your placement decisions:

- **Make an 'if possible' request with your ROP ad placement.** Most papers do their best to honour reasonable placement requests that accompany ROP orders, at no extra charge but on a space-available basis. Ask for placement in the front section, sports section, business section or any other preference. But be willing to settle for what you paid for, which is placement anywhere in the paper. Most readers flick through nearly all the paper on a daily basis, and that's why most advertisers are confident rolling the dice with ROP ads.
- **Ask about special rates** for display ads placed in the property and classified sections, as well as in special interest supplements that target your specific market.
- **If your ad has a voucher, tell your ad representative in advance.** Request placement on an outer edge of the page for easy cutting out and in a position that isn't up against a coupon on the reverse side of the page.
- **Leverage your budget.** Work with your newspaper to arrive at a contract rate based on the nature of your business and your advertising volume. Ask about a contract addendum assuring that a certain percentage of your ROP placements is in a preferred placement.

## *Finding value in the classified section*

The classified section is the bargain basement of the newspaper, and it just keeps getting smaller as more and more marketers move their classified ads online. Still, if your market isn't Internet-savvy, classified ads can still pay off. Here's what to know:

- **Small-print classified ads** are typeset by the newspaper and arranged into interest categories.
- **Classified display ads** feature headlines, illustrations, special typestyles and advertiser logos. They're available in sizes smaller than those accepted in the rest of the paper, and they stand out on the otherwise all-type pages of the classified section.

Classified ads follow many of the same guidelines as other print ads, so consider the following:

- Use a short headline set in boldface capital letters to draw readers in.
- Write your ad to talk directly and personally to a single target prospect.
- Avoid abbreviations unless you're certain that most people are going to understand them.
- Place your ad in a number of classified categories if it appeals to more than one interest area.
- Include your contact info and give the reader a reason to call – to request an estimate, find out the price, view the product, schedule an appointment or take some other action.

# A few special pointers for placing magazine ads

When a full-page colour ad in a major national magazine costs hundreds of thousands of pounds, you may wonder why your small business should even bother considering magazine advertising. The reason is that thousands of special-interest, small-circulation (and vastly more affordable) magazines exist, as well as local, regional or even city newspapers and magazines in which you can place an ad for a fraction of the full-edition price.

## Selecting magazines

The only magazine worth your ad investment is one that's consistently read by people in the target audience you aim to reach. Find out which publications your customers, prospective customers and those who influence your customers subscribe to or read regularly.

TIP

Beyond conducting customer research, also look into which magazines serve your industry or those in your target audience. Try searching the online databases available in your local or city library, especially the British Library Business and IP Centre in London and regional centres in Birmingham, Leeds, Liverpool, Manchester, Newcastle and Sheffield.

## Scheduling placements

As you schedule magazine ads, consider the following:

- **Frequency matters.** Be sure that your budget is big enough to place your ad in the same magazine at least three times over a three-to-six-month period. Or, if you want to advertise during a single month, choose three magazines with similar readership profiles and run your ad in each one, building frequency for your message through *crossover readership* among publications. One way or the other, you need to reach your target audience multiple times to make an adequately strong impression.
- **Magazines have long lead and response times.** For example, if you're trying to inspire summer holiday business, you need to run your magazine ads well in advance of July and August in order to allow prospects time to read your ad, request information and make plans. Unlike newspaper and broadcast ads, response to magazine ads builds slowly and continues for months and even years.
- **Full-page ads dominate, but partial-page ads compete well.** Partial-page ads frequently share the page with other ads and end up toward the back of the magazine, but they also share the page with editorial content, which means that readers often spend more time on the page than they do with a full-page ad.
- **Concept and design make or break your ad.** If you're advertising in a high-quality magazine, *definitely* invest in professional copywriting, design and production to create an ad that represents you well in the highly competitive ad environment.
- **Success stories are built on frequent placements of small, well-designed, black-and-white ads.** If you can't afford the production and placement of a full-colour ad, run a small black-and-white or classified ad instead. Use the space to invite readers to *Request our colour catalogue* , *Visit our website* , or other invitations that lead readers of your small-space ad to a larger presentation of your business.

- **Work with magazine ad reps.** Explain your business, your desire to reach the magazine's circulation and your budget realities. If you have an ad that's produced and ready to go, ask to be contacted when *remnant space* (last-minute, unsold ad space) is available – usually at a fraction of the regular cost. Also enquire about regional editions or any other means of placing your ad at a reduced rate.
- **Take advantage of merchandising aids available to advertisers.** The magazine may have a *bingo card* that invites readers to circle numbers for additional information from advertisers. All you have to do is offer a brochure or other free item. You receive labels for all respondents – a great way to gather enquiries and build your database.

  Also, ask for *tear sheets* mounted on boards reading *As Seen in XYZ Magazine* for display in your business.
- **Reprint colour ads for use as posters or direct mailers.** Maximize the cost and leverage the credibility of being a major magazine advertiser by turning the ad into promotional material.
- **Consider including a QR code.** Turn print media into an interactive tool that allows readers to scan and click to reach your website home page, landing page, online video, or other content referenced in your ad. See the nearby sidebar 'QR codes: Let customers point and shoot to reach your business online '.

### QR CODES: LET CUSTOMERS POINT AND SHOOT TO REACH YOUR BUSINESS ONLINE

Known as two-dimensional bar codes because they can be scanned side-to-side or top-to-bottom, *QR codes* (for Quick Response) are read by smartphone apps to decode and interpret a website address and use the phone's network to reach the corresponding page. Using QR codes is free for all involved. To get a QR code, just enter your site address into a QR code generator like `http://qrcode.kaywa.com` or `www.qrstuff.com`. To read QR codes, download one of the many QR-scanning apps (or use the in-built scanner on your smartphone). To see how QR codes work, scan the code in this box with your smartphone and you'll go straight to an author page on Amazon.

***Tip:*** When using QR codes in your advertising, be sure that you send people to a mobile-friendly version of your site.



## *Considering Yellow Pages, Directories and Their Digital Alternatives*

If your customers are the kind that lug the phone books that hit their doorsteps through the front door (and not straight to the recycling bin), then traditional Yellow Pages listings are important to your business. If your customers have moved their directory searches online, you should, too. The decision is really that easy. When it comes to Yellow Pages and other directory ads, go where your customers go.

But one way or another, be sure that your business shows up in whatever directories your customers use, online or off-line. Otherwise, they won't find you at the very time they're most ready to buy.

Research published in 2016 by the Local Search Association found that:

- Search engines are the top choice for consumers seeking information on hotels, theatres and the cinema (83–86 per cent); for pharmacies, supermarkets and car repairs, that drops down to around 40–45 per cent.
- Consumers under the age of 34 are more likely to use online searches, while those over age 55 use print Yellow Pages and other traditional sources, such as newspapers, for local information.
- Rural residents, people in areas where broadband speeds are low and those with lower incomes tend to use print Yellow Pages more than suburban and urban consumers.

REMEMBER Most experts conclude that future usage will continue to slant even further toward online directories over print directories. And all agree that, regardless of how consumers seek information, being found in searches is absolutely essential, because after looking up a business, the majority of consumers make a business contact, and after contact, eight of ten make a purchase.

Before buying ads in the printed Yellow Pages or any of the independent directories pitching for your business, take two steps:

1. **Find out which books your customers use – if any.**

   Simply ask callers how they found your number. Admit that you're seeking their input as you determine which directories customers prefer.
2. **Ask the directory salespeople for proof of how their books are distributed and then do your own research to confirm that the books are reaching and being used by consumers.**

   If you know owners of companies with ads in the directory, call to ask how well the directory worked. Or get old copies of the directory and compare ads in your category. If your competitors were in the book a few years ago and are out of it this year or in with reduced-size ads, the ads probably pulled less-than-impressive results.

If you decide to place ads, you've a few decisions to make:

- **Choose the right classifications.** Each category you add costs more money, so limit entries to sections your prospects are most likely to check.
- **Select the right size.** If you don't have many local competitors, you hardly need a large ad to stand out in your field. Also consider the nature of your competitive arena. In some business categories, the most established and respected firms run the smallest and most subdued ads.
- **Decide whether to add colour.** Study the section where your ad will run to see whether colour is necessary to compete on the pages. If you opt for colour, read the rate card carefully because colour charges vary from one directory to another but always mount up quickly.
- **Write the right ad.** Research shows that directory readers look for two things: a solution and a business they can trust. They also appreciate information, business hours, and directions to listings of products or brands and professional endorsements and affiliations. But in a tight space, what you really need to present is your business name, an easy-to-read phone number and web address, and how to reach your street location. If your customers are tech-savvy, a QR code can lead them to additional information. (Check out the earlier sidebar 'QR codes: Let customers point and shoot to reach your business online '.)
- **Keep your ad simple.** Then use a border to set it apart.

REMEMBER Don't accept the first directory ad price you're given. Directory ad prices are based on size, ad placement history and whether the ad you're placing is larger than in previous years. Tell the rep that you need to compare rates with other directory offers, and chances are good that your comments will be met by a better price. After you agree to a price, be sure to get it in writing, and *always* insist on a proof of your ad before the directory prints.

## Broadcasting Your Message on Radio, TV and Online

With an estimated 26.8 million private domestic households (approximately 97 per cent) in the UK owning televisions, your customers are unquestionably tuned in to the broadcast world. Whether they're tuned in to TV ads or not is another question. Nearly all TV viewers skip the ads at least some of the time.

Still, research confirms that TV ads are the most memorable form of advertising. And few advertising channels can beat radio for delivering an immediate message to a targeted and often captive audience.

The drawback is that low-budget broadcast ads – especially TV ads – air alongside ads by mega-marketers who spend millions on slick productions that make locally produced ads look as cheap as, in comparison, they are. Furthermore, even the most frugal TV ad schedule can break a small business marketing budget, and for that reason many small businesses rightfully cross TV advertising off the list of possible marketing channels.

Yet others – especially restaurants, retailers, campaign and event organisers, and those seeking to reach local audiences in small, relatively affordable market areas – consider broadcast advertising essential to success. If broadcast advertising is important to your small business, this section helps guide production and placement decisions.

## Producing radio ads

In 30 or 60 seconds, a good radio ad grabs attention, involves the listener, sounds believable, creates a mental picture, spins a story, calls for action and manages to keep the product on centre stage and the customer in the spotlight – all without sounding pushy, obnoxious or boring.

Done perfectly, a radio ad is a one-on-one conversation with a single target prospect, written and produced so well that the prospect hears the introduction and says, in essence, ‘Shh, be quiet everyone, I need to hear this. It’s talking to me.’

Great writers *write out loud* when creating radio ads. Here’s how:

- **Use language that’s written exactly the way people talk.**
- **Write to the pace that people talk, not to the pace at which they read.**
- **Include pauses that give people time to think and the announcers time to breathe.**
- **Cut extra verbiage.** You wouldn’t say ‘indeed’, ‘thus’, ‘moreover’ or ‘therefore’ if you were explaining something exciting to a friend. Don’t do it in your radio ad, either.
- **Rewrite elaborately constructed sentences full of phrases linked together with *who* , *which* and *whereas* .** For example, instead of, ‘The new fashions, which just came off the Paris runways, where they made international news, are due to arrive in London tomorrow at noon’, go with, ‘The newest Paris runway fashions arrive in London tomorrow at noon. You’re invited to a premiere of the world’s leading looks.’
- **Tell listeners what to do next.** Prepare them to take down your phone number (‘Have a pen handy?’) or repeat your number for them. Most important, help them remember your name so they can look you up later.

WARNING Don’t waste radio time telling people to ‘Look us up in the Yellow Pages’. Chances are good they don’t use the Yellow Pages, and if they do, they’ll probably find your competitors there, too.

## Producing TV ads

‘I saw it on TV’ has become a mark of having made it into the advertising major leagues. To get there, though, be prepared to make a financial commitment. Successful TV advertisers have two things in common: they earmark adequate ad production budgets and they fund media schedules that span at least a multi-month period. If you can do both those things – produce a quality ad and fund an adequate schedule – TV advertising can deliver awareness and credibility for your business.

TIP You can reduce costs by airing ads on satellite channels at a fraction of the price of major station ad rates, but look long and hard to be sure that the stations you choose reach adequate numbers of the audience you're targeting. Also, remember that while the media cost of satellite TV is relatively low, your ad's production value still needs to be high enough to meet viewer expectations and to show well in this competitive advertising arena.

WARNING *Do not* create your own TV ad or marketing video. Bring in the pros, share your objectives, leave room for creativity and then evaluate their ad concepts and recommendations against the aims you seek to accomplish. Why the insistence? Consider this: your ad will play to an audience that has been trained to expect feature-film quality. To compete on a small business budget, you need a strong, simple ad concept and clean, well-edited visuals. The first step towards making a good impression is to get help from those who deal with video productions every day.

## Logging in to webinars

Sometimes called *web seminars* or *webcasts* , a *webinar* is an event that a business or an individual hosts to address an audience that can be located anywhere and that has access to online connections and phone lines.

In the context of advertising, webinars provide your customers (or prospective customers) with valuable information through online presentations that help you achieve visibility in your field and a stronger reputation as a thought leader. They also help forge and deepen customer relationships.

To attend a webinar, participants log in via a web browser or web conferencing tool to view presentation visuals and to hear the webinar's audio portion, which can also be reached via a phone connection.

Some webinars simply share expertise. More often, though, they generate leads from those who listen in, like what they hear and follow up by joining mailing lists, requesting meetings or proposals, registering to download e-books or other content, or taking other steps towards client relationships.

If you're thinking about hosting a webinar, consider these points:

- **Upside:** When you host a webinar, you can speak from anywhere, using a web conferencing tool or Internet browser to share audio and visuals, usually in the form of PowerPoint slides, with people who can log on from anywhere.
- **Downside:** The fact that almost no one likes the sound of the name *webinar* hasn't slowed webinars from becoming the content-delivery means of choice for those who want to establish themselves as experts and thought leaders. As a result, among invitees, webinars have acquired a ten-a-penny reputation. As proof, just go to a site like `www.webex.com/webinars` to see the number of free and fee-based webinars in dozens of categories.
- **Takeaway:** Expect your webinar to face strong competition for attendee attention. To succeed, you must:
  - Know the audience you want to reach, including what problems they face and want addressed.
  - Decide on a topic that addresses a real problem that hasn't been addressed a million or a

dozen times already.

- Select a presenter who is great in terms of reputation, expertise and engaging style.
- Be prepared to announce and promote your event – because no one is sitting around waiting for a webinar invitation.

- Host a terrific event by getting familiar with webinar-hosting tools like WebEx ( www.webex.co.uk ), GoToMeeting ( www.gotomeeting.co.uk ) and AnyMeeting ( www.anymeeting.com ). As a cool new alternative, you can also try a Google+ Hangout ( https://hangouts.google.com ), which can be broadcast live and shared via YouTube.
- Record your presentation for post-presentation sharing and download, making up for what may be meagre attendance with what can be terrific leveraging of webinar content after the event.

# Snail-Mailing and Emailing Your Customers Directly

Television ads win awards and build awareness. Social media wins buzz and launches relationships. Direct mail wins customers and return-on-investment contests.

Direct mail is called *one-to-one communication* because it delivers your marketing message to carefully selected prospects and customers one at a time. One-to-one communication is the exact opposite of mass media advertising, which uses the shotgun approach – that is, you create an ad and use newspapers, magazines and broadcast media to spread the message far and wide. One-to-one communication aims your message only at specific and well-defined individuals.

## Using one-to-one marketing

When you employ one-to-one marketing, you bypass mass media vehicles and take your ad straight to the letter boxes, telephones and computer screens of individuals who are prime prospects for your product or service. You may hear the terms *direct marketing* , *direct mail* , *direct-response advertising* and *database marketing* used interchangeably in discussions about one-to-one marketing, but they each represent different aspects of the direct marketing arena. For the record, here are definitions for those terms and others:

- **Direct marketing** involves a direct exchange between a seller and a buyer, without the involvement of retailers, agents or other intermediaries.
- **Direct mail** is the primary means of direct marketing communication. It involves sending promotional announcements in the form of letters, postcards, packages or emails directly to targeted prospects.
- **Direct-response advertising** announces a promotional offer and invites consumers to respond directly to your business – by phone, in person or by clicking a QR code to reach a landing page on your website – to make a purchase or obtain additional information. (Check out the earlier sidebar 'QR codes: Let customers point and shoot to reach your business online '.)

- **Database marketing** entails compiling detailed information about customers and prospects and then using the data to match and send specialised offerings to consumers in different *customer segments* , based on the demography, interests and values of customers in each group.
- **Direct sales** are purchase transactions that occur directly between a buyer and seller. Mail order and e-commerce are the primary vehicles for direct sales.
- **Telemarketing** involves communicating with prospects and customers over the telephone –by *inbound calls* made by consumers to telephone numbers that they see in ads, sales materials or online, or by *outbound calls* made by a business to the homes or offices of target prospects.

  WARNING Be aware that most people hate outbound telemarketing calls so much that almost 19 million phone numbers are registered on the Telephone Preference Service (TPS) – a central list of UK consumers who have opted out of receiving marketing calls. Companies are legally required to screen their outbound marketing lists against the TPS before making cold calls (see www.tpsonline.org.uk ).

## Marketing with direct mailers

All direct mailers, regardless of look, message or purpose, are alike in one way: they go straight to your prospects' letter boxes or inboxes rather than reaching them through mass-media broadcast and print ads.

### Setting up for success with direct mail

Direct mail is among the easiest of all marketing communications to monitor for success. With each mailing, you know exactly how many pieces you're sending and therefore how many prospects you're reaching. And because direct mailers almost always request an easy-to-track direct response (in the form of a sale, an enquiry, a visit to your business, a click or some other prospect action), within days (for email) or weeks (for surface mail), you can count the responses to determine the effectiveness of your direct mail effort.

REMEMBER Most successful direct mailers incorporate these factors:

- **A targeted list:** To be great, a direct mail list must reach genuine prospects for your product or service.
- **A compelling offer:** The *offer* is the deal – the catalyst to which the consumer reacts.
- **An attention-getting format:** Some mailers involve nothing more than a regular or oversized (*jumbo* ) postcard. Others involve only a good sales message in a white envelope or an email message. Some are elaborate packages that contain samples and other enclosures (including brochures, CDs or product samples). Just be sure that your approach is consistent with your company's brand image and capable of conveying your message and meeting your marketing objectives.

### Deciding between email and 'going postal'

Email tends to dominate conversations about direct mail, largely because email is so immediate and inexpensive. But don't write off the benefits of direct mail sent by surface post, primarily because you can send what's now called *snail mail* to new prospective customers, while email to strangers falls into the dreaded (and illegal) category of spam.

For a look at the differences between using surface mail or email to send direct mail, see Table 4-1.

**TABLE 4-1 Differences between Sending Direct Mail by Surface Mail and Email**

| ***Surface Mail*** | ***Email*** |
|---|---|
| Is often considered junk mail | Is often considered and blocked as spam |
| Arrives in a letter box with less mail than in previous years | Arrives in an increasingly crowded inbox |
| Can be sent to all prospective target prospects | Can be sent only to those who have opted in or had previous contact with your business |
| Typical response rates are 3 to 4 per cent when mailings go to those on your house list of customers and prospects, and lower when sent to rented lists of people who match the profile of your target audience | 'House lists', which can include only established customers or those who have opted in to your mailings, result in open rates of around 20 per cent and conversion rates just under 2 per cent |
| Can be used for reaching new prospects | Can be used for making offers to established contacts who have opted in to your list |
| Great for presenting photos, visuals or samples | Great for conveying messages that prompt recipients to click for more information |
| Great for sending material with a 'keeper' quality | Great for immediate response offers such as 'register now' or 'download now' |
| Costs time and money to produce and send | Can be produced and sent immediately and with little expense, and can be used to test and quickly alter headlines or offers |

## *Producing brochures, fliers and more*

You can get your print design out to the public in an easy and inexpensive way, using brochures, fliers, posters and many other forms – your imagination is the only limit to what you can do with a good design for all your printed materials. Your word-processing or graphics software, a good inkjet or laser printer, and the help of your local photocopy or print shop (which should also have folding machines) allow you to design and produce brochures quite easily and also come up with many other forms of printed marketing materials. In this section, however, the focus is largely on producing a basic brochure, because this form's easy, a business staple and effective at marketing your company.

TIP

You can also do small runs (100 or less) straight from a colour printer. Buy matte or glossy brochure paper designed for your brand of printer and simply select the appropriate paper type in the print dialog box. Today's inexpensive inkjet printers can produce stunning brochures. But you have to fold these brochures yourself and the ink cartridges aren't cheap. So print as needed or try contacting your local copy shop. Kall Kwik and many other copy shops now accept emailed copies of files and can produce short runs of your brochures, pamphlets, catalogue sheets or other printed materials on their colour copiers directly from your file.

REMEMBER Many brochures foolishly waste money because they don't accomplish any specific marketing goals; they just look pretty, at best. To avoid creating an attractive but pointless brochure that doesn't achieve a sales goal, make sure that you know:

- Who will read the brochure
- How they will get the brochure
- What they should discover from and do after reading the brochure

These three questions focus your brochure design and make it useful to your marketing.

Marketers often order a brochure without a clear idea of what purpose the brochure should serve. They just think a brochure is a good idea: 'Oh, we need them to, you know, put in the envelope along with a letter, or, um, for our salespeople to keep in the boots of their cars; maybe we'll send some out to our mailing list or give them away at the next trade show.'

With this many possibilities, the brochure can't be properly suited to any single use. It becomes a dull, vague scrap of paper that talks about the company or product but doesn't hit readers over the head with any particular appeal or call to action – something that's become increasingly important, as consumers can look up information about your company online at any time.

### Listing your top three uses

Define up to three specific uses for the brochure. No more than three, though, because your design can't accomplish more than three purposes effectively. The most common and appropriate uses for a brochure are:

- To act as a reference on the product, or technical details of the product, for sales prospects.
- To support a personal selling effort by lending credibility and helping overcome objections.
- To generate leads through a direct-mail campaign.

Say you want to design a brochure that does all three of these tasks well. Start by designing the contents. What product and technical information must be included? Write the information down and collect necessary illustrations, so that you have the *fact base* (the essential information to communicate) in front of you.

### Writing about strengths and weaknesses

After you've created your fact base (see the preceding section), organise these points in such a way that they highlight your product's (or service's) greatest strengths and overcome its biggest challenges. Don't know what your product's strengths and weaknesses are? List the following, as they relate to sales:

- The common sales objections or reasons prospects give for not wanting to buy your product.
- Customers' favourite reasons for buying, or the aspects of your product and business that customers like most.

With your fact base organised accordingly, you're ready to begin writing. Your copy needs to read as if you're listening to customers' concerns and answering each concern with an appropriate response. You can write subheads in the format 'Our Product Doesn't Need XXX' and 'Our Product Brings You XXX' so that salespeople or prospects can easily see how your facts (in copy and/or illustrations) overcome each specific objection and highlight all the major benefits.

# Using Billboards and Other Out-of-Home Ads

Most of the ways of getting your promotional message covered in this chapter involve working from your desk in a fairly conventional manner. But you can take the fight to the enemy – reading 'advert' for fight and 'potential customer' for the enemy.

*Out-of-home ads* include billboards; roadside signs; waiting room signs; wall murals; building or facility signs; vehicle signs; cinema ads; bus, metro or tube ads; digital kiosk ads; and even flyover signs. Wherever prospective customers are likely to be standing, sitting or waiting, you'll probably see an advertising opportunity, usually accompanied by the name of the company to contact for advertising information.

In the UK, a small number of companies (including CBS Outdoor, Clear Channel and JCDecaux) manage most of the outdoor ads you see in towns and cities, on the side of roads, in bus shelters and inside metro, tube and train stations. Contact them to find out about available locations, costs and contracts. Or, when you see a billboard in a desirable location, look along the bottom of the sign for the owner's name and then call for availability and cost information.

In scheduling outdoor ads, a few key terms apply:

- **Circulation** is measured by the number of people who have a reasonable opportunity to see your ad or sign message.
- **A full showing** or *#100 showing* describes the number of boards necessary to reach 100 per cent of the mobile population in a market at least once during a 30-day period. A *half showing* (or *#50 showing* ) reaches 50 per cent of the mobile population. Anything less than a *#25 showing* isn't considered adequate for an advertising campaign, although the placement of one or two boards may be useful as directional signage.

In placing and creating billboards, two truths prevail:

- **Location is everything.** Before buying an outdoor ad, drive by the ad site to be sure that the location is in an area that reaches your prospects and enhances your image and that the sign is lit for night-time visibility. Then, after your ad is posted, drive by it occasionally to confirm that lights are working, the installation is correct and the ad is free of graffiti.
- **Ads must pass the at-a-glance test.** Most viewers look at an ad for five seconds, read seven words and take away two ideas – your name and the reason to buy your product. Use large, legible type with adequate spacing between letters, words and lines; strong colour contrasts; and graphics that people can see and understand in a flash.

For more affordable outdoor ads, look into tourist-oriented directional (TOD) signs (available through the local highways authority on local roads and Highways Agency if you want to place them on motorways or national trunk roads), vehicle signage (including magnetic door placards) and posters, which are becoming more and more affordable to produce. Just search for ‘digital poster printing’ to reach links to resources.

Finally, a walk down any high street confirms that sandwich boards and street signs are making a comeback. If you choose to go down this route, be sure that you’re in compliance with local authority guidance and follow this advice:

- Create a sign that reflects the brand and quality of your business image.
- Use colourful graphics, with highly contrasting colours to pull attention.
- Put a border around the sign so it doesn’t merge into its surroundings.
- Highlight a special or a promotional offer to invite people inside.

# Chapter 5

# Public Relations and Publicity

**IN THIS CHAPTER**

**Connecting public relations and publicity**

**Turning into a news source**

**Writing and disseminating news releases and preparing for media interviews**

**Managing bad publicity**

Let’s smash two notions right up front:

- *Public relations is not simply whitewashing* .
- *Publicity is not free advertising* .

There! With those two misconceptions out of the way, count on this chapter to confirm what public relations is, what publicity is and how you can use each of them to increase your company’s visibility, supplement and reinforce your advertising, and enhance your reputation in your market and industry.

WARNING If you wait until you face an image problem to launch a public relations campaign, you’ve waited too long. Use public relations and publicity to *enhance* your image, not just to right a wrong or fix an image disaster.

## *The Relationship between Public Relations and Publicity*

The same people who think that *marketing* is a dressed-up word for *sales* will tell you that public relations is a way to get publicity and that publicity is a way to get free media coverage. That’s like saying fashion is about hem lengths. There’s a shard of truth in there, but that shard is hardly the full story.

### *Taking a wide-angle view of public relations*

The CIPR (Chartered Institute of Public Relations) says ‘Public relations is about reputation – the result of what you do, what you say and what others say about you … Public relations practice is the discipline that looks after reputation with the aim of earning understanding and support and influencing opinion and behaviour.’ Other professionals say that public relations involves activities that aim to establish, maintain and improve a favourable relationship with the public, upon which an organisation's success depends.

In the *For Dummies* arena, public relations means doing the right thing and then talking about it – using publicity and other non-paid communication opportunities to inform those whose positive opinions favourably affect your business.

Here's a list of the different areas of public relations and what each one does:

- **Media relations:** Establish editorial contacts, distribute news releases and story ideas, and become a reliable and trustworthy news source by providing guest posts and editorials and participating in media interviews, forums and events. Publicity is part of media relations, and media relations is part of – but not all of – public relations.
- **Employee or member relations:** Use newsletters, meetings and events to interact with internal audiences and to demonstrate that your company's interest in doing the right thing starts at home.
- **Community relations:** Build ties to your local market area by joining groups, serving on boards, spearheading charitable endeavours and donating time, products, services or funds to causes and projects that benefit your community. As you undertake community relations efforts, do so first because you believe in the cause and second for the visibility you receive as a good community member.
- **Industry relations:** Join industry associations, participate in industry events and serve as a board member in groups that represent your business arena. A strong industry role keeps your business at the forefront and establishes your credibility with colleagues, consumers and editorial contacts.
- **Government relations:** Build relationships with elected officials. Acquaint them with your company so they've a favourable impression should they be asked to comment on your business or should you need their help in the future. (Just as with bankers, you're wise to make friends with politicians long before you need their help.)
- **Issue and crisis management:** Sometimes, news about your business is confusing and, once in a while, it may even threaten your image. One function of public relations is to explain and build support for complex issues and to manage crises when they arise.

## *Focusing on publicity*

When you get mentioned in the media, that's *publicity* . It sounds so simple, but a surprising amount of planning and effort goes on behind the scenes before a company gets a 'free' mention in a newspaper or magazine, on a blog or social media page, in a TV or radio story, or even in another company's newsletter.

Those who spend much time generating publicity will tell you that the results of their efforts are *valuable* but hardly *free* . It takes both time and money to develop news stories, make and maintain media contacts, stage events and implement programmes worthy of editorial coverage.

But each time you succeed in generating positive publicity, you score a triple victory:

- First, you win valuable editorial mentions in mass-media vehicles.
- Second, you win consumer confidence, as people tend to believe the editorial content of mass media more than they do paid advertising messages.
- And third, you generate third-party mentions and features that you can share in social networks

and newsletters and reprint to distribute via direct mailings, sales presentations and press kits.

# Becoming a News Source

To generate publicity, you have to start with a news item of interest, and that takes knowing the differences between promotional messages. If there's even a chance that editors, reporters or bloggers – or their audiences – are going to say 'so what?' about the story you're advancing, it'll never see the light of day.

But even beyond a news story, to achieve publicity you need a media kit in both hard-copy and digital form that reporters, editors and others can access for more information. And of course you need a list of media contacts and a strategy for maintaining media relationships and responding to media interest.

## Creating a media kit and online media centre

If you want to be cited in media outlets, called on by meeting planners or contacted by local organisations seeking a lunchtime speaker, you need to be ready with professionally produced materials that those seeking official information about your business can access, reproduce and quote.

Most small businesses create media kits in two forms: in hard copy, usually contained in a folder called a *media kit* , and online as a page on their website.

Online, don't make people register to access your media kit contents, and do make it simple for them to leave their email addresses and requests for customised information. In hard copy or online, here's what to include:

- Business facts, including history and product and service profiles
- Head shots and bios of key people in your business in several forms – for example, 100-word, 50-word and 20-word descriptions
- Professionally produced photos and graphics, including high-resolution versions of your logo in several sizes
- A list of topics on which you're prepared to share expertise, each backed by a short statement that piques curiosity and sounds interesting and natural should a journalist choose to quote directly from your media kit
- Samples of or links to media appearances and coverage
- Background information such as white papers, fact sheets, speeches and links to demonstrations and presentations
- Social media links
- An invitation welcoming requests for guest posts and original articles
- An invitation for media interview requests
- Contact information, including office phone and mobile phone numbers, email addresses and mailing address

## Establishing and maintaining an all-important list of

# media contacts

The first step towards getting your news out there is to create a list of media contacts that serve the audience you want to reach. Target the following outlets:

- **Your local daily newspaper:** In making contacts, keep in mind that general and 'hot' news goes to the city or news desk. News that relates to feature sections of the paper – sports, home, business, entertainment and so on – goes straight to department editors. Go to your paper's website to find out the name of the person who covers your field, and make contact to find out whether you should deliver releases to the news desk, the section editor or directly to the beat reporter.
- **Regional weekly and business publications:** Study back issues and media kits to familiarise yourself with the regular columns and upcoming special focus topics. Think about angles for stories that you can discuss with the editor. Then call to introduce yourself and discuss ways that you can assist in providing information for news stories.
- **Radio and TV stations that broadcast in your local area:** Include those in nearby towns and cities where some of your customers may come from or you would be willing to travel for work.
- **Publications that serve your industry or business sector:** Go to the publication's *masthead* , which is the editorial staff listing that's normally listed on its website and on one of the early pages of each printed issue. Find out the names of the writers who cover the kind of news you generate and include them on your news release distribution list.
- TIP **Blogs and electronic magazines that your target audience reads:** For blogs that reach your target audience, search the directory at `www.ukblogdirectory.co.uk` . Also do a general Google search for the name of your business arena or products, along with the word *blog* or *community* . When you find sites that address your audience and cover stories like the ones you plan to generate, add them to your media list. Even more important, start following them. Subscribe to their RSS feeds so you stay current on the nature and tone of the content they feature. Only then are you ready to make contact, following the advice in the nearby sidebar 'A blueprint for blog PR '.

## A BLUEPRINT FOR BLOG PR

Joshua Waldman ( `www.careerenlightenment.com` ) wrote *Job Searching with Social Media For Dummies* (Wiley), and, primarily by activating social media, he catapulted his book to the number two slot among all Amazon business books. He did it by reaching out to a carefully crafted list of 500 bloggers and media contacts with customised messages appropriate to their wants and needs. Here's a summary of the PR game plan he employed:

1. **Segment blogger contacts.** Top bloggers don't have time to read and review all the books they receive, so Waldman sent offers for free guest posts. Mid-tier bloggers are trying to draw traffic and build engagement, so with a review request Waldman offered a free review copy and five copies for competitions. He offered lower-tier blogs, which struggle with relevancy, a book for review.
2. **Always ask first.** Waldman didn't send any blogger a book or post out of the blue, which is

considered intrusive new product spam. Instead, he sent introductory emails extending the offer and asking for their interest and response.

The result of Waldman's actions? Blogger coverage, Internet radio interviews and – thanks to traditional PR outreach and the reverberating effect of online visibility – features on CBS and ABC News and in the *Chicago Tribune* and *U.S. News & World Report* .

The lessons from Waldman's actions? Be persistent. Begin with an introductory email. To those who respond positively, send a reminder email before launch day. Remove those who respond negatively from the list. Send all others up to three email prompts ('Last week I sent you an email about my forthcoming book; I haven't heard from you. If you're interested… .'). Then, the day after launch, reconnect ('Wow, the book launched at number two on Amazon. Would love for you to review it… .').

The bottom line? Start making your blogger list – now.

### *Establishing media contacts*

Get familiar with the audience and content of each targeted media outlet and, if at all possible, introduce your business before the first news release arrives.

Contact editors or reporters to briefly introduce your business; to explain the kind of news it generates; to list the type of useful information, industry stats, market research or other helpful info you'd be glad to share; and to mention your availability to serve as a resource whenever you can be of assistance.

TIP For online news sites, introduce yourself by participating through useful comments to blog or news posts.

### *Maintaining media relationships*

You want to earn a reputation as a business that sends only newsworthy releases. Skip over any item that isn't timely, doesn't announce a major milestone or has no unique angle or hook.

Make yourself available to the media. Alert those who answer the phone at your company to direct media calls to you immediately. If you aren't the owner of your organisation, do all that you can to get the top person to be available as well. Nothing is more damaging to your efforts than the most powerful person in your company saying 'no comment' or refusing to be interviewed by news writers when they call.

REMEMBER Promptly return media calls and be sensitive to deadlines. Don't call near the deadline and don't take more time than you need. If your answers involve complex explanations, offer to email summaries of lengthy material. Also, don't assume that the media contact heard or understood everything you said. Follow each conversation with a short note summarising key points and providing links to additional relevant information.

WARNING Finally, always assume that you're on the record. See the section 'Managing media

interviews ' later in this chapter for more information.

## Getting real with publicity expectations

The fable about the oil driller who threw in the towel just a few feet before reaching liquid gold is a good analogy for what most small businesses term their *failed publicity campaigns* . They send out five, maybe even ten, news releases, nothing happens and they quit – disappointed and without a clue of how close they came to achieving the result they so badly desired.

To generate publicity, commit to a long-haul programme of activity and keep the following in mind:

- **Don't expect instant or even consistent results.** Here's the truth: most news releases never make it into the media. In fact, personal contact and follow-up generates more coverage than just sending out pre-packaged news and crossing your fingers.
- **Don't carpet-bomb the media by sending the same release to all media outlets.** Instead, customise the story to specific audiences and news vehicles. Especially if you're aiming for coverage in well-read blogs, establish contact and enquire about interest in your story before sending a tailored release, and keep each release focused on a single topic of interest to each media outlet's audience.
- **Don't expect news coverage as a perk for your advertising investments.** Arm-twisting is the worst of all routes to good publicity. The only way your advertising investment helps your publicity effort is that your ads build awareness. As a result, when your release arrives, your editorial contacts may be familiar with your name and brand.
- **Don't peddle hype as news.** If your story's focus is why you think your product is better than that of a competitor, that's hype. But if your story describes a change of importance to the public, that's news. Newsworthy releases announce financial results, special events, awards given or received, staffing or management changes, reactions to legal or financial difficulties (see 'Crisis Communications: Dealing with Bad News ' later in this chapter), and product, technology or industry announcements, all presented in terms that matter to the media outlet's audience.
- **Don't hound the media.** Never demand an explanation for why a release hasn't run. If you're concerned that your releases are being ignored, buy an hour or two of a publicist's time to get a professional assessment of your efforts, along with guidance for presenting your news in the future.
- **Aim for quality, not quantity.** Don't try to get publicity by blasting out endless releases, and don't write releases that are even one sentence longer than they need to be. Send releases only when you have news of interest to readers or viewers. Keep each release hype-free and to the point. Follow a standard news release format (described later in this chapter), and make sure that your grammar and spelling are flawless.

# Spreading Your News

When you're ready to generate news coverage, start with this question: Is your story a local, industry or national/international story? The answer can focus your distribution strategy. Until recently, you had three essential avenues to circulate your news:

- **Distribute news releases on your own by hand, mail or email to a list your business has developed and maintained.** This approach is especially common for local or targeted industry news stories.
- **Hire a public relations firm.** Especially for stories with broad-reaching impact, professionals often have more open channels to news sources, and they distribute news through appropriate wire services and the Associated Press.
- **Use a news distribution wire service.** PR professionals and individual businesses use services such as Business Wire ( `www.businesswire.co.uk` ) for simultaneous release of material to news networks, newspapers, magazines, TV and radio stations, sites such as Google News and Yahoo, and investment and research departments in the business and financial world. PR Newswire ( `www.prnewswire.com` ) provides the same service but isn't limited to business press.

Today, you've one more essential approach to news distribution: an ever-growing number of blogs.

Best of the Web ( `https://botw.org.uk` ) is a substantial indexed directory of thousands of blogs. Anyone seeking publicity needs to know the route to blog coverage, which involves these key steps:

- **Follow the blogs that influence your target audience.** Don't even think about approaching a blogger until you're familiar with the blogger's content and tone, and preferably until the blogger has become familiar with you. How? Subscribe. Read. Comment. Repeat.
- **Send customised news announcements to each blogger.** Follow the instructions each one posts regarding preferences for how to pitch stories. Anything less is considered the equivalent of PR spam. For a good example of how to customise your blogger approach, check out the earlier sidebar 'A blueprint for blog PR '.

## *Preparing news releases*

News releases summarise stories appropriate for coverage in the editorial portion of news media. News releases are also called *press releases* , but the term *news release* provides a more appropriate label that encompasses the role of broadcast and Internet news.

TIP Whether you distribute your release via traditional media or online, after you circulate it to media outlets, amplify your news in the following ways:

- Post your release on your own website *before* distributing it elsewhere. That way, search engines point to your site as the origin of the content. Beyond that, when people, including reporters and bloggers, land on your site, your release can lead to unexpected and valuable coverage for your business.
- Post your release on social media.
- Distribute your release to those of influence to your business, including clients and those in a

position to refer business your way.
- Post the release within your company. Employees should never have to find out their own company's news through the media.

### *Writing a news release*

When developing news releases, whether for print or electronic distribution, first decide on an *angle* from which to present your news. This angle involves deciding what makes the facts you're sharing timely, interesting and worthy of media interest. Good publicists present the same news from a number of different angles – one for the local media, one for national media, one for industry media and so on.

In all cases, your release needs to cover the following points:

- **Contact information** so that recipients can find out more if they want to.
- **A date that the news can be released –** most often *For Immediate Release* but occasionally after a specified date or time.
- **A headline** that's active (in other words, it should include a verb), succinct (it should fit on no more than two lines) and benefit-oriented (it should tell what's in the news for the media audience).
- **A dateline** that states the city from which the release originated, followed by the date the release was issued.
- TIP **A clear presentation of the facts,** including a summary of who, what, where, when, why and how in an *inverted pyramid style* . That means revealing the most important news details in the first sentence and unpacking your next most important facts sequentially into the following paragraphs, ending with the least important but necessary details.
- **A short closing paragraph,** called a *boilerplate* , that summarises information about your company.

Table 5-1 helps you put your release to a final test of newsworthiness before you put it into circulation.

## TABLE 5-1 Spotting the Good and Bad in News Releases

| ***Attributes of Releases That Get Results*** | ***Attributes of Releases That Get Ignored*** |
|---|---|
| Feature timely news about your products or services, your staff, recent legal or legislative actions, industry changes or other items of interest to the public | Contain promotional messages, convey recycled stories that have already been covered by competing news media or present self-serving puff pieces |
| Are customised messages tailored to the audience of a specific news vehicle, often accompanied by a brief note written to an established editorial contact | Are blanket mailings that relay the same exact news to competing media with no unique angle, no offer for interviews or no other effort to customise the story |
| Contain crisp, clear, accurate and factual language | Are full of superlatives (biggest, brightest, strongest and so on), opinions and hype |
| Describe benefits to the target audience of the media outlet | Emphasise product features rather than benefits and use insider terminology |
| Make a clear point regarding why the news is important and how and when people can act upon the information conveyed | Fail to answer the fundamental question, 'Who cares?' |

| | |
|---|---|
| Use quotes from management, customers and industry leaders | Fail to make a clear point about how the news affects your industry, your business or, especially, your customers |
| Are intriguing and believable | Are boastful or stretch the bounds of credibility |

### *Producing hard-copy news releases*

If you deliver your release by mail, hand or fax (which is becoming rarer every day), prepare your story in the longstanding form of a printed release, as illustrated in Figure 5-1 .

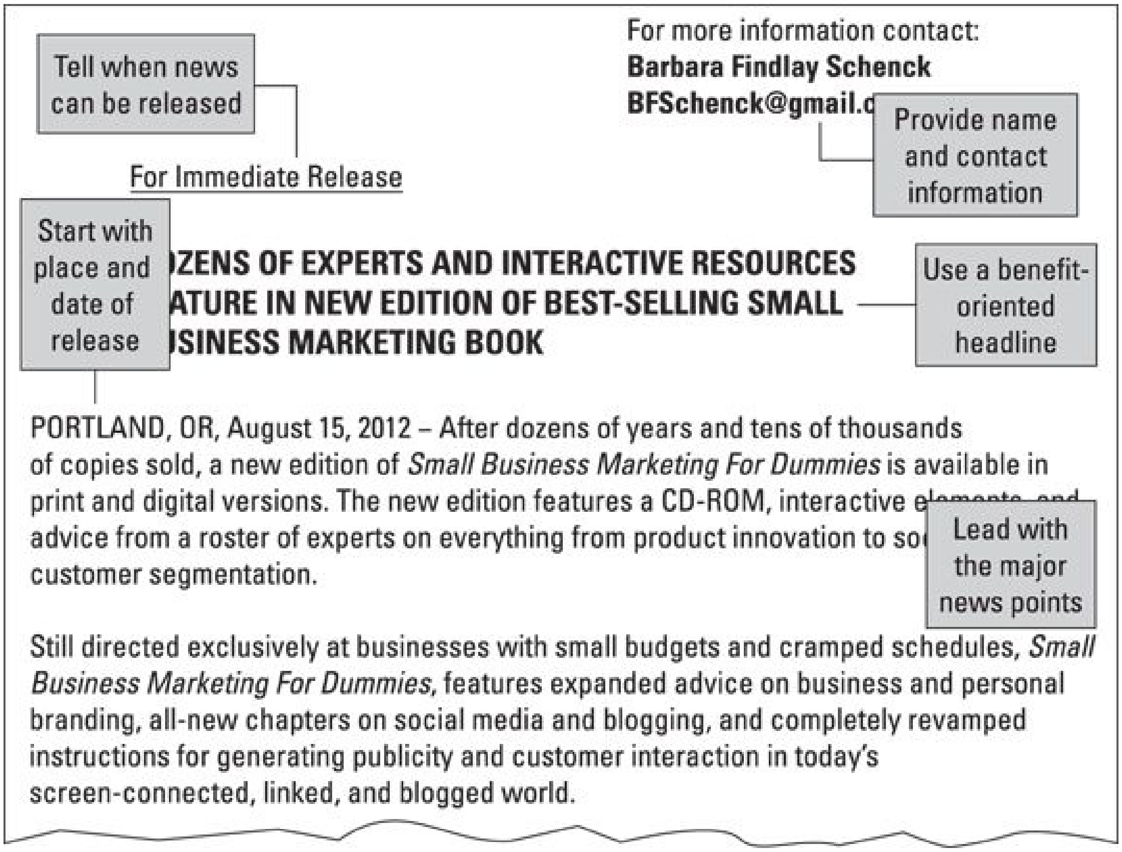





**FIGURE 5-1:** This sample shows a standard format for printed news releases.

TIP The hard-copy printed release is becoming something of an antique in a world where news is increasingly submitted electronically, but the format is still the basis of official news announcements. Figure 5-1 shows what's involved.

### *Sending releases electronically*

Emailing news releases is immediate, cost-efficient and effective – *if* you take a few steps first.

Start by checking media outlet websites to find out their news submission specifications and to obtain editorial email addresses. Or contact the assignments editor at your target media outlet (or better yet, the editor you hope will handle your news).

Explain that you've a news release you believe is of interest and ask if the editor prefers to receive submissions by email. The editor will probably ask the nature of your news, in part to provide accurate delivery directions, so be ready with a one-sentence answer.

WARNING If the editor prefers electronic delivery, confirm the email address. Also ask whether the editor prefers the release as an attachment or typed straight into the email message. Don't make assumptions. Most editors won't open attachments, so never send them unless requested.

If the editor requests your news as an attached file, you can simply email your printed news release document. If not, prepare your news in an email message following these guidelines:

- Type your subject line in uppercase and lowercase, presenting a short headline for your release that can be read, in full, even on a mobile screen: for example, *Lancaster Landscaping Free Waterfall Workshop* . If the release comes from an email address that includes your business name, you don't need to repeat it in your subject line.
- Write and send your email in plain text. Don't use HTML or other mark-up languages, as they can reduce the readability of your news.
- If possible, start each email message with a customised line. For example, you may use *News Release for [name of news contact] at [name of media outlet]* , followed by a short description of why the story is a good fit for the editor, reporter or blogger's audience and what type of coverage you're aiming for.
- Paste your release into the message box. Your release should begin with the words *For Immediate Release* and follow the content instructions for standard printed releases.
- Include hyperlinks that lead to supporting information or product landing pages on your website. The links provide helpful information to reporters or editors preparing stories based on your release, and they appear in any media outlets that post your release.
- End your release with an invitation to request additional information or interviews, followed by your contact information in this format:
  - Contact person's name
  - Company name
  - Office and mobile phone numbers with area code
  - Email, website and physical addresses
- Don't attach files, photos or artwork unless the recipient has specifically instructed you to do so. Instead, include a link to your website, where high-definition artwork is available. (See the nearby sidebar '[Preparing and submitting artwork digitally](#) '.)
- TIP Print a copy of your email release so that you've a reference copy handy when editors respond to request additional information.

REMEMBER If you send an identical release to those on your media list instead of sending tailored releases to individual media contacts, take great care not to reveal the names and addresses on your list. Instead, use an email group or distribution list or send the release to yourself with all recipients listed in the blind carbon copy (Bcc) field.

## PREPARING AND SUBMITTING ARTWORK DIGITALLY

Increasingly, media outlets emphasise art in their page designs. They need good images to accompany stories, which presents a great opportunity for businesses that submit photos or graphics in easily usable formats.

Follow these steps as you make digital art submissions:

- Start with a clear, well-exposed image that has good composition, good focus and interesting subject matter.
- Submit an image that's at least the size you hope it's going to appear in the media outlet or, better yet, the size the editor has requested.
- Prepare your photo or art for adequate digital resolution before sending. Nearly any newspaper can use your image if you submit it at a resolution of 250 to 300 PPI, which means pixels per inch. (You'll also hear the term DPI, which means dots per inch.)
- Obtain permission to submit artwork before attaching your file to an email message. When writing the email that accompanies the file, type your caption into the subject line (for example, 'Photo: *Small Business Marketing For Dummies* book cover'). In the message box, type your *cutline* , which is a more detailed caption of the photo or artwork. If your photo includes people, include the complete names of all who are recognisable. (Keep in mind that publications rarely use photos featuring groups of more than four.) Close your email with your name and contact information.
- Most media outlets can receive your image if you compress it and send it in JPEG format.
- Transmit your image in RGB (red, green, blue) colour format if possible. Most images originate in RGB, which is the most common colour mode for viewing digital images on-screen and the default setting in photo software.
- If you're submitting a digital photo, change the file name designated by the camera (which is probably something like DSCN0015.JPG) before submitting.
- One last step: be patient. Your image may not be used this time, but if you're a good, reliable source, in time your efforts pay off.

# *Managing media interviews*

When you hit the publicity jackpot and a reporter calls, be ready!

### *Before the interview*

Get the details. Confirm the media outlet and deadline, along with the interview topic, the story's angle and the type of questions you'll be asked. Ask whether the reporter is interviewing others for the same story. The answer gives you an indication of the nature of the story and allows you to prepare your remarks accordingly.

Then take time to prepare yourself. Unless the reporter is on a deadline or calling in response to a release that you put out (in which case you should have talking points prepared and by your phone), buy a couple of minutes' time by asking whether you can wind up a meeting or project before returning the call – and then do so, preferably within a half hour. But before hanging up, ask whether the reporter has specific questions in mind. That way you can be prepared when you call back.

After you find out the scope of the interview, jot down the two or three most important ideas that you want to convey about the topic. Grab any appropriate reference materials that help you make your points clearly. Consider negative issues that may arise and develop short responses. And think about what photos, charts, industry statistics or other materials you'd like to offer to the reporter to enhance the coverage.

### *During the interview*

Proceed with confidence – and caution – during media interviews. Answer questions clearly and then stop talking. If you try to fill time with additional comments, you run the risk of overshadowing your message or saying something you don't want to see in print or hear on-air.

### *After the interview*

Following the interview, thank the reporter and ask when the story will run or air. Don't demand prior review, but do offer to be available to assist in confirming any facts or quotes. Also, put your thanks into writing in a follow-up note that summarises key points and provides links to more information.

Be prepared for the fact that after interviews, stories sometimes get cancelled or don't run on the scheduled date. Also realise that you may notice discrepancies between the way the story is worded and what you thought you said. Request corrections only for actual and important errors, not for differences of opinion or approach. Instead, look for a positive aspect of the coverage and highlight that point in a thank-you note to the reporter. Good words get you further than nit-picking or criticising.

**WATCH YOUR WORDS**

People pay a big price for attacking someone's reputation in the media. To stay out of trouble in media interviews, steer clear of negative opinions about others.

For the record, here are two terms with which you don't ever want direct involvement:

- **Libel:** Printed statements that are untrue, defamatory and harmful.
- **Slander:** The verbal form of libel.

## *Staging news conferences – or not*

Companies like the concept of news conferences a lot more than editors and reporters do. In fact, many media organisations, including many local newspapers and stations, simply won't attend ribbon-cutting and launch events, considering them promotional and easily described in simple news releases. Even the most newsworthy conference (in your view) can be eclipsed by late-breaking news.

Stage a news conference only for a huge and time-sensitive announcement and only in the following cases:

- When you need to announce important news simultaneously to all media
- When the news is best told in person, backed by displays and followed by the chance for reporters to ask questions

- When you’re presenting important speakers or celebrities

Schedule and announce the news conference well in advance. Send invitations in the form of brief letters or announcements that you format like news releases but with the words *Media Advisory* replacing the words *For Immediate Release* .

# *Crisis Communications: Dealing with Bad News*

Chalk it up to bad decisions or just plain bad luck, but sometimes, bad news happens. When it does, work fast to find out what went wrong with your business, collect all pertinent facts and prepare to fix the problem, if possible.

Waste no time before circulating facts about what happened and, if possible, what actions you’re taking to see that it won’t happen again. As much as you’d like to run and hide, don’t. The last thing you want is for those who care a lot less about your reputation than you do to be speculating or spinning the story for you. Almost certainly, your business will fare better if you show a concerned face and release a truthful explanation through the same media channels in which the bad news is travelling.

TIP Public relations strategists have complete scenarios to use in what are called *crisis communications* . If your event is likely to have negative ramifications that continue for more than a few days, and if the bad news seems likely to reach out further than your local market, call on pros to help you manage the story.

TIP It’s not a weakness to admit that you can’t deal with everything yourself and may need help. There is nothing worse than a poorly briefed and prepared CEO who faces the hostile press when their company name is directly linked to a disaster – think BP and oil spills. Get a professional to help you. You can find a professional PR agency either through your local directory, a recommendation or even Google. Look for a PR agency that is a member of the PRCA ( www.prca.org.uk ). All PRCA members are bound by a professional charter and codes of conduct, and benefit from exceptional training.

# Chapter 6

# Doing Business Online

**IN THIS CHAPTER**

**Understanding the power of the Internet and how to use it**

**Checking out how you can add value to your business online**

**Getting help with selling on your website**

**Making sure that you get seen online**

**Being safe online**

According to the Centre for Retail Research, e-commerce is the fastest growing retail market in Europe. Sales in the UK reached £52.25 billion in 2015 and are growing at a rate of 17 per cent each year. Many retailers report that about half of the people browsing their website do so on smartphones and tablets, though relatively few shoppers complete their purchases in this way.

The range of products sold online is extending considerably, and the way that businesses do business is changing too. For example, car buyers used to make five or more visits to a dealer while making up their mind, but now, according to research by the University of Buckingham, 86 per cent do most of their tyre-kicking online, making barely one showroom visit before making their choice. So, showrooms have been supplanted by websites and social media work on platforms like Facebook and Twitter.

Making your online presence effective, then, is vitally important. This chapter gives you a good grounding in what you need to know to harness the power of the Internet.

TIP Social media is part of your online presence. Read Chapter 7 in Book 5 for tips on reaching your customers through social media.

## Appreciating the Power of the Internet

So just how big is the Internet? Well, in April 2016 over 3 billion people, approaching a third of the world's population, were online and using methods of connectivity infinitely superior to the early primitive telephone links. According to the Internet Statistics Compendium, compiled by Econsultancy and available for free ( https://econsultancy.com/reports/internet-statistics-compendium/ ), each online shopper in the UK spent £1,174 on average during 2015; that's £54 more than the average American shopper.

As well as reaching virtually every corner of the planet, the Internet is now able to deliver a rich seam of valuable products in its own right. For example, when the first Internet bookshop opened up in 1982, it simply took orders for physical books by email. Barely two decades later, Amazon was selling more Kindle editions than hardback versions of its books.

## *Ruminating on richness versus reach*

The Internet has largely changed the maths of the traditional trade-off between the economics of delivering individually tailored products and services to satisfy targeted customers (‘richness’) and the requirement of businesses to achieve economies of scale (‘reach’). Figure 6-1 shows how as the richness grows, so too does the number of potential customers. The Internet is the perfect medium to enable richness and reach to extend. The near-impossible-to-find second-hand book that you had to track down laboriously and at some cost is now just a mouse click away. The cost of keeping a retail operation open all hours is untenable, but sales can continue online all the time. At one time, a small business couldn’t have considered going global until many years into its life. But thanks to the Internet, today the business can sell its wares to anyone, anywhere, with a basic website costing a few hundred pounds and with little more tailoring than the translation of a few dozen keywords or phrases and a currency widget that handles its payments. The Internet has made real what in the 1970s Marshall McLuhan, a Canadian visionary of marketing communications, called the ‘Global Village’.

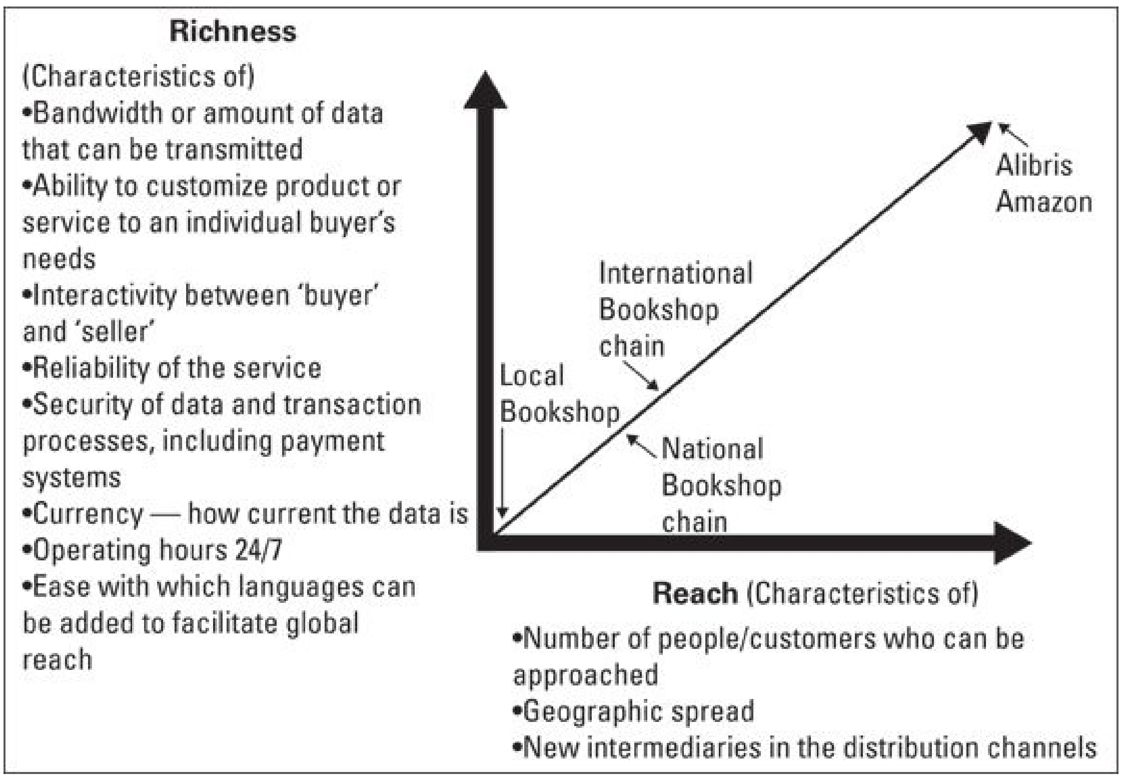




**FIGURE 6-1:** Richness versus reach in the book business.

The book business is a powerful illustration of the way a product and its distribution systems endure in principle while changing in method over the centuries. From 1377, when the earliest-known printed book was produced in Korea, through to Gutenberg’s 42-line Bible printed in the 1450s, which in turn laid the foundations for the mass book market, the product, at least from a reader’s perspective, has had many similarities. Even the latest developments of in-store print-on-demand and e-book delivery such as that by Amazon’s Kindle look like leaving the reader holding much the same product. What has, however, transformed the book business is its routes to market, the scope of its reach and the new range of business partnerships and affiliate relationships opened up by the Internet.

## *Checking out clicks and bricks*

Of course the Internet business world and the 'real' world overlap and, in some cases, overtake. Jessops, for example, died on the UK high street in January 2013, closing 187 stores, only to be born again on 28 March that year with a slimmed-down estate of 30 shops and a major presence on the Internet, under a new owner, Peter Jones of *Dragons' Den* fame. Many of the old economy entrants to the e-economy have kept the 'mortar' as well as acquiring 'clicks'. Trust stems from customers being able to physically see what the company stands for. Tesco, a UK-based international retailer, uses specially developed software to offer an intelligent Internet tool that reacts to customers' shopping habits, suggesting different sites related to subjects or products they're interested in. In this way, Tesco hopes to build a similar level of trust to that achieved in its stores, but over the Internet. The firm uses its local stores for 'pick and pack' and delivers locally using smaller vehicles.

When Holly Tucker and Sophie Cornish launched their online retail venture in 2006, they knew they were innovators. Their business, Not on the High Street, puts hundreds of personalised and unique gifts – gold rings, linen shawls, organic scented candles, overnight bags and more – all on the one website. Rather than trudging around dozens of shops or scouring the Internet, they have placed a near-inexhaustible choice of gifts under the umbrella of a single online shopping centre. In fact, the collections of gifts they offer are unlikely to feature on many high streets, now almost exclusively the domain of big multiples with standardised product ranges. The flood of charity shops that fill up vacant slots left by the growing band of failed retailers are unlikely to appeal to the discerning gift buyer either.

It's hardly surprising then that the business hit a £6.4 million turnover in year two, it reached £14 million in 2010 and it has since soared past the £100 million barrier, no doubt helped by their decision to hire Jason Weston, formerly of Amazon, and Mark Hodson, from PayPal, in 2011. The founders put in £70,000 of their own money as an initial investment, raised by mortgaging their homes. The rest of the funds, some £7.5 million, came from venture capital firm Index Ventures, which has a track record of success in the sector, having previously backed Betfair, Net-a-Porter and Last.fm. Ben Holmes, a partner at the venture capital firm, recognised that Tucker and Cornish were onto something with their idea of putting 35,000 products sourced from small businesses around the country on a single website, available to drop into one online shopping basket. Most of Not on the High Street's 3,200 suppliers have no online presence themselves or are too small to have much visibility in a crowded Internet marketplace.

## *Recognising the limits – you have none!*

Even if you think that e-business offers you few advantages, you can find yourself facing a range of unexpected threats and competitors heading your way courtesy of the Internet. For example, the competitors that a new off-line business currently faces are probably small – perhaps even big – firms in its own country or area, and large international firms from elsewhere in the world. But with the Internet, the new business may now have small firms similar to itself – but based anywhere in the world – entering its market. Potentially, this reality can pit business start-ups against hundreds if not thousands of competitors, all with the advantages of nimbleness and being driven by hungry entrepreneurs just like themselves – and you too, of course.

WARNING Your business faces dangers as a consequence of the Internet by virtue of its near unlimited capacity for penetrating and opening up markets to new entrants and innovations. Not only can competitors of all sizes from around the world attack your market using the Internet, but if you don't have an Internet presence, your company may also:

- Appear old fashioned and out of date compared with other firms that do have websites.
- Miss out on some business that may only go to firms with an Internet presence. This problem is particularly true of rural markets, where the Internet offers a degree of choice that's otherwise only available to customers in major cities.
- Lose its best staff, who leave in search of more stimulating and forward-thinking places to work.
- Miss out on the operational cost saving that can be made using e-business, which may make you uncompetitive so you lose out to other firms.

# Reviewing What You Can Do Online

You can be forgiven for thinking that a website is just for those who plan to sell on the Internet. That's certainly a powerful argument for getting online and perhaps the easiest one to justify financially. Using a website to sell is so important that the topic has a whole section to itself later in this chapter (see 'Selling Goods and Services '). But selling isn't the only valuable use your business can get from being on the Internet.

## Generating advertising revenue

When you have a website, you have 'readers' who other people will pay to reach, just as they would if you had a hard-copy magazine. You can sell space on your website yourself, but you should be too busy running your business to get diverted with this type of distraction.

TIP The easiest way to get advertising revenue is to get someone else to do the hard work. Google AdSense (www.google.com/adsense/start/#), for example, matches advertisements to your site's content, and you earn money every time someone clicks on an ad on your site.

## Recruiting staff

When you start to grow your business, you can advertise for staff on your own website. In that way, you can be sure that applicants know something about your business and you can cut out most of the costs of recruitment. In addition, nearly a quarter of all jobs are filled using *job boards* , websites where employees and employers can get together much along the lines of a dating agency. The Internet's advantages are speed, cost and reach. You can get your job offer in front of thousands of candidates in seconds. The fees are usually modest, often less than regional paper job adverts. Services through job boards range from the passive, where employers and employees just find each other, to the proactive, where the website searches online candidate databases and makes suitable candidates aware of your vacancy.

You can find out more about recruiting staff online in Chapter 2 of Book 3, along with other aspects of recruiting staff.

## Answering frequent questions

Businesses get dozens of phone calls and letters asking essentially the same questions. By having a frequently asked questions (FAQ) section on your website, you can head off most of those enquiries and save time and money.

TIP CSGNetwork ( www.csgnetwork.com/csgfaqsgen.html ) has a free FAQ generator. Just enter the questions you receive frequently and their respective answers, click the generate button and the script outputs a complete FAQ page for you.

## Carrying out market research

The Internet is a rich source of market data, much of it free and immediately available. But you can't always be certain that the information is reliable or free of bias, because it can be difficult if not impossible to always work out who exactly is providing the information. That being said, you can get valuable pointers as to whether or not what you plan to sell has a market, how big that market is and who else trades in that space.

Turn to Chapter 6 in Book 1 to find out more about different sources of market data on the Internet, as well as market research in general.

## Making money from affiliates

Affiliate marketing is a massive business. Imagine that a clothes shop recruits a partner (or affiliate) who promotes a link from her website back to the clothes shop's link and then performs an action, such as signing up to the clothes shop's newsletter or making a purchase. The affiliate gets either a flat referral fee or a percentage of the sale. The clothes shop knows that the referral has come from the affiliate's website because the link contains a unique identifying code that the shop can trace back to the affiliate.

Many intermediary companies facilitate the partnership between advertiser and publisher, from both technical and payment perspectives.

You could try joining eBay's Partner Program ( https://partnernetwork.ebay.com/uk/home ) or Amazon's affiliate program, Amazon Associates ( https://affiliate-program.amazon.co.uk ). You can display ads for certain products on Amazon and earn commission if someone clicks through to the Amazon website as a result.

TIP You can check out dozens of other affiliate advertising schemes at the Affiliate Gateway ( www.theaffiliategateway.com/directory/category ), a site that has an affiliate program directory with hundreds of programmes listed.

# Establishing an Internet Presence with a Website

Thousands of small companies seduced into having a presence on the Internet quickly become disappointed. Part of the reason is that in the rush to put together a website, they end up with little more than an online leaflet or brochure. *E-commerce* , which is where the real value from being on the Internet arises, comes about only when you can buy and sell products and services, just as you can with any other route to market, and equally importantly when you can open up a dialogue with customers. That conversation can be as simple as a strong FAQ section, a blog or an invitation to ask for specific information.

Persevere because the gain is almost always worth the pain. Here are a few of the other benefits of being on the Internet for a small business:

- You can have global reach from day one, without the bother of getting a passport, a visa or turning up at an airport.
- You can extend your opening hours to 365 days a year, 24 hours a day, without creating an enormous wages bill or imposing impossible demands on the few people you have who can deal with sales enquiries or handle customer support.
- Things can change quickly in a small business. If you do business online, you can make changes to your product and service offers or prices quickly and inexpensively and fine-tune your propositions.
- You can reduce human error by eliminating certain stages in each transaction. The more times a piece of information is handled between a customer's enquiry and the order being fulfilled, the greater the chances of something going wrong.

As well as deciding exactly what copy you want on your website, you need to figure out what the website should look like and what you want people to do on it – whether you just want them to read, place orders, get into discussions and so on. At this point, you may well decide that you want a helping hand, so read on …

## Deciding on content

The danger with producing content for websites is that you fall into the trap of believing that because it costs virtually nothing to load your site up with copy, pictures, diagrams and videos, you should do so. Chapter 1 in Book 5 explains how to get under your customer's skin. Think through what you want website visitors to do as a result of arriving at your site – place an order, ask a question, gather more information, see a demonstration and so forth – and then produce the minimum clear content to achieve those goals. Make the content credible, original, current, varied and concise – readers typically ignore content beyond the first one-and-a-half to two page lengths.

Information on your site needs to be fresh and informative. Nothing is quite so off-putting as being on the fastest method of global communication known to humanity and seeing an invitation to a seminar that's already taken place or a special offer that expired weeks ago. You can buy in a news feed covering topics related to your business such as finance, travel or politics, or just general news, to ensure that your front page is always busy and topical, without you having to do a single thing. Check out sites such as Feedly ( `https://feedly.com/i/welcome` ) that harvest hundreds of thousands of news articles every day from the most respected news sources and categorise them into topics covering virtually every industry.

## *Designing the website*

You probably already have a basic website writing tool with your office software. If you use Microsoft Office, you can find free web design tools in the Publisher section of your software. Basic stuff, but it gets you up and running. For more on building a website for free, check out Lisa Lopuck's *Web Design For Dummies* (published by Wiley).

You can also find hundreds of packages from £50 to around £500 that, with varying amounts of support, help you create your own website. Also take a look at these sites:

- **Top 10 Best Website Builders** ( www.top10bestwebsitebuilders.co.uk ) provides a regular report on the best website creation templates rated by ease of use, help and support, value for money and a score of other factors.
- **Web Wiz** ( www.webwiz.co.uk/kb/website-design ) has a tutorial covering the basics of web page design and layout.

More expensive options come with access to an editor, hours of webmaster assistance per month, a domain name, hosting, email and more.

TIP Good website design is essential to having a successful experience online. Here are some website design dos and don'ts:

- **Do think about design.** Create a consistent visual theme, grouping elements together so that your readers can easily follow the information you're presenting.
- **Do plan your site navigation.** Research shows that visitors have to be hooked within three clicks or they jump ship to a more user-friendly website. So, clear signposting is essential, with a simple menu of options on every page and a link back to your homepage so visitors can get back to their starting point. Your pages need to be organised intuitively so they're easy to navigate.
- **Do consider *loading time* (how long it takes the recipient's computer to download your data).** If loading takes too long, people may leave without looking at your site at all and you may have lost an opportunity for a sale. Use graphics rather than photographs, which take up too much memory. Optimise your hypertext mark-up language (HTML), especially on your home page, to minimise file size and download time by removing excess spaces, comments, tags and commentary. You can check your website's loading time at the search engine optimisation company 1-Hit's website: www.1-hit.com/all-in-one/tool.loading-time-checker.htm (search engine optimisation is explained in the later section 'Gaining and Monitoring Visibility ').
- **Do decide on Flash or HTML5.** Which technology will you use: Flash or HTML5? Flash has been around longer and is machine independent – that means you website looks the same on any device. However, it has cost to the developer and the Flash plug-in for some Apple mobile devices may not work well. On the other hand, HTML5 is free but is device dependent – that means your website has to be customized to the device it's being viewed on. Note that there are no problems viewing HTML5 pages on Apple mobile devices.
- **Do optimise for searching.** Build in keywords, tags and markers so that search engines easily

find your site (see the later section 'Gaining and Monitoring Visibility ').

- **Don't have pointless animation.** Many are distracting, poorly designed in terms of colour and fonts, and add unnecessarily to file size, slowing down your reader's search.
- **Don't use the wrong colours.** Colour choice is crucial: black text on a white background is the easiest to read and other colours, such as reds and greens, are harder to read. Check out Visibone's website ( www.visibone.com/colorblind ) for a simulation of the web designer's colour palette of browser-safe colours.
- **Don't waste your readers' time.** Making readers register on your site may be useful to you, but unless you have some compelling value to offer, don't. If you absolutely must, keep registration details to a couple of lines of information.

TIP Check out The World's Worst Website Ever ( www.theworldsworstwebsiteever.com ) to see how to avoid the biggest howlers, and in consequence how to get your website design right.

## Checking out competitors

To get an idea of what to include and exclude from your website, check out your competitors' websites and those of any other small business that you rate highly. You can also get a few pointers from the Web Marketing Association's Web Award ( www.webaward.org ). Take a look at the Winners section where you can see the best websites in each business sector. Also check out The Good Web Guide ( www.thegoodwebguide.co.uk ), which contains thousands of detailed website reviews.

TIP You can keep track of how many times your competitors change information on their websites by using the services on offer from companies such as WebSite-Watcher ( www.aignes.com ).

WARNING Don't get into the habit of constantly changing the fundamental layout of your website. Customers may wonder if it's still you that's running the show! Customers expect consistency as well as currency when they come to your website.

## Using a consultant

Thousands of consultants exist who claim to be able to create a website for you. Prices start from £499, where a consultant tweaks an off-the-peg website package slightly to meet your needs, to around £5,000 to get something closer to tailor-made for you. The Web Design Directory ( www.web-design-directory-uk.co.uk ) list hundreds of consultants, some one-man or one-woman bands, others somewhat larger. You can look at consultants' websites to see whether you like what they do. The Web Design Directory also has useful pointers on choosing a designer.

TIP If you're working within a set budget, you can consider auctioning off your web design project. Make sure, though, that those you offer the auction to are going to do the job that you need. Using People Per Hour (`www.peopleperhour.com`), you state how much you're prepared to pay with a description of the project, and freelancers around the world bid under your price, with the lowest bidder winning.

REMEMBER If you decide to use a consultant to create your website, make sure that she builds it on a widely used platform such as Wordpress so that after it's up and running, you can make small updates yourself. Otherwise, you incur further expense and delays every time you want to make a change, such as changing a price, adding a product or revising a specification.

TIP Wordpress has such a massive following that all sorts of *plug-ins* – small add-on programmes – enable functionality such as e-commerce to be easily added at low cost.

## Registering domains

Having an Internet presence means that you need a *domain name* – the name by which your business is known on the Internet and that lets people find you by entering your name into their browser address box. Ideally, you want a domain name that captures the essence of your business neatly so that you come up readily on search engines, and one that's as close as possible to your business name (see Chapter 2 in Book 1 for more about naming your business).

Domain names come in all shapes and sizes. Those such as '.com' exude an international/US flavour, and '.co.uk' implies a UK orientation. Charities usually opt for '.org' or '.org.uk', and '.net' or '.net.uk' are used by network service providers. Businesses often use '.biz', but it doesn't really matter what domain you use: what you want is to be seen.

REMEMBER Some domains are restricted. For example, '.ac.uk' is used by higher education institutes in the UK and '.gov.uk' is used by UK government departments.

TIP If your business name is registered as a trademark (refer to Chapter 2 in Book 1), you may (as current case law develops) be able to prevent another business from using it as a domain name on the Internet.

After you've decided on a selection of domain names, your Internet service provider (ISP), the organisation that you use to link your computer to the Internet, can submit a domain name application on your behalf. Alternatively, you can use:

- **Nominet UK** ( www.nominet.org.uk ), the registry for British Internet domain names, where you find a list of members who can help you register (though you can do so yourself if you're web-aware).
- **A world directory of Internet domain registries** if you want to operate internationally; for example, by using a '.com' suffix or a country-specific domain. Check out www.internic.net .
- **A company that sells domain names,** such as Own This Domain ( www.ownthisdomain.co.uk ) and names.co.uk ( www.names.co.uk ), which provide an online domain name registration service, usually with a search facility so you can see whether your selected name has already been registered. Electric Names ( www.electricnames.co.uk ) has a detailed domain name registration on its website, as well as offering a same-day registration service for prices between £10 and £25 per annum.
- **A free domain** that you obtain along with free web space by registering with an Internet community. These organisations offer you web pages within their community space as well as a free domain name, but most communities only offer free domain names that have their own community domain tagged on the end – this addition can make your domain name rather long and hard to remember, and unprofessional.

### *Hosting your website*

As well as a domain name, you need to make your website visible to people searching on the web. Doing so is the function of a *host* , a service that stores all your website pages and makes them available to any computer connected to the Internet. Think of hosting as a sort of telephone exchange that makes sure that people can connect with each other.

Expect to pay a monthly fee that varies depending on how much information you plan to put online. Less than £5 per month should meet the needs of most new businesses putting their toe in the water.

TIP Read *Web Hosting For Dummies* by Peter Pollock (Wiley) for the lowdown on everything about web hosting.

## *Selling Goods and Services*

Everything from books and DVDs, through computers, medicines and financial services and on to vehicles and real estate are sold or have a major part in the selling process transacted online. Holidays, airline tickets, software, training and even university degrees are bundled in with the mass of conventional retailers such as Tesco that fight for a share of the ever-growing online market. The online gaming market alone has over 217 million users.

WARNING Not all business sectors are penetrated to the same extent by the Internet. According to Internet research company Forrester ( www.forrester.com ), although sales of clothing and footwear online is a multi-billion-pound business, it accounts for only 8 per cent of total sales. Contrast that with computers, where 41 per cent of sales occur online.

You may decide that you want to handle sales from your website yourself. Doing so certainly puts you in control, but it's not the only way to get business online. You can sell through other people's websites and even get someone else to despatch your goods and collect the cash. These options have their strengths and weaknesses, which are explored in this section.

## Using third-party websites

Selling online may be a sound way into your market, but you still have another option: tag along with someone else, much as you would if you were selling a product into a shop. That way you don't have to deal with the procedures of selling on the Internet that, aside from having your own website, require systems for showing and describing the goods and services on offer, as well as ordering payment and fulfilment facilities (these topics are the subject of the following sections).

WARNING The main advantages to setting up your own selling procedures are that you've greater control over where your products appear, which can be important to people passionate about their venture, and you get to keep the whole profit margin rather than sharing it with others in the channels of distribution. Setting up your own online sales operation requires several thousand pounds of investment upfront and a continuing stream of investment to keep your systems up to date, much as a retailer would need new shop fittings.

The other way of getting your goods and services to Internet markets is to piggyback on established, ready-built e-tail platforms:

- **Amazon** (`www.amazon.co.uk/gp/seller/sell-your-stuff.html`) will list, take payment for, insure and, if required, pick, pack and deliver your products through its distribution system. Amazon provides tools to make it easy for you to upload inventory onto the website, and you can have an unlimited number of listings to sell to its millions of customers. No fixed-term contract exists and charges depend on the type of products sold.
- **eBay** (`http://pages.ebay.co.uk/businesscentre`) isn't just a place to pick up a bargain and sell last year's ski gear when you move on to a snowboard. Sure, that's one side of the business; the other is the 160,000 or so people in the UK, Power Sellers as they're known, who make anything from a few hundred to tens or even hundreds of thousands of pounds. You can become a Bronze-level Power Seller when your minimum value of sales reaches £750. (*eBay.co.uk For Dummies* by Marsha Collier, Jane Hoskyn and Steve Hill – published by Wiley – is a good place to find out more about selling on eBay.)
- **IBidFree.com** (`www.ibidfree.com`) was set up by Shane McCormack, a former eBay seller, with the proposition that you can have all the features of eBay but for free. IBidFree.com was created as a perfect opportunity for the person working from home trying to market their products without all their profits being swallowed up by charges and fees. The rules are few and, unlike eBay sellers, sellers are encouraged to place a link in their auctions back to their own websites. They're also allowed to directly email each other to allow for better communication.

## Building a store front

Okay, so you've decided to take the plunge and set up your own shop front. If you were selling from a shop, you'd set out your window display and have a basket for customers to drop their shopping into prior to checking out and paying. Your online store has much the same features, with buttons and boxes around your order page allowing customers to select colours, sizes and quantities; place their order; pay; and track the progress of their delivery. You need to decide what you want your online store to do, because with linkages to other services, you can arrange payment, delivery and even stock re-ordering, all of which come at an increasing price, eating into your profit margin.

You can choose between dozens of companies in the field, such as altcom ( `http://altcom.co.uk` ) and EKM ( `www.ekmpowershop.com` ), which offer turnkey online shop fronts from £19.99 a month. GoECart ( `www.goecart.com` ), founded in 2000, doesn't charge any listing or transaction fees, and a merchant can open a store for around £600 a month. That fee includes all you need: a shop front, trolley buying system, payment acceptance, fraud protection, complete order and stock management, and web traffic statistics. This fee covers up to five admin users. GoECart also claims to have the most search-engine-friendly architecture.

## *Getting paid online*

If you're going to trade on the Internet, you need some form of online payment such as a credit card merchant account. An alternative is one of a new breed of businesses tailored expressly for the Internet. The leader of the pack is PayPal ( `www.paypal.com` ). It claims to have 100 million accounts around the world and that firms using its services get an average of 14 per cent uplift in sales.

Using PayPal, you can in effect get a merchant account with all major credit and debit cards in one bundle, without set-up fees or a lengthy application process, and start accepting payments within minutes. PayPal isn't free; you pay 20p per transaction and a sliding charge ranging from 3.4 per cent if your transactions amount to £1,500 in any month down to 1.4 per cent if sales are above £55,000 a month.

TIP PayPal's Micropayments provides special rates for your low-value transactions, which is cost-effective for items selling for less than £8.

WARNING eBay's international payments incur additional costs. PayPal charges a standard cross-border fee of between 0.4 and 1.5 per cent and a foreign currency conversion fee of up to 4 per cent.

Worldpay ( `www.worldpay.com` ) and Durango ( `www.durango-direct.com` ) offer similar services.

TIP You can keep up with all the various services by reading the Merchant Account Forum ( `www.merchantaccountforum.com` ), a free newsletter set up by Richard Adams, who was so frustrated in his efforts to set up a merchant account for his first online business that he decided to launch a site to review merchant accounts.

### Fulfilling orders

You’ve two main options when it comes to actually getting products and services to customers after they’ve bought them online. The simplest way is doing it yourself: take the orders, clear the payment and despatch the product.

Alternatively, MetaPack ( www.metapack.com ) automates and improves customer delivery using one or more of 23 carriers that provide between them around 590 services. You detail what you’re sending, to whom, when you want it delivered and any other particulars such as security, and the MetaPack software recommends a solution and can do anything from printing off a despatch label to booking a courier pick-up. Or, if you don’t want the hassle of managing your own fulfilment, you can ship your products to an outsourced fulfilment business that handles as much or as little of the process as you want. Contact ILG ( www.ilguk.com ), or search the UK Warehousing Association’s membership database ( www.ukwa.org.uk ), where you can look for a company in your area by specific tasks such as garment hanging, order picking, shrink-wrapping and cold storage.

TIP Amazon ( http://services.amazon.co.uk/services/fulfilment-by-amazon/features-benefits.html ) has its own fulfilment service. When you include the cost of overheads such as warehouse costs, packing supplies, postage and labour, dealing with customer service enquiries, and returns handling, letting Amazon do the job may actually be a cheaper option than doing it yourself. Amazon claims to be able to get a small electronic item through its entire system, from stock held in its warehouse to cash in your bank, for around £1.85.

## Gaining and Monitoring Visibility

Unless the world that matters to you knows how to find your website, you’re winking in the dark. The tricks of the trade start with ensuring that your *homepage* is chock full of words and phrases that people would put into their search pane to find your website and that their chosen search engine can find. That’s where this section comes in.

REMEMBER As well as ensuring that people find your website through a web search, promote it off-line such as by featuring your website address on all products and publications.

### Understanding search engines

Online searching services are often grouped under the single heading of *search engines* . However, two distinct services exist, directories and search engines, that both contain the key to unlocking the wealth of information contained across the Internet. Directories and search engines differ mainly in the way that each compiles its database of information:

- **Directories:** These depend on people to compile their information. You submit your *URL* (your website address), with a brief description of your content. Editors view the website, see whether it's appropriate for the directory and place it in a category. Each category is subdivided into more specific categories. Dmoz ( `www.dmoz.org` ) claims to be the largest human-edited directory.
- **Search engines:** Unlike directories, no human interaction takes place with the websites submitted. Instead, search engines have three major elements that attempt to arrive where the surfer is trying to get to:
  - **The spider (also called the crawler):** The spider visits a web page, reads it and follows links to other pages within the site. The spider is looking for HTML tags or markers that the website creator weaves in to a web page, making it more likely that the spider finds a particular page.
  - **The index:** Everything the spider finds goes into the *index* , which is a bit like a big digital book holding a copy of every web page the spider finds. This 'book' is updated every time a web page changes. Until a web page is entered into the index, it's not available to those searching with a search engine. Hence, the longer the interval between a site being *spidered* , as this process is known, the less likely that information searched for is relevant or current.
  - **Search engine software:** This program is the one that sifts through the index to find search matches. It also ranks matches according to criteria to suggest which pages are most relevant. Some give a percentage score to each result, suggesting which is most likely to be the site with the information you require.

TIP Check out Search Engine Watch ( `http://searchenginewatch.com` ) to keep abreast of major search engines and *meta search engines* (sites that give you results from several search engines at once). The site has tips for moving up search engine rankings.

## Optimising your website

*Search engine optimisation* (SEO for short) is the best way to be sure of getting ranked highly in the results returned by the various search engines in order to attract potential customers. Some of the work you can do yourself, without shelling out pounds; other work costs you. The following sections lay out your options.

TIP The bible on this subject is *SEO For Dummies* by Peter Kent (Wiley) with the absolute beginner in mind. Now in its sixth edition, the book walks you through increasing your online ranking and explains the ins and outs and best practices of successful SEO.

### Doing what you can for free

Start by brainstorming how customers can enquire about your products or services, as well as keywords and phrases used in your industry. Then make a list of the words that a searcher is most likely to use when looking for your products or services. As a rule of thumb, for every 300 words on your web page you need a keyword or phrase to appear between 10 and 15 times. Search engines thrive on content, so the more relevant content, the better.

TIP Good Keywords ( www.goodkeywords.com ) has a programme to help you find words and phrases relevant to your business and provides statistics on how frequently these words are used. Good Keywords also has several additional filters and tools to help you refine your keyword lists, but these come at a price, as you may expect. Expect to pay upwards of £35.

Search engines also like important, authoritative and prestigious terms. So although you may not be able to boast 'by Royal Appointment', if can get your press releases quoted in the *Financial Times* , your comments included on popular blogs or your membership of professional associations mentioned on your home page, your chances of being spidered rise.

Another way to gain visibility is to search out other websites with which you can swap links for free. For example, you may be able to persuade a company selling marine insurance to put a link on its site to your boat-selling website in a reciprocal arrangement. Such relationships are known as *affiliate marketing* , which is new speak for a kind of finder's fee.

A variation of affiliate marketing is banner advertising on sites that you can't get onto for free. You can even sell advertising yourself, but you need to prove a substantial volume of visitors to your site first. A number of online UK business directories exist, such as UK Business Directory ( www.business-directory-uk.co.uk ) and FreeIndex ( www.freeindex.co.uk ), offering free listings to UK businesses and companies in exchange for a link from your company website linking to their directory.

As you may expect, Google has a service to help you connect to online searchers. You can pay for an advert to appear next to or above the search results any time the keywords you've selected to promote your business come up in a Google search. A click on that ad takes searchers to your website. You pay Google when someone sees the ad and clicks through to your website, and Google auctions off the keywords, with the winners appearing earlier in the search list. Check out www.google.co.uk/ads/adwords/ for an explanation of how the process works.

### Using a submissions service

You can build words into your website to help search engines find you. You can also go to a professional. Submission services such as Submit Express UK ( www.submitexpress.co.uk ), Rank4u ( www.rank4u.co.uk ) and Wordtracker ( www.wordtracker.com ) have optimisation processes that aim to move you into the top ten ranking in key search engines. 'Aim' is the important word here. These services don't guarantee anything, so the proof of the pudding is in the eating. If it works, you can always go back for a second helping.

Payment methods vary. For example, Rank4u has a no-placement, no-fee deal where you pay only after it's achieved the positioning you want. This service isn't on offer to every business all the time, so you need to check it out yourself. 123 Ranking ( www.123ranking.co.uk ) has optimisation packages aimed at small and new businesses from £344 per annum. Search Engine Guide ( www.searchengineguide.com ; go to Search Engine Marketing) has a guide to all aspects of search engine marketing.

### *Paying for placement*

If you don't want to wait for search engines to find your website, you can pay to have your web pages included in a search engine's directory. That won't guarantee you a position; so, for example, if your page comes up at 9,870 in Google's list then the chance of a customer slogging her way to your page is zero. The only way to be sure you appear early in the first page or two of a search is to advertise in a paid placement listing. Major search engines such as Google AdWords (www.google.co.uk/adwords/) and Microsoft's Bing (https://secure.bingads.microsoft.com) invite you to bid on the terms you want to appear for, by way of a set sum per click.

TECHNICAL STUFF If you have a compelling proposition, you may persuade a search engine to offer you a 'pay-for-performance' deal, where it takes a share of the profits you make from having extra visibility.

## *Tracking traffic*

A wealth of information is available on who visits your website: where they come from in terms of geography, search engine and search term used; where they enter your website (homepage, FAQs, product specifications, price list, order page); and how long they spend in various parts of your website. That information is aside from the basic information you automatically receive from orders placed, enquiries made or email contacts.

You can use visitor data to tweak your website and content to improve the user experience and so achieve your goals for the website. For example, you may find that lots of visitors are entering your website via a link found on a search engine that takes them to an inappropriate section of your site, say the price list, when you want them to start with the benefits of your product or success stories. By changing the keywords on which your website is optimised, or by putting more visible links through the site, you can drive traffic along your chosen path.

TIP Check that your website is accessible and user-friendly at all times. Many people are impatient when it comes to web usage, and if a website doesn't work immediately, go elsewhere!

A good way to measure the success of your website is to make use of the free Google Analytics package available from the Google website (https://analytics.google.com). Google Analytics tracks the traffic that comes to your website from all *referrers* – that is, email marketing, search engines, pay-per-click downloads, display advertising and links from PDF documents. In doing so, Google Analytics gathers and reports data that shows how well your website is doing and enables you to make sense of all this information. The package also serves up statistics that provide details about the people who visit your website, and allows you to track your landing page quality and to see the specific pages that your visitors are viewing.

Google Analytics is aimed at marketers and business types, rather than webmasters and technologists – techie types – which makes it easy to use.

## Making the move to mobile

The world’s online population will grow from 3 billion to 4 billion before 2020, and more and more people will access the Internet through their mobile smartphones. The Internet Society Global Internet Report 2015 provides the following compelling reasons for paying attention to smartphones in your marketing:

- 192 countries ensure widespread mobile Internet connectivity with active 3G mobile networks – which cover almost 50 per cent of the global population – and 4G and 5G networks are also available in much of the developed world.
- The majority of mobile handsets sold worldwide are smartphones; in addition, tablet sales will soon exceed total computer sales.
- Over 1 million *apps* (mobile application software) are available; global app downloads have now topped 100 billion.
- Time spent using apps exceeds time spent on smartphone browsers and, in the US at least, exceeds time spent on desktop and mobile browsers combined.
- Mobile Internet access has already leap-frogged fixed-location access in many countries because of limitations in network coverage. In Kenya and other parts of Africa, the farming and fishing sectors receive a significant boost from using the Internet to access pricing intelligence and improve their market presence.

TIP Google’s Webmaster site has the lowdown on how to make the move to mobile and the mistakes to avoid (https://developers.google.com/webmasters/mobile-sites/get-started).

# Practising Safe Online Business

Keeping your business secure used to mean putting a strong lock on the door and installing an alarm system. But these days, online business is a huge target for organised criminal gangs. Whether it’s through data theft or other intrusions by hackers, the threats to the security of your business are very real.

The whole idea of keeping one step ahead of these canny cyber gangs can seem intimidating, especially whenever you hear about big companies falling victim to cyber-crime – if the big guys can’t even keep their own data secure, how can you? These are real concerns, and the always-on nature of broadband and mobile phones means your office is constantly connected to the Internet. You’ll also be entrusting your website with a third-party host, and most likely your email too – so you have to ensure the companies you’re dealing with are putting in the right measures to keep your data secure. And let’s not forget too that any intrusion into your website that takes it off-line for any period of time is detrimental to your business.

Fortunately, you can take some down-to-earth measures, most of which involve nothing more than good old common sense. You don’t need to spend lots of money to make your information and that of your all-important customers secure.

## Building security up front by installing a firewall

You probably know how important a firewall is in a personal sense. It filters out unwanted intrusions such as executable programs that hackers seek to plant on your file system so they can use your computer for their own purposes. When you're starting to do business online, the objectives of a firewall become different: you're protecting not just your own information but also that of your customers. In other words, you're quite possibly relying on the firewall to protect your source of income as well as the data on your computers.

Just what is a firewall, exactly? A *firewall* can be an application or hardware device that monitors the data flowing into or out of a computer network and that filters the data based on criteria that the owner sets up. Like a porter in the reception of a block of flats, a firewall scans the packets (small, uniform data segments) of digital information that traverse the Internet, making sure that the data is headed for the right destination and that it doesn't match known characteristics of viruses or attacks. Authorised traffic is allowed into your network. Attack attempts or viruses are either automatically deleted or cause an alert message to appear to which you must respond with a decision to block or allow the incoming or outgoing packets. A good firewall protects traffic going in and prevents suspicious traffic going out (a rogue program on your computer reporting to 'home base', for instance).

TIP

Tech Support, a non-commercial community website staffed entirely by volunteers, produces a regularly updated guide to the best free firewalls ( www.techsupportalert.com/best-free-firewall-protection.htm ).

## Preparing for the worst

When you're lying awake at night, you can be anxious about all sorts of grim disasters: flood, fire, theft, a computer virus, you name it. Prevention is always better than cure, so the following sections outline steps you can take to prevent problems. But, should a problem arise, you also find ways to recover more easily.

### Insurance … the least you can do

You're bound to think of ways to spend money that are a whole lot more fun than paying insurance premiums. But there you are every month, setting up direct debits to protect yourself in case something goes wrong with your house, car, even yourself and your pets. And yes, you have another item to add to the list: protecting your business investment by obtaining insurance that specifically covers you against hardware damage, theft and loss of data. Consultancy firm PricewaterhouseCoopers discovered that around four out of ten UK businesses were insuring against damage caused by data loss. You can also obtain a policy that covers the cost of data entry or equipment rental that would be necessary to recover your business information.

### Back up everything

Be sure to regularly back up your data. If that seems like a lot to remember, use a cloud-based system where you can not only keep all your data safe, but you can make it accessible from anywhere and at any time. If you use cloud-based software such as Microsoft 365, your licence will also enable you to use the latest versions of common Microsoft Office programs.

TIP The Cloud Standards Customer Council, an authority on cloud-based computing, regularly produces a guide to the subject. Their latest guide can be downloaded free at www.cloud-council.org/deliverables/CSCC-Practical-Guide-to-Cloud-Computing.pdf.

## *Keeping your wireless network secure*

Being able to access the Internet from anywhere in the house using your laptop or other wireless Internet device gives you great freedom, but it's essential that your wireless network is secure – if anyone can hop on to your Internet connection with their laptop and not have to type in a password, then nearby spies may be able to intercept fragments of sensitive data as it's transferred across the airwaves.

Neighbours could also use *your* Internet connection to download and share copyrighted music or movies, or conduct illegal activity online. This eats into your monthly download allowance and slows your Internet connection down. What's more, whatever dodgy activity they get up to may then be tied to you, not them – so it's crucial to keep that virtual lock on.

Thankfully, securing your wireless network these days and only letting authorised devices, such as your laptop, access it is relatively straightforward – it's just that so many people fail to sort out this security solution.

### *Setting a password for your network*

All your wireless devices should be talking to a device called a *router* (the gadget with the antennae sticking out of it). To secure your network, you need to encrypt it.

The process varies from router to router, so read your manual for the specifics. Encrypting the network typically involves these steps:

1. **Log into your router.**

   You need to access your router's setup screen. To do so, log into the router by typing its numerical *IP* (Internet Protocol) address into the address bar of your web browser (such as Internet Explorer or Firefox). The IP address is usually 198.168.0.1 or 198.168.1.1 (but it's best to check the manual).

   Before you can log in you may be prompted for the router's username and password (this is different to the password you'll set to protect the wireless network). The factory-set login for many routers is the username 'admin', and a password of simply 'password', but again, check your manual. (Make sure you change this factory setting later to something hard to guess.)

2. **Choose your security encryption method.**

   Next, you set up a password for your wireless network, which you can access in the 'setup' process. You ideally want to use WPA2-PSK. Don't choose WEP (Wired Equivalent Privacy), because this is an older and less secure connection method. Under ‘WPA2-PSK Security Encryption’ is a section for a Network Key (8 to 63 characters). This network key is your password. Type something in the box that’s hard to guess (see the next section) and click Apply.

WPA2-PSK stands for Wi-Fi Protected Access 2 – Pre-Shared Key. Without going into great detail, this method is a far more secure way for home and small office users to protect their network. Hackers wanting to break the encryption of your network won’t be able to keep up because the encryption keys used to authenticate devices are constantly changing.

You also see the term SSID in your router settings; this stands for Service Set Identifier and is a name you give your wireless network to distinguish it from any others nearby. Bear in mind that this name will be publicly broadcast to anyone in range. You can hide the broadcasting of this name so that any device wanting to connect to your network must also type in the SSID as well as the network password.

### *Picking passwords that are hard to guess*

You put a lot of effort into picking the names of your kids and pets, and now you get to choose passwords. But the point of creating a password is to make it difficult for thieves to figure out what it is. That is true whether you’re protecting your own computer, downloading software or subscribing to an online publication.

One method for choosing a password is to take a familiar phrase and then use the first letter of each word to form the basis of a password. For example, the old phrase ‘Every Good Boy Deserves Fruit’ would be EGBDF. Then, mix uppercase and lowercase, add punctuation and you wind up with eGb[d]f. If you really want to make a password that’s hard to crack, add some numerals as well, such as the last two digits of the year you were born: eGb[d]f48.

Whatever you do, follow these tips for effective password etiquette:

- **Don’t use passwords that are in a dictionary.** It takes time but not much effort for hackers to run a program that tries every word in an online dictionary as your password. So if it’s in the dictionary, hackers will eventually discover it.
- **Don’t use the same password at more than one site.** It’s a pain to remember more than one password, not to mention keeping track of which goes with what. Plus, you tend to accumulate lots of different passwords after you’ve been online for a while. But if you use the same password for each purpose and your password to one site on the Internet is compromised, all your password-protected accounts are in jeopardy.
- **Use at least six characters:** The more letters in your password, the more difficult you make the life of the code-crackers.

WARNING When it comes to passwords, duplication isn't only boring but also dangerous. It's especially important not to choose, say, the same password you use to get into your bank or PayPal account for logging into your Facebook or Twitter account. If a hacker discovers your password on Facebook, she could use it to hijack your email account and discover a lot of personal information that you find is no longer personal.

## *Using low tech helps too*

Here are some basic suggestions for how to protect your hardware and the business data that your computers contain:

- **Lock your office.** Everyone has locks on the outer doors of their house, but go a step further and install a deadbolt lock on your office door.
- **Lock your computers.** Kensington (`www.kensington.com`) offers a variety of computer locking systems for both desktop and laptop computers. Most laptops come with a Kensington lock slot, apart from some slimmer Mac offerings.
- **Locate your laptop.** Unbeknownst to someone who's up to no good, you can install an innovative theft recovery system called GadgetTrak on your hard drive. Then, if your laptop is stolen, the software tries to locate its coordinates using Wi-Fi technology. GadgetTrak (`www.gadgettrak.com`) even snaps a photo of the thief using your laptop's built-in webcam! Other similar innovative services are available. Although recovery isn't guaranteed, the software may bring extra peace of mind.

# Chapter 7

# Social Media Engagement

**IN THIS CHAPTER**

**Recognising the benefits of social media**

**Measuring, assessing and improving social media engagement**

**Relying on words and pictures**

**Considering audio, video and other social media engagement tools**

Social media engagement (SME) is the ‘stuff that happens’ during your social media marketing campaigns. SME is an essential part of social media marketing. If you don’t connect with others in social networks – and if they don’t respond to you – you don’t have engagement. Without engagement, you’re simply broadcasting messages that fall on deaf ears. Nobody wants that to happen, right?

In this chapter, you discover how to start thinking about SME, including the benefits of engaging with customers. You consider who participates in SME. (Hint: it isn’t just you.) You also explore concepts that explain how SME happens – or how it should happen – if you’re using best practices.

If you’re being thoughtful about the way you communicate with – and connect with – others online, you’ll have greater success in reaching customers via SME. But first you need to understand what it is, how it works and what your role is in making it happen.

TIP Two titles will bring you right up to speed with every aspect of this dynamic and evolving field: *Social Media Engagement For Dummies* by Aliza Sherman and Danielle Elliott Smith and *Social Media Marketing For Dummies* by Shiv Singh and Stephanie Diamond (both published by Wiley).

## *Explaining the Why, Who and How of Social Media Engagement*

The Oxford Dictionary has a suitably pithy definition of social media: ‘websites and applications that enable users to create and share content or to participate in social networking.’ Social media can be seen as a collection of online communications channels dedicated to community-based input, interaction, content-sharing and collaboration.

Social media may still be in its infancy, but it’s prolific and influential. Today, using social media for business is a mainstream activity, and the options are numerous and expanding fast. Aside from the usual suspects – Facebook, LinkedIn and Twitter – you find hundreds of sector-specific sites.

Then you have word-of-mouth forums including blogs, company-sponsored discussion boards and chat rooms, and consumer product or service ratings websites and forums. Social media sites make up at least half of the top 20 websites in most regions of the world.

The following sections take you through the many benefits of SME, help you understand how it works, and cover different ways to measure and assess the impact of your SME activities.

## Seeking the benefits of social media engagement

When will it ever end? Technology changes constantly and so quickly that it feels like the moment you gain a new skill or figure out how to use a new online tool, everything changes again and your newly acquired skills seem obsolete. Let's face it: SME seems to change daily.

REMEMBER Simply put, SME is the process by which online communications and the content you post online help you build connections with other people within online communities. SME involves the use of the tools of social media – social networks, for example – to build relationships with others that, ideally, result in some kind of reaction, interaction or action.

You may be wondering why you should consider using SME. Maybe you're satisfied with your current marketing strategies that involve concrete numbers and set dollar amounts. Maybe you're buying advertising in traditional media such as print, television or radio, and even though you've witnessed its declining effectiveness over the years, it's what you know.

Maybe you're committed to advertising online with banner ads, skyscraper ads and interstitial (*pop-up* ) ads. Sure, the number of click-throughs on your ads has declined, but you chalk it up to people being busy with publishing their own content and being too distracted by Facebook and Twitter activity to pay attention the way they used to do.

You may even be concerned about losing control of your content or copyrights. Nobody fully controls information that's published online. SME acknowledges and encourages not only the consumption of the information you put out there but also lets others interpret, remix (by adding their own ideas) and share it. You can still protect your copyrights and trademarks in social media as you have been doing over the past several years on the Internet. But in SME, you want people to spread your message, and you need to let them do it in their own ways.

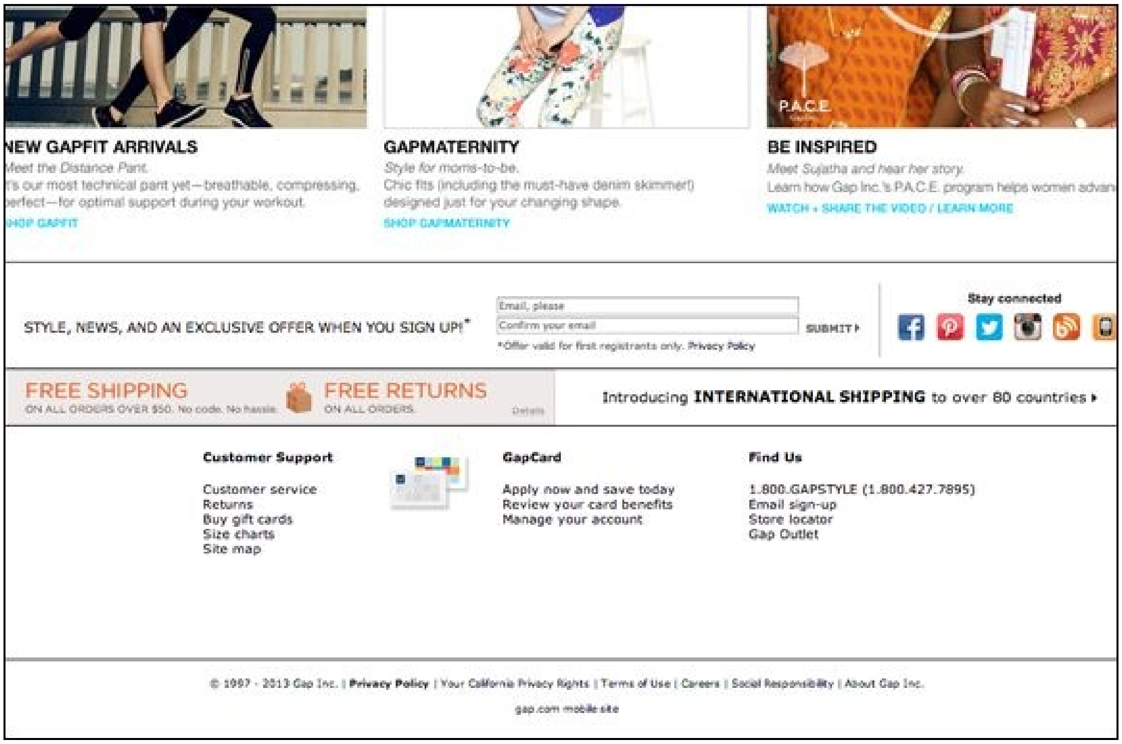
REMEMBER This isn't your grandparents' marketing campaign. The world of marketing online as you once knew it has changed drastically since social networks entered the scene, and it's changing even as you read this chapter.

### Keeping up with changing consumer needs

Today's consumers are using the Internet for both personal and professional activities, and they're savvier than ever about the way companies like yours are trying to reach them. Though they're inundated and overwhelmed by blatant advertising that tries to pull at their attention, they now tune out most ads, especially the ones that aren't relevant to them.

Your customers and your prospects want you to be available to them whenever they go online. Just as they expect a search engine to give them instant results for information they're seeking, consumers who go online to search for your company expect that you'll have not only a website but also a presence on at least one of their favourite social networks.

TIP Add social media icons representing the social networks where your company is present and participating to your website, including links directly to each network so that your website's visitors can connect with you in the way they prefer. In Figure 7-1 , you can see that Gap embeds social media icons in the footer of its website so that they appear on every page.




*Source: Gap.com*

**FIGURE 7-1:** Typical social media icons on a website.

### *Humanising your brand in the marketplace*

You may have heard the word *authentic* tossed around in blog posts, articles, workshops or lectures as an important aspect of SME. You may take this to mean *real* , as in genuine, honest and transparent, rather than fake, overly commercial, insincere or shady. Another way to think of it is this: be human.

'Of course I'm human!' you say. 'And so is my team. We're *all* human.' This is certainly true; however, you need to be human in social networks. Don't subscribe to a regimented formula, set stringent restrictions or automate every possible action to avoid investing the time and effort it takes to truly engage – and to be engaging – in social networks with your following.

REMEMBER Your main goal in SME is to be human, real and responsive so that people want to connect with you and your company in the same networks where they connect with their family and friends.

In the age of information overload online, social media impressions must be even more attractive and more constant and consistent to make a dent in someone's attention. And it all begins with a human touch and with genuine, human connections made via social networks and other social media tools and platforms.

### *Strengthening connections with customers*

SME requires you to create meaningful impressions to build awareness, gain trust and increase customer loyalty. SME also provides your happy customers with the means to spread the word about how great you are to their friends, fans and followings – all of whom may be potential customers for you. More than anything, well-executed SME helps you close sales and then keep the conversation going.

WARNING Consumers won't be engaged if you give them the impression that you care only about sales. They're interested in having a relationship with the brands they love, not in consuming commercial after commercial. For ongoing engagement, find interesting topics to talk about and share.

When you build your presence in social networks, keep in mind that people aren't only connecting with you and your brand and its representatives by liking your Facebook Fan Page or following you on Pinterest – they're also connecting with other people who like your brand.

### *Tapping into new markets*

SME includes using online networks and tools for outreach and interactions. The nature of many of the networks you use for engagement provides you with a built-in reach beyond your immediate audience. Some networks have features that amplify your messages and reach better than others.

For example, when fans of your Facebook Page Like, comment on or share your posts on Facebook, their friends can see signs of their interaction with you. You have the potential to increase your reach exponentially to your fans' friends. On Twitter, if someone Retweets your message, it's amplified to people beyond your own following. It's the same principle with Pinterest Repins, YouTube thumbs-up votes and LinkedIn or Google+ shares. Whenever people pass along the information they read, watch or hear online from you, your content and brand gain more exposure.

REMEMBER The most popular social networks offer paid advertising options to reach highly targeted audiences. You can reach the right audience based on not only demographics but also their affinities, and in some cases, their connections to your friends, fans or followers.

### *Reaping the rewards of an engaged community*

An engaged community is attentive and responsive. That kind of attention and responsiveness can be leveraged for your business in many different ways:

- **Customer feedback:** Receive immediate input from your customers about their needs to better serve them or to identify business and marketing opportunities.
- **Market research:** Ask your community to answer questions, take polls or surveys, and fill out questionnaires to produce on-the-fly market research that you can apply to your business.
- **Brand evangelism:** Someone who feels connected to your brand often voluntarily talks about you with their friends, fans and followers.
- **Brand ambassadorship:** Provide exclusive perks and incentives to turn your brand evangelists into ambassadors for your company.

WARNING Negativity ignored breeds more negativity. Don't focus only on the people who say positive things about your brand and ignore the naysayers and critics. Look for opportunities to address unhappy customers and turn around their opinions.

TIP Don't forget that an unhappy customer whose problem is solved frequently becomes an evangelist for your company by telling everyone how their complaint was dealt with promptly and to their satisfaction.

## *Seeing how people and organisations engage with social media*

Many people are involved in the exchanges that make up SME. Every person goes online with different needs and different expectations. Knowing what motivates people as they use the Internet helps you better engage with them. Pinpointing your own motivations for being online and using SME to reach customers and prospects is also vital.

Not all roles in SME are set in stone. Both people and entities have presences online and in social networks, and all of them contribute to the engagement process in different ways.

### *Individual consumers*

In today's social web, individuals have more power than ever. Consumers are increasingly aware of the power they hold: for example, a person with a blog can review products, build awareness of a brand and drive sales. Someone can share their opinions about a brand on their favourite social networks, and these thoughts can then spread exponentially.

### *Online communities*

Your online community is a collective, a virtual place, and it contains the groups of people who fuel SME. Your SME efforts can't happen in a vacuum. The activities of SME happen within online communities, even communities composed of only two people, such as you and someone else.

Social media platforms and tools convert an individual person into a network of people, interconnected as friends, fans, followers or other types of connections. Social networks link people to others whom they know personally, but just as often to people they don't know. The connection between individuals in social networks may be through another person or even a shared interest. Brought together, they form a community.

### *Your business*

Any interaction has by definition more than one participant. In SME, your company or organisation can be one of the participants. 'But a company isn't a person,' you may say. True. Therefore, your challenge is to make your company – a corporate entity or the brand that represents it – more human and to understand some basic rules of engagement, both implicit and explicit.

TIP Survey your friends, fans and followers online to understand why they connect with you, determine what topics interest them and see what they expect to hear from you. Look for the intersections between what you need and what they need, and focus on common areas for better engagement.

### *Your employees*

Even if you're the only person engaging via social media for your company, anticipate that employees, team members, assistants or even agencies will, at some point, complete these tasks on your behalf. Spell out your ground rules for online engagement now rather than wait until you need to hand over the duties to someone else.

Your company's internal guidelines for SME will often look similar to the public guidelines you post for your online community to follow. That's because the basic tenets of good community behaviour work well regardless of the participants or environment.

The following list describes some issues to address to cover the way your employees handle SME for your company:

- **Frequency of participation:** You need guidelines to specify how online communities and conversations should be integrated into people's day-to-day work.
- **Approved content:** Let your social media editorial calendar be your internal guide for developing and publishing approved content.
- **Response style:** Spell out the way your team needs to respond, such as when to Like people's comments on Facebook or how to respond to a Retweet on Twitter.
- **Policing process:** Outline steps for removing inappropriate content or comments online, and spell out who has the power to delete material.

To a certain degree, allow employees to use their best judgement when interacting online. As long as everyone is aligned in terms of values, tone and overall goals, your team should be able to respond and act as needed, especially if you – or their supervisors – aren't available to respond promptly. Delays in responding can create a negative situation in social networks. Attentiveness and responsiveness can help avoid potential problems.

WARNING You aren't immune to the dangers of careless online communications and inappropriate exchanges in social media. One mistake can snowball into an avalanche of trouble for your company. Watch what you say and publish online, and be a role model to your employees in terms of appropriate online behaviour.

## Setting goals for social media engagement

SME is an essential part of social media marketing – it's the way you share content online in social networks and the way others respond to that content. SME consists of several parts, like pieces in a puzzle:

- **Audience:** The people you want to reach and engage
- **Content:** The type of information you put out there
- **Reaction, interaction and action:** The ways people can respond to you
- **Outcomes and measurement:** The results of engagement

SME may be the 'stuff that happens' during your social media marketing campaigns, but it's also the way you do things to make that stuff happen. The following sections identify five goals of SME, all of which involve interactions with people.

### Building trust and credibility

Online, as in life, you can build better relationships and have more positive outcomes in communications if the people who are communicating trust each other. Trust in the off-line world is built over time, and trust in SME is no different.

### Being present with a human touch

Technology tools exist to automate many tasks, but still no substitute exists for actual human interaction. Even the best artificial intelligence software can't fully replicate human sentiment, emotion and sensitivity. Many aspects of SME can be automated, but without the human element – the personality, emotions, reactions and responses – engagement can fall flat or even utterly fail.

REMEMBER Use canned messaging and automated responses sparingly to supplement, not dominate, your presence in social networks. You can't expect others to be present and to engage with you online if you aren't there as well.

### Creating connections

You want more friends, fans and followers in your social networks, but don't think that amassing sheer numbers gets you closer to achieving your business goals. Bigger numbers may look attractive on the surface, but if the wrong people help you accumulate them – individuals who aren't in your target demographic and who aren't interested in what you have to say – those connections are empty and meaningless.

SME works best when you respect your connections and understand that their time and attention are valuable – and often stretched to the limits. Your connections in social media are only as strong as the effort you invest in obtaining and cultivating them over time.

### Sparking conversations

We may use the terms *broadcasting* , *publishing* or even *sharing* to describe sending information by email, via the web and social networks, or by using mobile devices. When you're participating in SME, though, you're *conversing* . Everything you post online should be thought of as the beginning of a conversation.

TIP A great way to start a conversation is by telling a story. Storytelling in SME is a powerful tool – you can do it by using words, images, audio and video. Tell stories that are compelling enough for others to want to pass them along.

### Driving interaction

The activity that goes hand in hand with sparking a conversation happens during the conversation and after it ends. You have business goals – of course you do. You want people to take action, whether it's to click on your web ad banner, sign up for a prize or content, contact you or make a purchase. All these actions require deliberate effort – they don't happen automatically. Any telephone salesperson who initiates cold calls can tell you that hang-ups and rejections are much more common than actual sales.

## Assessing the impact of social media engagement

SME can be challenging. As with any aspect of marketing, particularly newer ones that haven't weathered the test of time, SME has its pluses and its minuses. You have more opportunities than ever before to reach your customers in new ways and get closer to them, but you need to know how to measure your engagement activity with your audience, as well as how to assess how you're doing. With careful examination of the results of your SME tactics and campaigns, you'll be better equipped to improve what you're doing.

### Determining what interactions are valuable

In advertising, costs and measurements are clear-cut, such as paying for an impression (cost per thousand or CPM – the 'M' actually stands for the French word for thousand, *million* ) whenever an ad is viewed; paying for a click (cost per click or CPC) whenever a viewer clicks on the ad; and paying for an action or a lead (cost per action or CPA). SME requires metrics that are different from online advertising, because the mechanics of engagement involve a variety of activities and responses.

With more interactions happening as you engage via social media channels, you have many more numbers to track and even more ways to interpret them. How do you determine which numbers are the most important to you and your company? Go back to your business goals, what you're trying to achieve and what you hope the target audience does in response to your actions. Then match up the numbers that reflect how people are responding to you and the actions they're taking with your goals. If you're seeing activity in your social networks that you can tie directly to supporting your business goals, you're on the right track. If not, re-evaluate what you're doing. Also consider whether the goals you're focusing on are best supported through SME.

REMEMBER SME isn't a silver bullet to achieve every marketing objective or solve every communications challenge. Just because you're reaching out to an online audience doesn't mean that they'll respond consistently. Take the time to cultivate relationships and make genuine connections to see more tangible results.

### *Knowing which numbers to measure*

The metrics you use to quantify your SME vary from service to service. However, this list describes some similar types of activities that take place across all of them:

- **Attraction:** Attracting a qualified, quality following is valuable. You can spend money to push messages to people via ads, but true engagement slowly and steadily builds the audience and connects with them over the long term. Measure the growth of your fan base by counting common metrics such as the number of friends, fans and followers and by noting actual customers (or even likely prospects) if you can identify them.
- **Interactions:** You must become part of the conversation online to convert participation by your friends, fans and followers into interaction. Seek out opportunities to reciprocate participation by liking, commenting on and sharing comments, and by praising others. Pay attention to mentions, requests and queries, and respond promptly. Keep track of these interactions, particularly the ones that move from social networks to other forms of communication such as email – or even in-person encounters.
- **Actions:** Actions are concrete and measurable when marketing online, even in SME, but they require consistent nurturing to take place more than once. Count and track comments and shares as well as Likes, Retweets, Repins and Favourites, and note increases or declines in those activities. Look for potential reasons for the ebbs and flows of these actions, and modify your engagement tactics to account for variables such as time zone differences and changes to social network features.
- **Transactions:** Customers and prospects can carry out many types of transactions in addition to actual sales. Don't discount activities such as taking polls, filling out surveys, listing contact information (and contact permission), and providing warm leads. Record all types of transactions that are closed throughout each week and month, and watch for trends. Look out for how different SME tactics translate into true transactions, including sales.

TIP Use a tool such as Hootsuite (https://hootsuite.com) to visually track follower growth and find out which content resonates most with your audience. With Hootsuite analytics, you can see just how much your social media impacts your goals. The basic facility is free and should be sufficient to demonstrate the value of your SME activities.

## *Measuring value-setting benchmarks to evaluate progress*

As with any measurement process, start with current numbers as benchmarks to establish a baseline or a starting point for analysing growth in your SME activities. Record not only your numbers in any social networks and other social media tools you're using but also more traditional measurements, including the tools described in this list:

- **Traffic to your website:** When you use the proper messaging, SME can drive traffic to your site.

  *Benchmark:* The number of visitors to your site
- **Referrers to your website:** One common measurement in web traffic analysis is the number of *referrers* , or sites that refer traffic to your website. Note whether you see an increase in traffic from Facebook, Twitter or another social media tool you use.

  *Benchmark:* The level of traffic that social networks drive to your site
- **Marketing email subscribers:** If you're using email marketing to reach customers or you're sending a regular e-newsletter, note the current number of subscribers and then the changes based on integrating email marketing into your social media messaging and networks.

  *Benchmark:* The number of subscribers and even the number of times that your email messages have been opened and shared
- **Customer service inquiries:** Note how many calls or emails you're receiving, and then begin tracking how they're handled in social networks. You may even receive fewer calls and emails, so be prepared for the shift to the customer relations aspect of SME.

  *Benchmark:* The number of customer service contacts and where they're taking place
- **Transactions:** Whether a transaction involves people signing up for demos or consultations or actually purchasing products, the numbers should change because of SME. If not, re-examine how you're encouraging people to transact.

  *Benchmark:* Current sales or other transactions

If you don't set benchmarks that reflect how you're meeting business goals, you can't accurately measure the impact of your SME activities.

TIP If you're using a management-and-measurement tool, pay for a professional-level subscription that lets you run reports and save them. Run reports at least monthly to track your progress, and then archive them. Check the numbers weekly if your networks experience a lot of activity or you're altering your engagement tactics. Record your numbers daily, such as an increasing number of fans and followers. Figure 7-2 shows a sample reporting feature in Hootsuite that helps you visually quantify the effectiveness of your SME efforts.


Source: Hootsuite

**FIGURE 7-2:** A sample report from Hootsuite.

# Using Words and Pictures

Throwing out the old tools you've been using and jumping onto the bandwagon to use a new and exciting communications and marketing technology can be tempting. You may feel like you have the capacity for only so many tools, so eliminating the old seems like a way to make room for the new.

Not all the older communications tools you're using are broken, however. Even though it's commonplace to consider social networks as the main tools for SME, understand that many of the tools you've been using online are part of the overall SME landscape.

## Managing email, forums, websites and blogs

Before social networks existed, people communicated online in different ways. *Electronic mail* (email) was used for sending direct messages to one person or to many people. Messages that could be read by groups of people morphed into forums, known as *Usenet newsgroups* , and eventually became the current form of online web-based forums.

Throughout these fast technological changes, the way people communicate has changed in major ways. Social networks and other multimedia and social media tools and platforms are incredibly popular, but the use of traditional online communications tools still has a lot of value. Email, online forums and websites can – and should – be incorporated into your SME strategy.

SME doesn't take place on social networks solely on the web. Social engagement aspects in a myriad of online and even mobile apps, tools and networks should work in concert to help you connect and interact with the target market.

### Email

Though email doesn't seem flashy or modern, it's still the most important engagement tool now in use, and it can tie in with social networks more easily than ever.

If SME consists of reactions, interactions and actions, email clearly fits the bill. When you send out an email, you and others can react, respond, interact and take actions such as these:

- Pass along the email to others.
- Download a file attached to the email.
- Click a link to visit a website.
- Play an embedded audio or video file.
- Fill out a form embedded into the body of the email.
- Take a poll or survey embedded in the email.
- Connect to someone's social networking accounts.
- Click a link to begin an online purchase.

Email is more than a message carrier: it's a conversation starter as well as a multimedia and multi-featured communications tool to engage others beyond simple back-and-forth communications.

### *Online forums (groups)*

When you have people gathering online to discuss common topics, you have the seeds for building an online community. Where you have an online community, you have the potential for actions, reactions and interactions. None of these activities are exclusive to SME, but they're common to all online communities where people gather, including web-based online forums or groups.

Though people still congregate and interact within web-based forums, they now have these community-building options that are powered by social media.

Online forums and groups work well when several factors are present:

- **A focused topic area or theme:** Conversations in the best forums remain on-topic.
- **Like-minded or interested people:** People join groups voluntarily based on their interests and needs.
- **Strong community leadership:** A good moderator keeps the discussion going with a light touch so that everyone feels welcome to the conversation.
- **Clear community rules:** Every group needs publicly posted guidelines that define proper behaviour and spell out bad behaviour.
- **Fair policing:** Many online communities police themselves, admonishing or removing individuals who post inappropriately, and others let moderators ban people.

TIP See *Online Community Management For Dummies* by Deborah Ng (published by Wiley) to get the nitty-gritty on managing an online community, whether it's based within a social network or not.

### *Websites and blogs*

You may not think of websites in relation to online community and SME, because websites are often considered static destinations and repositories of information rather than engagement tools.

Engagement isn’t only a means of attracting someone’s interest and attention, though a website can be attractive and attracting. To make a website more interactive, you have to add features to it beyond static HTML pages in order to turn a site visitor or reader into an active community member or customer.

Table 7-1 breaks down various ways to engage through websites and blogs.

**TABLE 7-1 Basic Engagement on Websites**

| *One Way* | *Two Way* | *Multiple Ways* |
|---|---|---|
| Signing up for an offer | N/A | N/A |
| Filling out a feedback form | Finding live help | Supporting the community |
| Sharing with a friend | N/A | Clicking a Like or Favourite widget |
| Answering polls (private results) | Answering polls (public results) | Answering polls with sharing |
| Emailing site owner | Adding comments to site | Adding social comments |

No matter how many interactive tools and features you place on your website or blog, people are increasingly inclined to move the conversation to their favourite social networks. That’s why it makes sense to embrace social networking for stronger and more consistent engagement than your website can provide and to integrate your social networks into your site to make the transition to those networks easy and seamless.

REMEMBER Your website content may be interesting, and people may return to read it, but if you can’t engage site visitors in dialogue, they’re less likely to convert to prospects – they’ll be avid but inactive readers.

## *Featuring with Facebook*

Facebook claims to have 1.55 billion monthly active users (as of March 2016), and it has become one of the largest social networks in the world. Facebook offers several layers of public and private information depending on which features members use and how members configure their privacy settings.

Interactions and conversations happen on Facebook in a number of ways:

- **Status update:** Post to the Wall of a Facebook Page, the personal Timeline, or a Group using text, photos, videos or links.
- **Comment, Likes and Shares:** React to posts by clicking Like, posting a comment or sharing the post.
- **Messenger:** Private message one individual or many Facebook friends. Pages and Groups are limited in terms of how they can message individuals to prevent spamming.
- **Check-ins:** Use a smartphone to check into a Place on Facebook if a Facebook Page has been set up with an actual location, or to a Facebook public event within three hours of the event’s start time.
- **Facebook chat:** Instant message one individual or groups of people.

Read and understand the Facebook Terms of Service ( www.facebook.com/legal/terms ). The site prohibits using a personal account or personal Timeline for commercial gain. Create a Facebook Page for your professional presence on the network, and keep your personal Timeline, well, personal.

## Developing Twitter

With more than 320 million monthly active users, Twitter is smaller than Facebook but has fundamentally changed how people communicate with one another. Twitter has impacted not only how individuals and companies communicate but also how people consume and report news. Nobody ever imagined that a service that limits messages to 140 characters could cause such enormous changes around the world. Twitter has flirted with changing its signature character count from 140 to a flabbergasting 10,000. So far, however, the jury is out on this proposal.

Unlike Facebook, Twitter conversations are predominantly open to the public, unless you choose to make your Twitter account private. Most people go with the default public setting to share their updates – or Tweets –with the world. Although private Twitter accounts are available, in order to engage easily and widely with others, your account must be public.

Twitter has its own way of organising conversations and interactions on its network that can be confusing to new users. You can communicate on Twitter by posting one of these elements:

- **Tweet:** A publicly posted message to your Twitter stream that also appears in the streams of your followers.
- **Retweet:** A publicly posted message that repeats or restates an existing Tweet from someone else that credits the originator and can be seen by your followers.
- **@mention:** A Tweet directed to someone specifically that appears in their stream.
- **Direct message (DM):** A message sent to someone else privately if you follow them and they follow you back.

## Driving Pinterest

Pinterest was touted as the fastest-growing social network of all time when it surpassed 10 million monthly unique visitors in January 2012. By March 2016, it had 176 million registered users, of whom 100 million are active.

Like Twitter, Pinterest is also changing the way that people communicate, focusing far more on images than on text. Though Twitter challenges you to publish messages in 140 characters or fewer, Pinterest pushes you to find more visual ways to convey your messages and position your brand. There’s no denying that Pinterest is all about the visuals.

You can communicate and interact on Pinterest using these actions:

- **Pin:** A post of an image and video to the Pinterest stream and to your topic-specific boards with descriptions.
- **Like:** A favourable reaction to other people’s Pins.

- **Repin:** Sharing other people's Pins to your followers.
- **Comment:** A response to Pins, but used less often than Likes and Repins.
- **Collaborate:** Pinning with others using Pinterest's group boards or secret boards.

WARNING Pictures speak louder than words – but a poor image is a hindrance, and not at all helpful when it comes to Pinterest.

## *Linking to LinkedIn*

LinkedIn has been around since 2003 – several years before Twitter was launched, and available to the public several years before Facebook. In April 2016, LinkedIn reached 450 million users. A laser focus on professionals and businesspeople sets LinkedIn apart from all other major social networks.

If you're looking to reach a more business-minded audience – particularly for business-to-business marketing – LinkedIn is a useful tool. You interact on LinkedIn using these methods:

- **News feed:** Post information in your own feed with text, images and attached files.
- **Like, comment and share:** Respond to posts from your connections, and they can do the same on your posts.
- **Company Page:** Publish and share corporate news to your Page followers.
- **LinkedIn email:** Send a message between connections.
- **LinkedIn inMail:** Reach non-connections by sending messages using this paid-membership feature.
- **LinkedIn Groups:** Public or private discussion forums for like-minded individuals or organisation members.
- **LinkedIn Polls:** Publish or respond to quick polls that can be shared through your news feed.

## *Going for Google+*

Google+ (often abbreviated as G+) hit 540 million users in April 2016 after a major re-launch in 2015.With Google+, you can share links, videos, pictures and other content with people who share your interests. You can also see what other people have shared in your stream.

The main interactions on Google+ occur through your:

- **Home stream:** See posts based on your interests and what you follow. In your stream, you can see posts that other people have shared. From your stream, you can +1, comment on or re-share the items that you see.
- **Collections:** See and share posts based on topics that you're interested in. You use Collections to organise posts based on your interests. You can follow other people's collections based on your interests so that your stream includes the content that you want to see.
- **Communities:** Have conversations with other people who share your interests.
- **People:** Follow people you know or are interested in. When you follow someone on Google+, anything they post to the public may appear in your Home stream, and you may automatically

find yourself following some of their Collections. People you connect with may receive a notification if you follow them, follow their Collections, or +1, comment on or re-share their posts.

TIP You can find out all about Google+ at https://plus.google.com .

# Leveraging Audio and Video for Engagement

When you evaluate tools for SME, you may not immediately consider audio or video. Listening to audio or watching video may seem at first glance to be passive activities. Granted, listening or watching doesn't involve the typical two-way or multiple-way conversations of SME. Still, audio and video can play an important role in stimulating engagement.

Both audio and video involve publishing content – in this case, multimedia files uploaded to or embedded into websites, blogs or social networks. Most places where you can post or view digital audio or video online usually include ways for people to Like, Favourite, comment on or share what they listen to or watch. These interactions happen either in a multimedia player or on the site where the content is uploaded.

Where you have content and where you have tools in place for responding to that content, you have the potential for engagement. Audio or video can attract attention and provide content to start a conversation – so audio and video cannot be left out of the SME equation.

## Enhancing with audiocasting or podcasting

*Audiocasts* are digital audio broadcasts on the Internet. You may also hear them referred to as *podcasts* because they're often played on iPods. In 2016, a third of Americans 12 years and older had listened to a podcast (Edison Research).

***Note:*** Podcasts can refer to video in addition to audio. In this book, *podcast* refers to digital audio online, and *video podcast* refers to, well, digital video online.

Most podcasts are available for listening or for download entirely for free. Radio stations and radio production companies can produce podcasts in professional studios with professional audio editors. Just as often, independent producers, marketers and audio enthusiasts can produce podcasts too, with varying degrees of production quality.

A podcast can be delivered by using these methods:

- **Live streaming:** Usually recorded
- **Recording:** Generally followed by broadcasting
- **Embedding on a site, blog or social network:** For instant or on-demand play
- **Archived on a network:** For individual download or subscription

## Videocasting or video podcasts

A mere handful of years ago, you couldn't confidently recommend using online video for digital marketing and SME. Bandwidth was still an issue for many people, and even with the fast-growing popularity of YouTube, consumers were unable to easily watch video on their Internet connections. Oh, how things have changed in the past few years!

Millions of people now watch videos online daily. Google sites – YouTube in particular – are the most popular, followed by Vevo and Yahoo! sites (comScore). A lot of videos are being watched and a lot of videos are being uploaded.

This list describes a few ways in which digital video that's hosted online can benefit your engagement. You can use a well-produced video to:

- **Grab the attention of your audience:** Video attracts attention. The Play button graphic on an image immediately compels action. (Click!)
- **Enhance content:** Video adds a dynamic dimension and an enhanced visual appeal to the content you publish.
- **Embed content in other formats:** Video can be easily embedded into websites, blogs and social networks, providing richer content to consume.
- **Inspire audience reaction:** Most online video players incorporate social features, including the ability to Like or Favourite and comment.
- **Share:** Digital video is easy to share, especially when someone shares a link to the video online or within social networks. Gone are the days of emailing large video files to share with connections.

Also gone are the days of having to spend a lot of pounds to produce highly polished, professional videos. These days, a minimally produced video can be as popular as (or even more popular than) videos with expensive video production.

## *YouTube*

The Grand Poobah of online video is undoubtedly YouTube. The website has more than 1 billion unique users visit every month, and they watch more than 6 billion hours of video. The number of people watching YouTube each day has increased by 40 per cent year over year since March 2014. And on and on it goes.

This list describes several winning features that make YouTube useful for SME:

- **It's free.** You can't beat free for hosting video files online, especially when files can be large and cumbersome.
- **It attracts numbers.** The sheer volume of members and viewers makes YouTube a natural choice for video hosting and engagement.
- **It benefits from search engine optimisation (SEO).** The added benefit of how YouTube videos show up in Google searches makes your YouTube videos potentially much more accessible.
- **It has tools that are easy to use.** Editing and embedding video can seem complicated until you use basic tools such as the ones offered on YouTube.
- **It has a number of community features.** YouTube incorporates engagement features into its site and video player, including the ability for anyone to Like, comment on, embed, email and share videos (as long as they're signed into their Google account). The site also offers a video commenting option.

- **It offers advertising options.** YouTube offers a number of paid advertising options to give your videos a boost and exposure to more people for potential engagement.

YouTube isn't the only free video-hosting site on the block. Vimeo, for example, offers a free membership level and provides good-quality video playback and an elegant video player. But if you're looking for the highest number of eyeballs on your video message – and potentially the highest number of interactions and shares for your video – YouTube is undeniably the right tool.

REMEMBER YouTube is considered the second-largest search engine in the world. (Google is first.) It doesn't hurt that Google owns YouTube. Your videos on YouTube may therefore have a better chance of visibility than if they're hosted on other video sites.

## Offering webinars and teleseminars

Webinars and teleseminars are other ways to engage your audience and offer meaningful, quality content. The difference between the two audio delivery forms is distinct.

- A *teleseminar* is an audio-only session or conference via phone or computer.
- A *webinar* incorporates visuals such as PowerPoint slides that require you to be in front of your computer to participate.

### Seeing the benefits of webinars and teleseminars

Both of these options offer benefits to your business or brand:

- **Trust:** Build trust by offering your audience the information and inspiration they need. If your audience trusts you, they'll continue to rely on you for information and products.
- **Expertise:** Webinars and teleseminars highlight your expertise. Show off what you know. Answer the questions your community wants answered.
- **Connection:** Hearing your voice on a teleseminar – or even seeing your face if video is part of a webinar – allows your community to develop a connection with you. Whether you like it or not, it isn't always the best product that wins. People are more likely to purchase from brands that get the connection factor.
- **Growth:** A growing customer base signals success. If attendees enjoy your webinar, share their experience, return and bring others with them, your community continues to grow.
- **Revenue:** It would be silly if you didn't factor in making money here, right? You can charge for teleseminars and webinars for what you show and tell. Building that trust and connection can pay off.

Although your decision to choose one over the other may come down to your preference, your comfort level and an assessment of the content you share, the distinct differences between the two may sway your opinion.

### Choosing between webinars and teleseminars

Here are some distinct differences between webinars and teleseminars to help you decide which format is better suited for you.

TIP Whichever you choose to produce, allow time at the end of the session for attendees to ask questions. Though it may be a slightly more complicated process on a teleseminar, a Q&A session allows you to engage with your attendees. Note that some teleseminar systems allow attendees to 'raise their hands' via a button on their phones to make a Q&A session more organised.

A webinar is the better choice when you need the following features:

- **Show and tell:** The visual aspect of the webinar – including slides, videos, images, charts and even streaming video so you appear in the presentation – creates a personal connection between you and your audience. It's a real seminar on the web.
- **Real-time interaction:** Attendees ask questions either verbally or via real-time text chat. You, as the leader of the webinar, can poll your audience and ask them questions. Keep in mind though, that unless your teleseminar has a web-based dashboard, it can be chaotic when attendees try to interact verbally.
- **Networking:** Without dashboards or web-based communications tools that let you and your attendees interact, teleseminars are more isolating experiences. Some webinar software even allows attendees to create their own profiles to facilitate personal branding and connecting.
- **Technology showcase:** Let's face it – a webinar is simply a fancier technology. As a business or brand that can master this type of format, you show your clients you're tech-savvy.
- **Feature set for attendees:** In addition to slides, webinars can contain video clips or live streaming video, polling and real-time text chat.

By contrast, a teleseminar can be a better choice in the following ways:

- **Ease of use for attendees:** To participate in a teleseminar, all someone has to do is pick up a phone and dial. The more technically capable can call in via their computers, but hands-down, teleseminars are much easier for attendees than webinars, which can require downloading and installing software to participate.
- **Preparation time:** Compared with the visuals needed to produce a quality webinar, including slides and possibly video, a teleseminar is purely audio-based, so you spend less time preparing.
- **Ease of access:** To participate in a teleseminar, you need only a phone line, compared with a computer and Internet connection for a webinar.

Webinars and teleseminars are equal in the following ways:

- **Cost:** Both are low-cost to produce. Although, there's a slight tip towards teleseminars, which can include the cost of the phone call or the conferencing call system (depending on what system you use), but services for a high-tech webinar tend to be higher.
- **Recording and replay:** The good news is both teleseminars and webinars can be recorded, archived and replayed later.

### *Selecting the right tool*

To get started with teleseminars or webinars, there are a variety of online options ranging from completely free to a regular monthly fee:

- Cisco WebEx ( www.webex.com )
- FreeConference.com ( www.freeconference.com ).
- FreeConferenceCallHD ( www.freeconferencecallhd.com )
- InterCall ( www.intercall.com )
- GoToWebinar ( http://gotowebinar.com )

Beware of extra or hidden costs. Read the fine print from each service to make sure that the pricing is straightforward and obvious. Also keep in mind that if you use your telephone instead of your computer to place calls, you may incur long-distance fees or eat up your mobile phone minutes.

# Considering Other Social Media Engagement Tools

Let’s face it: the world has gone mobile. Industry experts expect that by 2017, over a third of the world’s population will own a smartphone. That’s 2.6 billion smartphone users – pretty staggering as smartphones gained traction only when Steve Jobs launched Apple’s iPhone in 2007.

The increase in mobile device use for accessing the Internet also changes the way people access Internet sites. Check your website stats, watch out for the uptick in visits to your site from mobile devices and plan accordingly.

## Mobile applications

A mobile application, or *app* , is a compact piece of software that runs on a mobile device – a tablet computer, a smartphone or even a gaming device. The app can be a mobile version of a website or other online content, or be a self-contained application with content that resides entirely on a mobile device. Mobile apps pack features and functionality into relatively small files with interfaces that fit the smaller screens of tablet computers, smartphones and the like.

All the most popular web-based social networks have mobile versions that appear legible and clear on the smaller mobile screen. Many social networks offer their own mobile apps so that you can easily access their networks from your Android or iOS mobile device. Some web-based social networks with apps include Facebook, Google+, LinkedIn, Pinterest, Twitter and YouTube.

Some of these popular social networks can also be accessed from third-party mobile apps such as Hootsuite ( www.hootsuite.com ) that let you post to many of your networks from a single mobile device. All these dashboard tools for managing your social media also have web-based versions, and some even have desktop versions to make access to your social networks conveniently cross-platform. Without the mobile aspect, however, they would be missing a large and growing share of users as more people turn to their mobile devices to access and communicate online.

REMEMBER The proliferation of mobile devices continues to grow at an astronomical pace. According to YouTube, its traffic from mobile devices alone triples every year. More than 1 billion YouTube video views take place on mobile devices every day, and the average viewing session is now more than 40 minutes – an increase of more than 50 per cent year over year. That's *powerful* .

## Location-based services

*Location-based services* (LBS) are a subset of mobile applications. An LBS is a social network that's focused around places – actual physical locations – and it taps into the Global Positioning System (GPS) in a smartphone or mobile device to offer features and functionality (for example, location-tagging your photos and your posts). *Mobile* is the operative word for an LBS – it offers ways to turn social *media* engagement on the web into social *mobile* engagement.

Location and place are an integral part of how these services work. Practically every social mobile network prompts you to give permission to access your location to unlock functionality tied to where you are at any given moment.

Social mobile networks give you a whole new way to engage with your customers and prospects. You may have been told that reaching others in their email inboxes or through their favourite social networks on the web is a more intimate way to communicate and connect with them. Making contact through someone's smartphone or other hand-held mobile device ups that intimacy even further.

REMEMBER Using an LBS means you can connect and communicate with others, combining both a physical location and a mobile device. Location plays a major part in the functionality of an LBS, so look for ways to tie in places to your SME messaging and outreach.

### Checking in to locations to engage others

The act of checking in to locations may seem like a strange activity, but millions of people do it every day as a way of connecting with others and announcing what they're doing and where. Even if people aren't actively checking in to a place using an app with a check-in feature, they may post from a location – your physical business location – and tag their post or even their photograph with GPS data. Many share these check-ins and location-tagged posts and photos on several social networks, including Facebook and Twitter.

People check in to locations for a variety of reasons:

- **Letting their friends know where they are:** When someone is frequenting your establishment, encouraging them to check in can increase exposure to your brand and location.
- **Organising impromptu meet-ups with connections based on proximity:** As a business, you can benefit from additional foot traffic when someone uses an LBS to gather others to your location.
- **Broadcasting their activities as part of their general social network sharing:** Check-ins share

your location name, increasing your brand exposure.

- **Leaving tips, kudos or critiques of businesses they frequent:** Use check-ins as a customer service and marketing tool by noting what people like or where they may have a complaint, and take action to improve their experiences.
- **Accessing specials and deals from companies leveraging LBS marketing:** Stimulate interactions with customers by tying deals and offers into a popular LBS.
- **Competing with their friends for status:** This includes top positions on leaderboards, badges or kudos.

TECHNICAL STUFF A GPS location isn't highly accurate for indoor spaces. If you're looking to create check-ins within an indoor space, you can use ByteLight Services (an LED light; http://bytelight.com), a subsidiary of Acuity Brand, to help feed data about a customer's movement and activities within a confined space. The company's technology claims one metre of accuracy, which is far closer than a typical GPS location provides.

### *Choosing an LBS (or two)*

Here are a few of the popular social mobile networks that rely on or incorporate your location:

- **Foursquare (** https://foursquare.com **):** If you have a business with a physical location, you can claim the actual address on this service based on the GPS coordinates, allowing your customers to *check in* there. People nearby can discover your establishment and read tips or recommendations. The service also includes gaming features and badges. It combines check-ins, tips, deals and images. This service is available – and most commonly used – on smartphones: iPhone, Android, BlackBerry and Windows Phone.
- **Path (** https://path.com **):** This service aggregates check-ins, photos, videos, music, movies and other moments that you create on Path or by importing content from other social networks. It emphasises smaller connections – it's limited to 150 people – so it's more suitable for communicating with niche groups. You can use this service on iPhones and Androids.
- **Foodspotting (** www.foodspotting.com **):** Use this app to take photographs of meals at eating establishments and to find places to eat by perusing snapshots of dishes served nearby. Even if you aren't a restaurant, you can build your reputation by sharing great food images and reviews that tie back to your brand. This service is available for iPhone, Android, BlackBerry and Windows Phone.
- **TripAdvisor (** www.tripadvisor.co.uk **):** Founded in February 2000 in a small office above a pizza shop called Kosta's in Needham, Massachusetts, it is the world's most visited travel website, with 350 million unique visitors every month covering than 6.2 million businesses and properties in 128,000+ destinations.

# Book 6

# Growing and Improving Your Business

# Contents at a Glance

# Chapter 1

# Thinking Strategically

**IN THIS CHAPTER**

**Discovering why strategy can make a difference**

**Exploring low-cost leadership, differentiation and focus strategies**

**Examining other strategic alternatives**

**Devising your own strategy**

In this chapter, you find out how to formulate a strategy for your company that's in keeping with its basic mission. First, you explore why strategy is so important to the business-planning process. You then examine what it means to have a strategy and when that strategy works best, and review several basic strategies that you can apply across many industries.

These off-the-shelf strategies include efforts:

- To be the low-cost provider
- To differentiate your products
- To focus on specific market and product areas

You also find out about several other general strategic alternatives as well, which answer questions such as 'What does it mean to become more vertically integrated as a company?' and 'How should you act when you're the market leader or a market follower?' Finally, you consider some useful pointers for creating a strategic blueprint for your own company.

## *Making Strategy Make a Difference*

Some companies think that *strategy* and *planning* are four-letter words. Those companies would never think of using either term in the context of their own organisations. It isn't that these companies don't move forward; it's just that they don't talk much about it ahead of time. So why do the two terms have such bad reputations in certain quarters? More than likely, it's because they've been misunderstood or applied incorrectly. *Strategy* and *planning* have become such buzzwords in today's business world that their real meanings are easily lost in all the muddle surrounding them.

On average, small companies that have strategic plans have 50 per cent higher revenue and profit growth than companies that fail to plan. The following sections discuss what strategy means and when it works.

TECHNICAL STUFF Strategy is the centrepiece of every MBA program, and at the last count 165 Fortune 500 companies – arguably the most successful ventures in the world – were run by MBAs. The A–Z of successful businesses founded by MBAs runs from Akamai, a leading cloud platform, through the usual, often consultancy and financial, suspects, such as Bain Capital, Cisco Systems, E-Trade, Gap Inc., Intuit, Kayak.com, Match.com, Nike, Staples, Tesla Motors, TNT Group, Victoria's Secret and Zipcar.

## What strategy means

The word *strategy* comes from the ancient Greeks and translates literally as *the art of generalship* . When you compete, you probably feel that you're suiting up for battle, jousting with your competitors for the hearts and minds of customers.

Modern definitions of the word are even less precise, so here's an alternative definition of *strategy* for the business arena. A strategy does the following things:

- Describes how to reach the goals and objectives that you set for the company
- Takes into account the personal and social values that surround your company
- Guides the way that you allocate and deploy your human, financial and other resources
- Creates an advantage in the marketplace that you can sustain, despite intense and determined competition

Putting together a strategic business plan requires you to gather data, analyse the information and then do something with it – something more than just reformatting it, printing it and packaging it in a tidy report titled 'The Five-Year Plan'. In most cases, that kind of report begins and ends with numbers – revenue projections, cash flows, expense allocations and the like, which are things that don't help you figure out what to do next. Reports like this are sure to fall victim to the dreaded SPOTS (Strategic Plans on Top Shelves) syndrome: they gather dust and little else. These reports don't represent strategy or planning; they represent a waste of time.

What can you do to make sure that this doesn't happen to your business plan? For one thing, a healthy dose of plain old common sense works wonders as you pull all the pieces together to create your strategy. Experience in your industry and some nous are advantages, too. Unfortunately, we can't give you any of these gifts. But we can offer you some solid advice about laying out your strategy, including some hints that make you look like a planning pro.

TIP Keep the following questions in mind as you begin to formulate your strategic plan:

- What markets and segments does your company plan to compete in?
- Which products and services will your company develop and support?
- Where is your company's competitive advantage in these markets and products?
- How will your company sustain that competitive advantage over time?

The answers that you come up with go a long way towards keeping your strategy focused and on target, so you want to return to them from time to time at each phase of the planning process. See Chapter 4 in Book 1 for more on creating a business plan.

## When strategy works

Strategy works when you have a process to ensure that planning is consistently tied to the ongoing operations of your business. If strategic plans fail, it's usually because they don't seem to be relevant to the issues and problems at hand. Strategy and planning get linked with committee meetings, bureaucracy, overheads and all those other barriers that are thrown up to ensure that results aren't achieved. As a result, strategy and planning are seen by some companies as part of the problem, not a solution.

REMEMBER Strategy works best when strategic planning is integrated into every aspect of your business, every day of the week and every week of the year. An ongoing strategic-planning process means that you do the following things:

- Always question what makes your company successful.
- Continually observe customers and markets, tracking their wants and needs.
- Relentlessly examine the competition and what it's up to.
- Steadily work at maintaining your competitive advantage.
- Continually search for ways to leverage your core competence.

Some managers may do all these things automatically and intuitively. But if you want to make sure that strategy and planning are carried out in all parts of your company, you have to create a framework to ensure that it happens. When you make strategic planning a basic responsibility, you get the added benefit of including all levels of employees in the planning process. Employees often have different and equally valuable viewpoints about shaping strategy, and a strategic-planning framework ensures that their voices are heard.

TIP To start the ball rolling in your own company, pull together a group of employees who represent different functions and various levels in your organisation. Meet on a regular basis to talk about strategy and planning. Concentrate on how to set up a framework to promote strategic thinking, and focus on problems associated with the strategic-planning process itself. Then group members can take what they learn back to their own areas and begin to integrate strategic planning into the way that they do business.

# Applying Off-the-Shelf Strategies

Maybe you think your company's situation is absolutely unique and the issues you face are one of a kind. Does this mean that your strategy and business plan have to be unique as well? Not entirely. If you look through a microscope, every snowflake is different. But snowflakes have a great deal in common when you stand back and watch them pile up outside. Companies are like snowflakes. Although all the details give companies their individual profiles, companies and industries in general display remarkable similarities when you step back and concentrate on their basic shapes.

TECHNICAL STUFF Master business strategist and Harvard University professor Michael Porter was one of the first to recognise, and take an inventory of, standard business profiles. Based on what he saw, he came up with three generic approaches to strategy and business planning. These *generic strategies* are important because they offer off-the-shelf answers to a basic question: 'What does it take to be successful in a business over the long haul?' And the answers work across all markets and industries.

Generic strategies boil down to the following standard approaches (highlighted in Figure 1-1 ):

- **Cut costs to the bone.** Become the low-cost leader in your industry. Do everything that you can to reduce your own costs while delivering a product or service that measures up well against the competition.
- **Offer something unique.** Figure out how to provide customers with something that's both unique and of real value, and deliver your product or service at a price that customers are willing to pay.
- **Focus on one customer group.** Decide to focus on the precise needs and requirements of a narrow market, using either low cost or a unique product to woo your target customers away from the general competition.


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**FIGURE 1-1:** Generic strategies involve deciding whether to become the low-cost leader or provide unique customer benefits.

It's not surprising that cutting costs and offering something unique represent two generic strategies that work almost universally. After all, business, industry and competition are all driven by customers who base their purchase decisions on the value equation – an equation that weighs the benefits of any product or service against its price tag. Generic strategies merely concentrate your efforts on influencing one side of the value equation or the other.

## Low-cost leadership

Becoming the low-cost leader in your industry requires the commitment and co-ordination of every aspect of your company, from product development to marketing, from manufacturing to distribution, from raw materials to wages and benefits. Every day and in every way, you track down and exterminate unnecessary costs. Find a new technology that simplifies manufacturing? Install it. Find a region or country that has a more productive labour force? Move there. Find suppliers to provide cheaper raw materials? Sign 'em up.

A cost-leadership strategy is often worth the effort because it gives you a powerful competitive position. When you're the low-cost leader, you call the shots and challenge every one of your competitors to find other ways to compete. Although the strategy is universal, it works best in markets and industries in which price tends to drive customer behaviour – the bulk- or commodity-products business, for example, or low-end, price-sensitive market segments.

TIP This strategy is usually better suited to large companies that have the financial muscle to produce volume products at lowest cost. The typical small- and medium-sized enterprise (SME) struggles to compete against a big player with this strategy.

The following sections describe the ways in which you can carry out a cost-leadership strategy.

### No-frills product

The most obvious and straightforward way to keep costs down is to invoke the well-known KISS (Keep It Simple, Stupid!) principle. When you cut out all the extras and eliminate the options, your product is bound to be cheaper to put together. A no-frills product can be particularly successful if you're able to match it with a market that doesn't see any benefit in (or is even annoyed by) other products' bells and whistles – the couch potatoes whose video recorders sport a flashing 12:00, for example, or famous-writers-to-be who are baffled by their word processors.

In addition to removing all the extras, you can sometimes take advantage of a simple product redesign to gain an even greater cost advantage. Home developers have replaced plywood with pressed board, for example, to lower the costs of construction. Camera makers have replaced metal components with plastic. And, of course, there's always the Pizza Express solution; the company reduced costs at one point simply by making its pizzas a wee bit smaller.

Stripped-down products and services eventually appear in almost every industry. The most obvious examples today are:

- No-frills airlines such as easyJet and Ryanair

- Warehouse stores such as Aldi, Costco and Lidl, which offer a wide selection, low prices and no help
- Bare-bones brokerage houses such as Hargreaves Lansdown and TD Waterhouse, which charge low commissions on trades without any hand-holding or personal investment advice

### Experience curve

Cost leadership is often won or lost based on the power of the *experience curve* , which traces the declining unit costs of putting together and selling a product or service over time (see Figure 1-2 ).

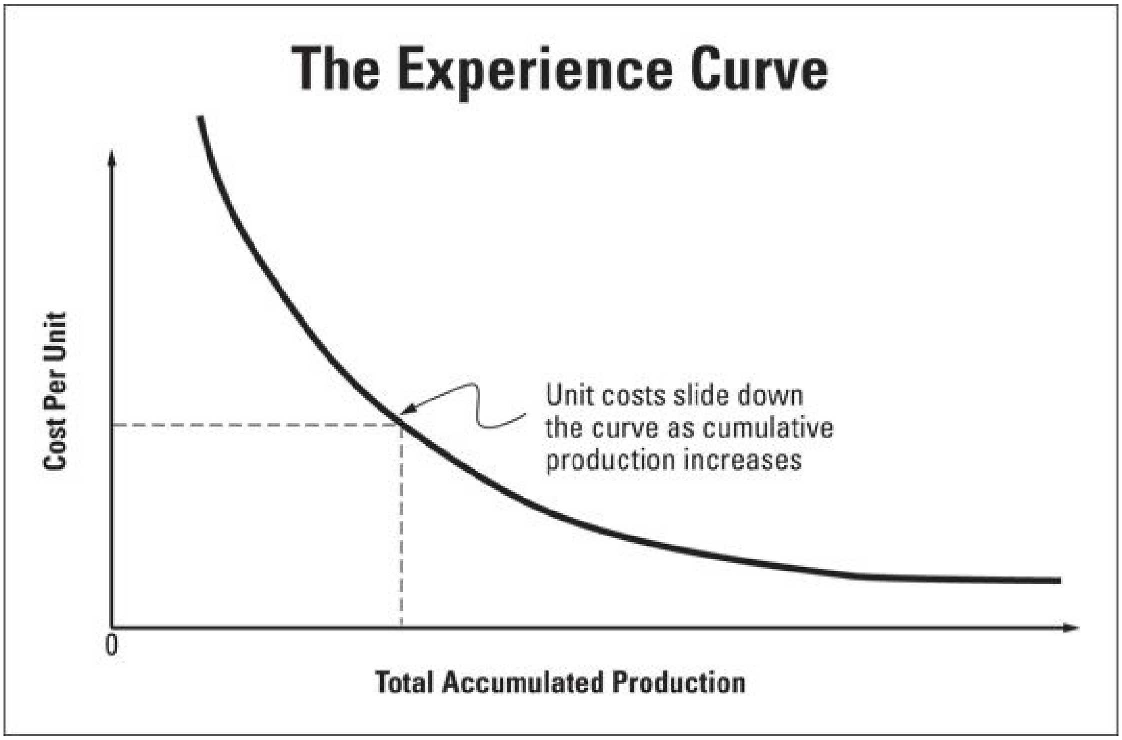




**FIGURE 1-2:** The experience curve traces the declining unit costs of putting together and selling a product as total accumulated production increases.

The curve measures the real cost per unit of various general business expenses: plant construction, machinery, labour, office space, administration, advertising, distribution, sales – everything but the raw materials that make up the product in the first place. All these costs combined tend to go down over time when they're averaged out over all the products that you make or services that you provide.

The underlying causes of the experience curve include the following:

- **Scale.** *Scale* refers to the fact that you have fixed business costs, which are fixed in the sense that they're not affected by how much of your product you make and sell. (Fixed costs usually include such things as your rent, the equipment that you buy, and some of your utility bills.) The more products you produce, the more you gain an immediate scale advantage, because the fixed costs associated with each unit go down automatically.

TIP Think about widgets for a moment. Suppose that you rent a building at £1,000 a month to house widget production. So as not to lose money, you have to add that rental expense into the cost of the widgets that you make. Perhaps the first month, you turn out only ten widgets. No matter what else they cost, you have to add £100 rent (£1,000 divided by ten units) to the price of each widget. But if you can boost production to 100 units the next month, you have to add only £10 in rent (£1,000 divided by 100 units) to the price of each widget, and you reduce your rental costs per unit by a whopping 90 per cent. Scale is good for business and your bottom line.

- **Scope.** *Scope* works a little like the scale effect, but scope refers to the underlying cost benefit that you get by serving larger markets or by offering multiple products that share overhead expenses associated with such things as advertising, product service and distribution. These expenses aren't exactly fixed, but you do gain an automatic scope advantage if the ad that you decide to run reaches a larger market or if your delivery trucks deliver two or three products to each of your sales outlets instead of one.
- **Learning.** Remember the first time you tried to tie your shoelaces? Big job. A lot of work. Now you can do it in your sleep. What happened? The more you tied your shoes, the better you got at it. The same is true whether you're on a factory floor, at a computer workstation or in a conference room. You (and your employees) get better at something the more you do it. As you learn, the overall cost of doing business goes down.

TIP A general rule suggests that all these underlying causes result in what's known as an 80 per cent experience curve. Every time you double the total number of products produced, unit costs go down by about 20 per cent – to 80 per cent of what they were before.

WARNING The cost benefit that you actually get out of your own company's experience is bound to vary and depends partly on your industry. A few industries don't benefit from experience effects at all. In industries in which the basic costs of raw materials are high, for example, there's not much room for gaining a big advantage through experience. Many service industries may not get much of an advantage from experience, either. It doesn't matter how good hairstylists become at what they do; it still takes them about an hour to wash and style each customer's hair, so the company's costs don't change.

### Low-cost culture

You can sustain low-cost leadership only if every part of your company is committed to keeping costs under control, and to reducing or eliminating expenses and unnecessary spending. This kind of commitment doesn't occur without leadership and the example set by the owners themselves.

REMEMBER Perhaps more than any other strategy and business plan that you can pursue, the push to be the low-cost leader in your industry succeeds or fails based on how well you actually carry it out. Knowing where and when to bring in cost-saving technology may be one important aspect of your drive, for example. But at the heart of your plan, it's absolutely critical that you figure out how to structure the company, reward your employees and create the spirit of a 'lean, mean fighting machine'. In the end, your employees determine just how efficient your company really is. This may mean that you don't drive a company car or that you never, ever make personal long-distance calls from work. You can bet that your employees will follow your lead.

TIP Low-cost leadership means exactly what it says. It's just not good enough to be first, second or third runner-up; it's not even all right to be first among equals. If you can't assume the cost-leadership position, you run the risk of playing a part in your own worst nightmare: a high-stakes, cut-throat industry in which price-war shoot-'em-outs threaten to destroy all the players. After all, if no one's a clear leader, everyone's a challenger, and when low-cost challengers decide to battle for market-share advantage, they use price as their favourite weapon. If you happen to find yourself in such a Wild West industry, take action. Look for new and different ways to compete – alternative strategies that are more likely to reward you in the end.

## Standing out in a crowd

Not every company can be the low-cost leader in an industry, and many companies don't even want to be. Instead, they prefer to compete in the marketplace by creating products and services that are unique, offering customers things that they just have to have – things that they're willing to pay a little extra for. The strategy is known as *differentiation* .

Differentiation has a great deal going for it, because companies can be different in many ways, which means that there are many ways to be successful. Although a low-cost strategy (refer to the earlier section 'Low-cost leadership ') can easily produce a win-lose situation for many companies, differentiation often creates room for more players, each of which competes successfully in its own special ways. That's not to say that competition isn't fierce, even when companies offer distinctly different products or services.

Companies that can make themselves distinct from their competitors often enjoy enviable profits, and they frequently use those extra pounds to reinforce their unique positions in the marketplace. A premium winery, for example, earns its reputation based on the quality of its grapes and the expertise of the winemaker, but it goes on to polish that reputation through expensive packaging and promotional campaigns. All these added investments make it more difficult for competitors to join in, but they also raise the cost of doing business. Although a maker of house wine has trouble competing in premium markets, a premium winery really can't afford to compete on price alone. No company can ignore cost, of course, even if it offers something that no one else does. Wine-lovers may be willing to spend £15 for a special bottle of Chardonnay but may baulk at a £30 price tag.

Chances are that you can make your company unique in a number of ways. You can set your product or service apart based on what it can do, how well it works or the way it is packaged and distributed. Then you can go on to develop any of these aspects into a successful differentiation strategy, creating a loyal set of customers along the way. Differentiation is the natural territory for the SME where volume and low cost aren't the deciding factors in success.

TIP Because a differentiation strategy hinges completely on your relationship with customers, however, stop and ask yourself several questions before you move ahead:

- Who are your customers?
- How would you best describe them?
- What are their basic wants and needs?
- How do they make choices?
- What motivates them to buy things?

Check out Chapter 6 in Book 1 for an insight on customers. The following sections describe ways that you can set yourself apart from the competition.

### *Product features*

You can often find the basic outlines of a successful differentiation strategy in what your product can and can't do for customers. After all, a product's features are frequently among the first things that a potential buyer considers. How do your products stack up? Are you particularly strong in product design and development? If so, you probably want to consider how to leverage your strength in developing new features to make your company's product stand out.

Unfortunately, product features represent a big target for your competitors to aim at, and trying to be different based on major product attributes alone is sometimes hard to sustain over the long haul. Technology-driven companies such as Sony, 3M and Intel have managed to stay one step ahead of the competition for many years by always offering the latest and greatest products. But it's not easy (or inexpensive) to be chased all the time.

TIP Rather than always take the lead in product development, you can make your company stand out by enhancing a product in more subtle ways, offering customers unique and tailored options that are appreciated all the more because they're often unexpected. Examples include an insurance policy that makes it easy to keep track of what you own and then automatically updates your coverage, and software that actually helps you remove every bit of itself from your hard drive when you want to get rid of it.

### *Product quality*

When you offer a product or service that's known for its quality, you take a big step towards standing out in the marketplace. In some sense, quality captures what differentiation is all about. Quality of one sort or another is what everybody seems to be looking for, and it's often in the eyes of the beholder. Although customers can't always tell you exactly what quality is, they know it when they see it, and when they see it, they like it – and may even pay a little extra for it.

Customers are likely to perceive quality in your product a bit differently from how they do quality in a service that you may offer. The differences between product and service quality are big enough, in fact, that the two are treated separately in Table 1-1 .

## TABLE 1-1 Product and Service Quality Examples

| *Product Quality* | *Example* |
|---|---|
| Performance | Do pots and pans get clean in the dishwasher? |
| Consistency | Is the restaurant's pasta special always tasty? |
| Durability | How long will the hiking boots last? |
| Reliability | Will the answering machine save all the messages? |
| Appearance | Does the watch have that special look and feel? |
| Brand name | Which stereo system is known for its quality? |
| ***Service quality*** | ***Example*** |
| Capability | Does the brain surgeon know what she's doing? |
| Dependability | Will the newspaper be delivered in the morning? |
| Responsiveness | Can the 999 emergency team arrive in time? |
| Integrity | How much should the lawyer be trusted? |
| Attentiveness | Does the bank clerk smile and say hello? |
| Tangibles | Which airline has the cleanest onboard toilets? |

The different quality dimensions depend on the industry that you're in and on the customers you're serving. Even in a particular industry, companies try to create successful differentiation strategies for distinct dimensions. The car industry is a prime example. When you think of Porsche, for example, you think of performance; Volvo means safety; and Toyota and Honda are reliable choices. These differences allow competitors to prosper in the same industry, each in its own way.

Things are a bit different in service industries. For one thing, you can't help but face the importance of customers' impressions when you're dealing with services. By definition, a service is something that can't be held; you can't really touch it, feel it or kick its tyres. So customers are in a bit of a quandary when it comes to making well-informed decisions. Figuring out what is and isn't a quality service is harder. How do you really know whether your doctor's a genius or a quack, for example? Is the pilot of today's flight an ace or just so-so? Is your dentist a saint or a sadist?

That's why perceptions come into play. When customers don't have all the data, they go with what they see. No matter what other dimensions are important, the tangibles – equipment, facilities and personnel – play a significant part in customers' perceptions of service quality. As an airline executive said:

> *Filthy toilets and dirty trays are bound to lead to engine failure.*

Because customers have no way of evaluating the quality of an airline's engine-maintenance programme, they look at the things that they *can* judge, and they form their opinions accordingly.

Caterpillar, Inc. is the giant company that builds those giant yellow machines that build motorways, bridges, dams and airports around the globe. Caterpillar makes some of the best heavy-construction machines in the world, but its customers are impressed by much more than just equipment specs. What really sets this company apart is its unmatched capability to deliver service and spare parts at short notice. Caterpillar makes this commitment to each of its customers: no matter where you are in the world, no matter what replacement part you need, they'll see that you have it to hand within 24 hours.

It's a big and expensive promise. Caterpillar has spent a fortune creating a global service network with distribution depots that can fulfil its pledge, which of course means higher prices for Cat equipment. But customers don't mind paying those extra pounds, because they know how much they stand to lose if they have to shut down huge construction projects for want of a spark plug or fan belt. So Caterpillar sells peace of mind along with its machinery.

### *Product packaging*

Customers often look beyond the basics in making the final decision on what to buy. In fact, your customers may be influenced as much by the packaging as by the standard set of features that your product or service has to offer. Accordingly, you can develop an effective differentiation strategy based on product packaging – how it's advertised, when it's serviced and where it's sold.

Given creative advertising, attentive service and sophisticated distribution, almost anything can be made unique in one way or another. If you don't believe us, check out the produce section in a classy supermarket. Fruit and vegetables are routinely identified by country, county or even farm of origin. Signs tell customers whether the produce was grown with or without chemicals, and even specify the harvest date. Each combination represents a differentiated product to be advertised, displayed and priced based on the unique benefits that it offers.

**IT'S ALL IN THE PACKAGING**

While the product is fundamentally what is being bought, what it comes in – the packaging – can be an important factor and perhaps even the deciding one when it comes to choosing among similar competing offerings:

- Calvin Klein underwear costs more than the Jockey brand, but Calvin Klein boxers and briefs are big sellers because they capture the imagination of men who want to look like Calvin Klein models in nothing but their undies.
- Avon products look a great deal like cosmetics that you can buy almost anywhere, but the Avon Lady still gets the attention of women across the country who want to be pampered on their own sofas with their favourite skin-care products.
- Local gift shops may not offer the lowest prices, but by serving up homemade cakes and jams when you come in the door, they provide a unique shopping experience that keeps many customers coming back.

## *A focus on focus*

The two generic strategies that are covered earlier in this chapter concentrate on one side of the customer value equation or the other. A cost-leadership strategy points out the price tag, whereas differentiation emphasises the unique benefits that a product or service has to offer. The final generic strategy plays off the first two strategies. A *focus strategy* still aims at either price or uniqueness, but it concentrates on a smaller piece of the action.

A focus strategy works because you concentrate on a specific customer group. As a result, you do a better job of meeting those customers' particular needs than do any of your competition, many of whom are trying to serve larger markets. The following sections discuss several ways to concentrate your efforts.

### *Niche markets*

Small, well-defined market segments provide an opportunity not only to meet customers' needs, but also to exceed their expectations. If these market segments happen to be at the high end, you're likely to be well rewarded for your attentions as the money keeps rolling in. Small, upmarket hotels, for example, pamper their well-heeled customers with valets, butlers and even a chauffeured service to restaurants and the airport. A new breed of takeaway food services treats customers to mix-and-match offerings from the best restaurants in town, well-dressed delivery people and even sit-down catering, complete with china, crystal and kitchen staff.

Customers are willing to pay a premium for this kind of service, and that means big profits. Niche markets don't have to be upmarket, of course; factory outlet stores are thriving by serving cost-conscious customers who have high-end tastes.

### *Targeted products*

Companies that are driven by volume sales in large markets often ignore so-called speciality products and services – all those non-standard items and services that have limited appeal and not much market potential. If these companies do get into a speciality business, they're usually fairly inefficient at it; size and overhead costs simply work against them. Speciality products and services spell potential opportunity for a focused strategy to be successful.

### *Limited territory*

Sometimes, a focus on geography results in cost advantages, better-served markets or both. Where local tastes are strong, for example, or service and distribution costs are particularly high, a regional business can flourish. Independent restaurants and grocery shops, TV stations and newspapers all attract a community of customers who want local news, buy regional products and like to patronise neighbourhood shops. Commuter airlines focus on regional service, offering frequent flights and the best schedules to out-of-the-way destinations, and they keep costs down by flying smaller planes, limiting facilities and running bare-bones operations.

REMEMBER A focus strategy works especially well if you're the new kid on the block, trying to establish a foothold in an industry in which the big guys have already staked out their claims. Rather than go after those fat, juicy markets (and get beaten up right away), you can sometimes avoid head-on competition by focusing on smaller markets, which may be less attractive to existing players. Once you're established in a niche market, you may decide that it's time to challenge the market leaders on their own turf. For example Morrisons, the supermarket chain, started out as a small local chain offering bargain prices and a limited range. The company became a major regional player, and with its acquisition of Safeway, is now the fourth largest supermarket chain in the UK, with annual sales in excess of £18 billion.

For small established companies in a market, a focus strategy may be the only ticket to survival when the big guys decide to come to town. If your company has few assets and limited options, concentrating on a specific customer segment or geographical region at least gives you a fighting chance to leverage the capabilities and resources that you do have.

Customer loyalty can prove to be a potent weapon, even against much larger companies. Tesco, for example, finds moving their superstores into small rural towns to be increasingly difficult, because the neighbours rally around local businesses and merchants that have made them satisfied customers over the years, despite the fact that Tesco probably has a wider selection of products at lower prices.

WARNING Unfortunately, a focus strategy is one of the most difficult to defend over time. Dangers lurk both inside and outside the company. If the market segment that you're in suddenly takes off, you can pretty much count on intense competition down the road from much bigger players with much deeper pockets.

If your market niche stays small, you face a powerful urge to spread your wings and expand into new and different markets, knowing full well that you may lose many of your original strengths and advantages. Your best bet is to stay focused. Small companies have the best chance of sticking around over the long haul if they stick to a strategy and business plan that concentrate their resources and capabilities, focusing their energies on serving a specific market segment better than anyone else out there.

# Checking Out Strategic Alternatives

A successful strategy and plan depend on your business circumstances – what's happening in the industry and marketplace, and what your competitors are up to. In particular, consider a couple of common business situations that you may find yourself in.

## Up, down or sideways

The range of activities that define your industry – called *vertical integration* – measure how many phases of the business you and your competitors are involved in. Vertically integrated companies are involved in many parts of an industry, from supplying raw materials to selling products and services to customers. Companies that are not vertically integrated tend to focus on one or two major aspects of the business. Some breweries, for example, concentrate on one central activity: the brewing of beer. Other breweries also get involved in growing the barley and hops; in making the beer bottles, labels and cans; in trucking the beer around; and even in running the pubs that sell the beer to all those loyal customers.

Exactly where does your company stand in terms of vertical integration in your own industry? The question's important, because it affects your decision about whether to become more or less vertically integrated over time. Several terms have been coined by business gurus to describe the strategic moves that you may decide to make:

- **Backward integration:** *Backward integration* means extending your business activities in a direction that gets you closer to the raw materials, resources and expertise that go into creating and producing your company's products.
- **Forward integration:** *Forward integration* means extending your business activities in a

direction that gets you closer to the marketplace by involving the company in packaging, marketing, distribution and customer sales.

- **Outsourcing:** *Outsourcing* means concentrating on your core business activities by farming out other parts of your company's operations to outside contractors and vendors that specialise in those particular areas.
- **Divesting:** *Divesting* means reducing your company's activities to focus on specific aspects of your business by spinning off or selling other pieces of the company.

Tables 1-2 and 1-3 describe some of the pros and cons of vertical integration.

## TABLE 1-2 Pros of Vertical Integration

| *Pro* | *Reason* |
|---|---|
| Efficiencies | If you're in charge, it's sometimes easier to co-ordinate activities at the various business stages along the way, combining related functions or getting rid of overlapping areas to streamline your overall operations. |
| Resources | If you have a hand in the upstream (early-stage) activities of a business, you can guarantee that your company has access to the raw materials and resources that it needs to stay in business. |
| Customers | If your company is involved in downstream (late-stage) activities, you not only get to know a great deal about customers, but you also create lasting relationships and secure your own long-term access to the market. |

## TABLE 1-3 Cons of Vertical Integration

| *Con* | *Reason* |
|---|---|
| Overhead | If your company tries to control all stages of its industry, it can run into all sorts of extra expenses because of mismatched operations, idle resources and added co-ordination costs. |
| Mediocrity | If your company is involved in a wide range of activities, it's much tougher to be the best at any of them, and the company risks becoming average in everything that it does. |
| Size and slowness | If your company is vertically integrated, its size often makes it difficult to quickly respond to change, and commitments to various parts of the industry leave it little room to be flexible. |

There's both good news and bad news in terms of deciding just how much vertical integration is best. Over the years, there have been swings in the popularity of vertically integrated companies: a rush towards control of all aspects of an industry is followed by the race to break up companies and concentrate on specific business activities. Then the cycle repeats itself.

Today's wisdom seems to come down on the side of breaking companies apart. Worldwide competition in all industries over the past decade has made it more cost-effective to go out and buy what you need rather than to try to build up resources and expertise inside the company. That practice has resulted in a wave of downsizing and restructuring as companies struggle to remain competitive at what they do best.

WARNING And the future? One thing seems to hold true across the swings and cycles: the most successful and profitable businesses most often do business at one of the two extremes of integration. Companies that are heavily integrated reap all the real benefits of vertical integration; those that concentrate on a single activity eliminate all the costs and inefficiencies. Whatever you do, try not to get stuck in the middle, with few of the benefits and too many of the costs.

## Leading and following

No matter what industry you're in, you can divide your competition into two major groups: the market leaders, and all the market followers nipping at their heels:

- *Market leaders* are those top-tier companies that set the agenda for the industry and make things happen; they're the ones in the driver's seat.
- The *market followers* , well, they follow along. But in this second group, you find the companies that work hard, think big and keep the market leaders on their toes.

Depending on the market situation, companies in both groups behave very differently. Whether you're already a part of an industry or are thinking of joining it as a new business owner, it's important that you understand what motivates both the market leaders and the rest of the pack. The following sections explore some market strategies.

### Market-leader strategies

Market leadership comes in various forms, from the absolute dominance of one company to shared control of the industry by several leading players. If you're a market leader, here are some possible strategic approaches for you:

- **Full speed ahead.** In this situation, your company is the clear market leader. Even so, you always try to break further away from the pack. You're always the first to make a move, whether in implementing new technology and introducing innovative products or in promoting new uses and setting aggressively low prices. You not only intend to stay on top, but you also want to expand your lead.
- **Hold the line.** Your company's certainly in the top tier in the market, but it doesn't have a commanding position of strength in the industry, so your goals centre on hanging on to what you've already got. Those goals may involve locking distributors into long-term contracts, making it more difficult for customers to switch to competing brands, or going after new market segments and product areas to block competitors from doing the same thing.
- **Steady as she goes.** In this case, your company is one of several powerful companies in the market. As one among equals, your company takes on part of the responsibility of policing the industry to see that nothing upsets the boat. If an upstart challenger tries to cut prices, for example, you're there to quickly match those lower prices. You're always scanning the horizon for new competitors, and you work hard to discourage distributors, vendors and retailers from adding new companies and brands to their lists.

### Market-follower strategies

Market followers are often forced to take their cues and develop strategies based on the strength and behaviour of the market leaders. An aggressive challenger, for example, may not do well in an industry that has a powerful, assertive company on top. Fortunately, you can choose among several strategic alternatives if you find yourself in a market-follower position:

- **Make some waves.** In this case, your company has every intention of growing bigger by increasing its presence in the industry, and you're quite willing to challenge the market leadership head-on to do it. Perhaps your strategy includes an aggressive price-cutting campaign to gain as much market share as you can. Maybe you back up this campaign with a rapid expansion of distribution outlets and a forceful marketing effort. The strategy requires deep pockets, will and the skill to force a market leader to blink, but in the end, it could make you the leader of the pack.

- **Turn a few heads.** In this situation, your company is certainly not one of the market leaders, but it's successful in its own market niche, and you want it to stay that way. So although you're careful not to challenge the market leadership directly, you're fierce about defending your turf. You have strengths and advantages in your own market segment because of the uniqueness of your product and customer loyalty. To maintain this position, you focus on customer benefits and the value that you bring to the market.
- **Just tag along.** It's easy to point out companies that have settled into complacency. Frankly, they're usually in rather boring industries in which not much ever happens. These companies are quite happy to remain towards the end of the pack, tagging along without a worry. Don't count on them to do anything new or different in the marketplace. (If you find yourself in a company like this, you may want to think about making a change while you're still awake.)

# Coming Up with Your Own Strategy

If you feel a bit overwhelmed by all the possibilities for devising a strategy for your own company, stop and take a deep breath. Remember one important thing: strategy isn't a test that you take once and have to get a perfect score on the first time. Instead, it's the way that you decide to do business over the long haul. Strategy is an ongoing process, so don't be alarmed if you can't see how all the pieces fit together all at once.

Coming up with the right strategy is something that you have the chance to work on over and over again – rethinking, revising, reformulating. If you approach strategy in the wrong way, you probably won't ever finish the task.

TIP As you begin to shape your own strategy, the following pointers can guide you:

- Never develop a strategy without first doing your homework.
- Always have a clear set of goals and objectives in front of you.
- Remember what assumptions you make, and make sure that they hold up.
- Build in flexibility, and always have an alternative.
- Understand the needs, desires and nature of your customers.
- Know your competitors and don't underestimate them.
- Leverage your strengths and minimise your weaknesses.
- Emphasise core competence to sustain a competitive advantage.
- Make your strategy clear, concise, consistent and attainable.
- Trumpet the strategy so that you don't leave the organisation guessing.

These guidelines are not only helpful for creating a strategy, but also useful for reviewing and revising one as well. Make sure that you return to them on a regular basis as part of your ongoing commitment to the strategy and planning process.

REMEMBER Companies that take strategy and business planning seriously know that to reach a target, it's 'ready, aim, fire' – not 'ready, fire, aim'. It's that simple. In other words, almost any strategy is better than no strategy at all. Companies that have clear strategies don't hit the bull's-eye every time; no strategy can promise that. But these companies succeed in the end because they subscribe to a strategic process that forces them to ask the right questions and come up with good answers – answers that are often better than their competitors' answers.

# Chapter 2

# Managing More than One Product

**IN THIS CHAPTER**

**Working with the product life cycle**

**Discovering ways to grow**

**Identifying strategic business units**

**Expanding online**

**Finding a business to buy out**

Watching over a product or service as it makes its way through the cold, cruel marketplace is an awesome responsibility. It requires a major commitment of time and resources, as well as a great deal of careful planning. First, you have to understand what's required for the product to be successful. Which attributes and aspects should you stress? How do you make sure that people take notice (and like what they see)? What must you do to support and guide your product or service along the way, getting it into the right hands? You want to take advantage of opportunities as they appear. At the same time, you have to worry about the threats and competitive pressures that are lurking out there.

Does this sound a lot like rearing a child? Well, your product's your baby, and as any parent will tell you, there's going to be one blessed thing after another. Think how many times you've heard a parent say, 'You think they're difficult now? Just wait until they get a bit older!'

Products and kids have a great deal in common: both of their worlds are continually changing, yet they eventually manage to grow up. For decades, the Dr Spocks of the business world have poked, probed, pinched and studied products at all ages, and they've come up with a useful description of the common stages that almost all products go through. When you create a business plan, you have to plan for the changes in your own product's life cycle.

In this chapter, you get to grips with the product life cycle and what it means for your company. You find out about ways to keep your company growing. You discover how to expand into new markets with existing products, as well as how to extend your product line to better serve current customers. You also explore the opportunities and pitfalls of trying to diversify. In addition, you consider strategic business units (SBUs) and get an overview of several portfolio tools to help you plan and manage a family of products.

## *Facing the Product/Service Life Cycle*

If you could use only one word to describe what it feels like to be in business and to compete in a market place, that word probably would be *change* . The forces of change are everywhere, ranging from major trends in your business environment to the shifting tastes and demands of your customers and the unpredictable behaviour of your competitors.

You may think that all these factors, stirred together, create a world filled with chaos and uncertainty. Not so. The experts have stumbled onto some basic patterns, and the cycles that they've created do a good job of describing what happens in the face of all the market turmoil and confusion.

One of these patterns – the *product life cycle* – illustrates what happens to a new kind of product or service after you launch it in the market. The product life cycle describes four major stages that your product is likely to go through:

- An introduction period
- A growth period
- Maturity
- A period of decline

Most product life cycles look something like Figure 2-1 .

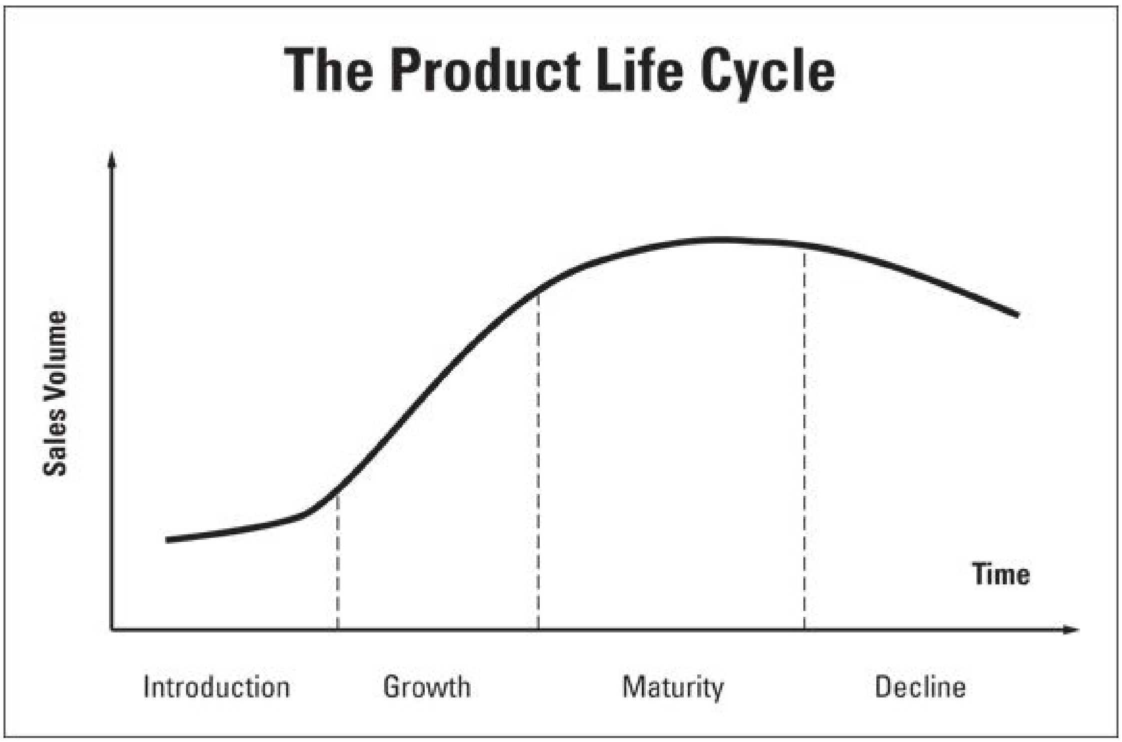




**FIGURE 2-1:** The product life cycle represents what's likely to happen to sales volume for a typical product or service over time.

The curve traces your product's sales volume over time. You can think about the sales volume in terms of the revenue that you take in or the number of units that you sell, and you may end up measuring the time scale in weeks, months, years or even decades.

Every stage of your product's life cycle presents a unique set of market conditions and a series of planning challenges. The different stages require different management objectives, strategies and skills. The following sections discuss what you need to think about at each stage.

## *Starting out*

You introduce a new kind of product or service in the market, and it begins to generate revenue. Because costs are relatively high at this stage, you usually don't find too many competitors around. Growth is limited instead by your company's ability to make the product, generate market awareness, and get customers to accept and adopt the new product.

At this stage in the product life cycle, efforts focus on getting your product out the door, or on rolling out the new service and ensuring that everything works the way that it's supposed to. At the same time, you have to drum up lots of interest and struggle to create a brand-new market. Table 2-1 points out many characteristics of the introduction stage.

**TABLE 2-1 Major Characteristics of the Introduction Stage**

| ***Component*** | ***Characteristics*** |
|---|---|
| Industry | One or two companies |
| Competition | Little or none |
| Key function | Research and development |
| Customers | Innovators and risk-takers |
| Finances | High prices and expenses |
| Profits | Non-existent to negative |
| Objectives | Product adoption |
| Strategy | Expanding the total market |

## *Growing up*

Your new product or service gains a reputation during the growth stage. Demand rises rapidly, and sales increase. Competition increases as well, as competing products jump into the fray to take advantage of an expanding market. Customers begin to develop brand loyalties, and companies tweak their product features to better serve customer needs – needs that are now easier to recognise.

As the growth stage kicks in, your priorities turn towards meeting growing product demand, improving your product or service, and targeting specific groups of customers. Along the way, you have to fend off a growing crop of competitors. Table 2-2 highlights characteristics of the growth stage.

**TABLE 2-2 Major Characteristics of the Growth Stage**

| ***Component*** | ***Characteristics*** |
|---|---|
| Industry | Many companies |
| Competition | Growing strength and numbers |
| Key function | Marketing |
| Customers | Eager to try products |
| Finances | Variable prices and costs |
| Profits | Growing rapidly |
| Objectives | Sales growth and market share |
| Strategy | Establishing and defending position |

## *Middle age*

The growth of your product or service begins to slow in the maturity stage, as market demand levels off and new customers become harder to find. New competitors are also harder to find, and the competition stabilises. Profits keep on growing, however, as costs continue to fall. Changes in market share reflect changes in product value and often come at the expense of competing products.

As maturity sets in, your attention turns towards reducing costs and finally reaping the benefits of stable profits. Although it's easy to feel comfortable at this stage, you need to think about what's going to happen next. Table 2-3 identifies the characteristics of the maturity stage.

### TABLE 2-3 Major Characteristics of the Maturity Stage

| ***Component*** | ***Characteristics*** |
|---|---|
| Industry | Not as many companies |
| Competition | Stronger, but stable |
| Key function | Operations |
| Customers | The majority of buyers |
| Finances | Competitive prices and lower costs |
| Profits | At or near peak |
| Objectives | Cash flow and profit |
| Strategy | Maintaining competitive position |

## *Senior stretch*

At some point in your product's life cycle, sales start to fall off and revenue begins to decline. Competitors drop out of the market as profits all but disappear. The decline stage may be triggered by large-scale changes in the economy or technology, or it may simply reflect changing customer needs and behaviours. Products still on the market in this stage are either redesigned, repositioned or replaced.

As the decline stage looms, you have to get back into the business trenches. Your work shifts to redesigning your product or redefining its market, or maybe coming up with new uses or different kinds of customers. If all these attempts fail, you have to concentrate on ways to get out of the market and not lose too much money. Table 2-4 shows various characteristics of the decline stage.

### TABLE 2-4 Major Characteristics of the Decline Stage

| ***Component*** | ***Characteristics*** |
|---|---|
| Industry | Few companies |
| Competition | Declining in number |
| Key function | Finance and planning |
| Customers | Loyal, conservative buyers |
| Finances | Falling prices and low costs |
| Profits | Much reduced |
| Objectives | Residual profits |
| Strategy | Getting out alive |

## *Determining where you are now*

TIP Take your own product or service and see whether you can come up with its estimated position on the product life cycle curve (refer to Figure 2-1 ). If you're stumped, ask yourself the following kinds of questions:

- How long has the product been on the market?
- How rapidly is the market growing?
- Is the growth rate increasing, decreasing or flat?
- Is the product profitable?
- Are profits heading up or down?
- How many competitors does the product have?
- How fast are product features changing?
- Are there more or fewer competing products than there were a year ago?

WARNING Perhaps you feel confident about where your product is in its life cycle. That's good. Just make sure, though, that you take the time to confirm your analysis. Chances are that you're going to get mixed signals from the market place, and the clues may even contradict one another. No two products ever behave the same way when it comes to the product life cycle. Unfortunately, acting prematurely on the evidence at hand can lead to hasty planning and a self-fulfilling prophecy.

Suppose that the widget manager at Global Gizmos Company detects a slowdown in widget sales. As a faithful believer in the absolute law of the product life cycle, he comes to the obvious conclusion that the growth stage for widgets is finally coming to an end. What does he do? For one thing, he begins to think about ways to reduce costs. Maybe he cuts the advertising budget and begins to phase out incentives for the sales force. What happens? Sales of widgets decline even further, just as he predicted. So he pats himself on the back for being the first to recognise the early stages of a worldwide widget decline.

But what if the sales slump is actually reversible, simply caused by a bit of bad weather, some delivery problems or any number of other reasons? By substituting blind faith in a business textbook for his own good judgement and careful analysis, the widget manager actually caused the outcome that he so confidently predicted in the first place.

REMEMBER What good is a business concept if you can't really count on it? Well, don't get us wrong here. The product life cycle is a powerful planning tool if you use it to support – not replace – your own solid skills. When it's deployed as an early warning system, the product life cycle alerts you to potential changes, allowing you time to plan for a different business environment and to respond quickly when your product finally enters a new stage in its life cycle.

## Milking cash cows

Products in decline aren't all bad news. Often at that stage the full costs of developing and launching them have been recovered, they no longer warrant much advertising or support, and as a consequence are major cash generators. By contrast, new products need bags of cash, so why not marry them up? Cash cows, as products in decline sometimes are, can be used to support tomorrow's stars.

See more on this process in the later section 'Aiming for the stars '.

# Finding Ways to Grow

Let's face it – your product simply isn't going to be the same tomorrow as it is today. You may not plan to do anything to it at all, but everything around your product is going to change. The world will take another step ahead. The economy, technology, your industry and the competition will all change a bit. As a result, your customers will think about your company and your product a bit differently, even if you see yourself as being exactly the same.

How does your company find ways to grow and prosper in the face of almost certain product mortality? You probably have every intention of creating a new business plan (beyond turning off the lights and locking all the doors) as your product begins to age. But which way do you turn? Mark Twain had a bit of tongue-in-cheek advice for people who prefer to keep things just as they are:

> *Put all your eggs in one basket … and watch that basket!*

Trouble is, the eggs are going to hatch, and the chicks will probably run away. So doing nothing except watching and waiting isn't really an option. But what are your alternatives?

Fortunately, you don't have to invent the alternatives yourself; planning for long-term growth has been a philosophical favourite of management gurus for decades. One of the pioneers of business-growth techniques was a man named Igor Ansoff, who came up with a simple matrix to represent the possible directions of growth (see Figure 2-2 ).

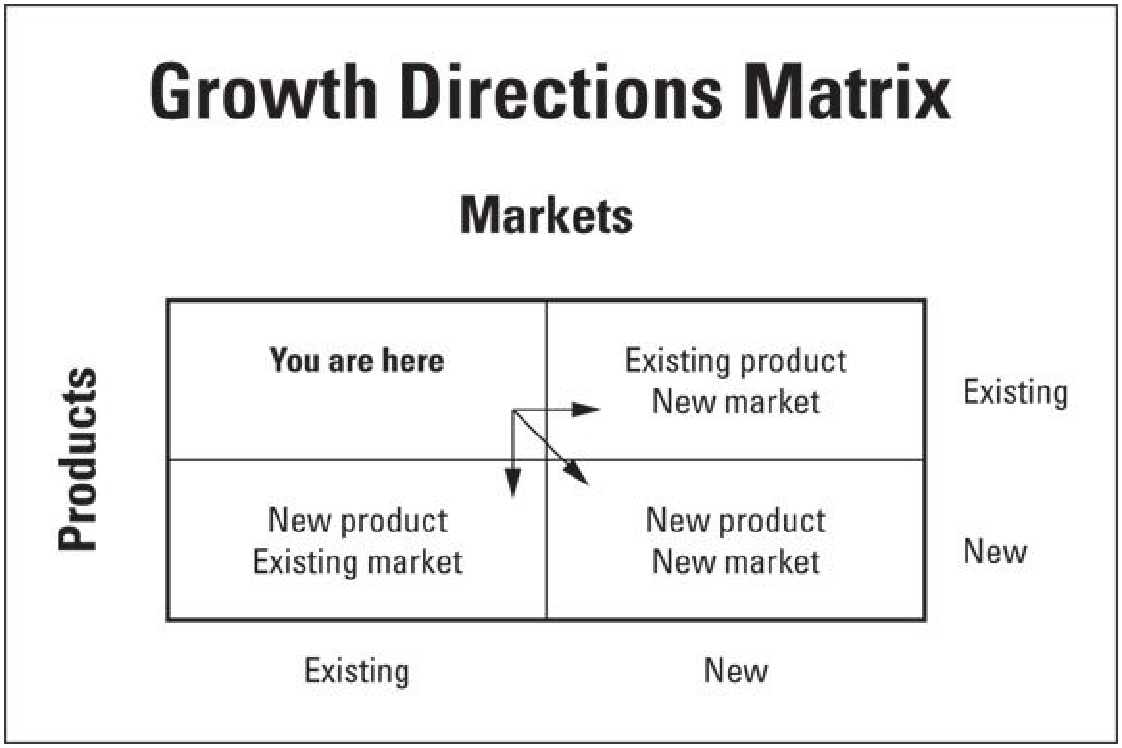




**FIGURE 2-2:** The Growth Directions Matrix describes different ways in which your company can grow, based on a combination of products and markets.

The Growth Directions Matrix really captures nothing more than basic common sense: it says that if you want to make your business grow, you have to start somewhere. Different strategies are more or less risky, so the logical place to begin is to take advantage of where you are today and what you have to work with – the least hazardous way forward. How fast you grow in any of these directions has everything to do with your own capabilities and resources, your appetite for risk and the rate of change in your industry. Consider the following ways in which you can move your company ahead:

- **You are here (existing product and market).** Continue to grow by doing what you're already doing, but do it a little bit better, so that customers use more of your product or service more often and in more ways than before. Encourage people to use more toothpaste, for example, by brushing their teeth (or even their dog's teeth) more often.
- **New market, existing product.** Grow in the near term by finding a fresh market for your existing product, either by expanding geographically or by reaching out to completely different kinds of customers. If you make baking soda, for example, get people to put baking soda in their refrigerators to keep them odour-free.
- **New product, existing market.** Grow by developing additional product features, options or even a related product family with the intention of enticing your existing customers. Think of the array of apple drinks that are available these days – everything from Appletiser to apple-flavoured water.
- **New market, new product.** Grow over the long term by going after new and unfamiliar markets with new and different products. Ford Motor Company, for example, used to make and sell prefabricated homes. With both dimensions of strategy (product and market) in unfamiliar areas, this is the riskiest way to grow.

TIP Without getting bogged down in a lot of details, try to come up with a dozen different ways to grow your company. Get yourself into the right frame of mind by first reviewing your company's mission and vision statements. (Don't have 'em? Flip to Chapter 2 in Book 5 for everything that you need to know.) Then complete the following steps:

1. **Identify three things that you can do right away to stimulate demand for your existing product in your current markets.**

   These things may include cutting costs, offering rebates or maybe coming up with some new product uses.

2. **List three steps that you can take in the next six months to capture new markets for your existing product.**

   Some ideas include radio or television ads that target new customers, direct-mail campaigns and stepped-up appearances at trade shows.

3. **Specify three development efforts that you can launch over the coming year to extend your current product line.**

   These efforts may include enhancing product features or adding options.

4. **Describe three directions that you can take over the next three to five years that will move you into new products and markets.**

REMEMBER More than one or two experts believe that any talk about brand-new products for completely new markets is really none of your business as a manager. These financial gurus think that managers are simply too biased to be objective when it comes to assessing totally new opportunities. They argue that you should return all your extra profits to investors and let them decide where to place their bets on the future. You probably don't agree with them; after all, investors have made monumental mistakes in the past. But they do have a good point. It's probably worth remembering that growth in new directions is a tricky business, no matter how it's done or who ends up doing it.

## *Same product/service, same market*

Many successful big-name companies have become as big and successful as they are by relentlessly pursing a single business, a single market or even an individual product decade after decade. When you hear the name BT, for example, you think of picking up a telephone. When you see a Coca-Cola sign, you imagine drinking a Coke. And when you pass a McDonald's, you probably picture a Big Mac. But these companies haven't turned into multibillion-pound corporations simply by launching their flagship products and letting the marketplace take care of the rest. Companies that largely depend on a single product spend enormous amounts of time and effort to continually rejuvenate and revitalise their core markets.

If you glance at the Growth Directions Matrix shown in Figure 2-2 earlier in this chapter, you notice that these companies invest heavily in the top-left box. How do they manage to do that successfully? They use the following four main strategies:

- **Encourage greater product use.** A company increases demand by encouraging its customers to consume more of a product or service every time they use it. Maybe that means getting customers to feel good about buying more or giving them a better deal when they do. Customers may do the following things:
  - Buy larger bottles of cola because they can save some money.
  - Apply for more insurance coverage because you carefully show them that it's the prudent thing to do.
  - Stay on the phone longer because the rates are lower.
  - Opt for a packaged computer or stereo system with all the components because it's simpler to assemble.
- **Generate more-frequent product use.** A company stimulates sales by getting customers to use its product or service more often. That may mean making the product more convenient, introducing it as part of customers' regular routine or offering incentives to frequent customers. Customers may do the following things:
  - Use toothpaste after every meal because they think it's hygienic.
  - Regularly drink wine at dinner because they think it's healthy.
  - Join a frequent-flyer programme and take an extra trip just to build more miles.
- **Devise new uses.** A company expands its market by coming up with new ways for customers to use its product or service. That may include getting customers to use the product at different times, in different places, on novel occasions or in unconventional ways. All of a sudden, customers may do the following things:
  - Snack on breakfast cereal during the day because it's handy and tastes good.
  - Put a radio in the shower and a TV in the bedroom because they're convenient.
  - Make videos of every imaginable event from childbirth to pet funerals.
- **Woo customers away from competitors.** A company can also increase demand for its product or service the old-fashioned way: by taking customers away from the competition. Although the result is sometimes a fierce and unwanted response from competitors, companies can do the following things:
  - Create incentives to switch from competing products and give rewards for staying put.
  - Concentrate on becoming a low-cost provider with the best prices around.
  - Package a product so that it's distinctive and stands out in the marketplace.
  - Focus on meeting or exceeding the needs of specific customer groups.

Companies that manage to grow in the same old market with the same old product do so by continually generating new demand as well as maintaining or even increasing their market share. Often, these companies succeed in slowing the product life cycle, extending its maturity stage almost indefinitely. In some cases, they even manage to reset the life cycle, pulling the product back into the growth stage by inventing new and creative product uses. But steady and sustained market penetration based on a single product doesn't always work forever, and companies sometimes have to look in new directions for growth.

# New market or new product

At some point in the life of your company, a single product or service may not be enough to sustain an attractive level of growth in your business. Where do you turn? The Growth Directions Matrix (refer to Figure 2-2 ) suggests that the most reliable and productive paths point to market expansion in the near term, as well as to extending your product line. These two directions for growth have the distinct advantage of building on capabilities and resources that you already have. Market expansion leverages your current product expertise, and product extension builds on your experience and knowledge of current customers and the marketplace.

Successful big-name companies such as BT, Coca-Cola and McDonald's usually are much bigger than just the flagship products that are associated with them. If you look closely at the ways in which they grow, they almost always do so through a combination of expanding into new markets and extending their product lines:

- BT looks for new customers in both local and foreign markets, and it also offers a range of calling services (including direct-dial, reverse-charge and third-party calling; messaging; paging; and Internet access services).
- Coca-Cola enters new markets throughout the developing world by offering a family of cola beverages that includes Classic Coke, Diet Coke and Caffeine-Free Coke.
- McDonald's is open for breakfast, lunch and dinner with Egg McMuffins, Big Macs and Chicken McNuggets, while at the same time making subtle variations to its products to fit in with local market needs: salads and wine in France, and even English language tuition for children in Japan, using the menu as the vocabulary.

## New market

Expanding into a new market is something that your company can do rather quickly, because it can take advantage of its current business model, copying many of the activities that it's already engaged in – producing, assembling and distributing products, for example.

You can expand your market in two basic ways: move into new geographical areas or go after new market segments:

- **Geography:** The most obvious way to grow beyond your core product and market is to expand geographically, picking up new customers based solely on where they live and work. This kind of expansion has many advantages. You not only do business in the same way as before, but you also have a head start in understanding many of your new customers, even with their regional differences. Because geographic expansion may require you to do business in unfamiliar areas or even new countries, however, you have to pay special attention to how your company must change to accommodate the specific demands of your expanded market.
- **New market segments:** Sometimes you can expand the market for your product or service by finding new kinds of customers. If you're creative, maybe you can identify a group of customers that you've neglected in the past. Look carefully at your product's features and packaging, how it's priced and delivered, who's buying and why they buy. Also, reassess the customer benefits that you provide. Then ask yourself how attractive a new market segment is in terms of its size and potential to grow. What strengths do you bring to the market? What competitors are already there? How do you plan to gain an advantage over the long haul?

### *New product*

Extending the number of products or types of services that you offer is something that you need to plan for well ahead of time. All too often, companies develop new product features, options and major product enhancements without giving much thought to the implications for the company's future direction and growth. Instead, a customer asks for this or that special feature, or a distributor requests a particular option or accessory, and before you know it, you have additional products to support.

The good news, of course, is that you already have customers. But you also have to be sure that those customers represent a larger market that benefits from your product extension and that the additional products make sense in terms of your own business strategy and plan.

You can extend your product or service in two basic ways: offer new features and options, or create related families of products:

- **New features and options:** The most common way to extend a product line involves adding bells and whistles to your product and giving customers the chance to choose which bells and whistles they want. The advantages are easy to tick off: you work from your existing strengths in product design and development, and you use real live customers to help you decide which incremental changes to make. It sounds like the perfect game plan.

  WARNING The danger comes from losing track of the bigger picture – where you want your company to end up. Individual customers, no matter how good they are, don't always reflect the direction of larger markets. So avoid creating a bunch of marginal products that you can't really sell or support. Instead, plan to develop a smaller number of products with features and options that are designed to meet the needs of specific market segments. The leading smartphone manufacturers take this approach, where each new model has more memory, a better camera, more cameras or a bigger screen, for example.
- **Related product groups:** You may create a group of products based on a common element of some sort. You can develop a product family to use the same core technology, to meet a series of related customer needs or to serve as accessories for your primary product. Apple has made a fortune out of this approach by first introducing the iPod, then the iPhone and then the iPad.

  You want the product group to look stronger in the market than the individual products do separately. That way, the risks inherent in product development are reduced, and the rewards are potentially greater. Take time to understand just how products in the group actually work together. Also, make sure that you address the separate challenges that each product poses in terms of customers, the competition and your own company's assets and capabilities.

TIP Before you put your plans for growth into action, make sure that they draw on your company's strengths, reflect the capabilities and resources that you have available, and help maintain your competitive advantage. Ask yourself the following questions:

- How well are you doing in the markets that you're already in?
- In what ways is the expanded market different from your current market?
- What parts of your business can you leverage in the expanded market?
- What functions and activities have to change to accommodate more products?
- How well will your extended product line meet specific customer needs?
- Is your extended product family stronger than each product by itself?
- How easy is it to scale up your business to meet the expected growth?
- How will your competitive environment change?

## *New product and new market*

Has your company hit a midlife crisis? Do you find yourself searching for attractive new customers, sexy technologies and aggressive competition? Well, it's not unusual for a company to think about rejuvenating itself from time to time. A plan to move in new directions often involves diversifying the company, moving down into the bottom-right corner of the Growth Directions Matrix (refer to Figure 2-2 ). That corner, after all, is where the grass always looks much greener – and the profits look greener, too.

WARNING But you have to balance the potential rewards against the challenges and risks that go along with diversification. Too many companies end up looking foolish as they try to learn new tricks in unfamiliar businesses without much time to practise – and they often face the financial consequences.

To better your odds of success, start by doing your homework, which means researching all the new issues and new players. If this task sounds daunting, it's meant to. The stakes couldn't be much higher.

Your chances of success improve substantially when you identify the ways that a potential new business is related to what your company already does. But even without the benefit of any existing product or market expertise, you can often discover aspects of a new business opportunity that play right into your company's core competence. Here's what to look for:

- **Name recognition:** If your company has worked hard to create a name for itself, you can sometimes make use of its brand identity in a new business situation. Name recognition is particularly powerful when the associations are positive and clearly defined, and can be carried over to the new product and market. Luxury car companies such as BMW, for example, now give their names to expensive, upmarket lines of touring and mountain bikes.
- **Technical operations:** The resources and skills required to design, develop or manufacture products in your own industry – or perhaps the technical services that you offer – may be extended to support additional product areas. Japanese electronics giants such as Sony and Mitsubishi, for example, are experts in miniaturisation, automation and quality control. Given those skills, they can acquire original technology or experimental products and then go on to create product lines based on their expertise.
- **Marketing experience:** If your company has a great deal of marketing expertise available, you can often put that expertise to good use to expand the awareness and strengthen the positioning of

a new product. Examples include the creative software products that small, independent developers produce and then sell to larger companies such as Symantec, now itself part of Norton Security, or Netscape, an AOL subsidiary valued at $4.2 billion on its takeover – companies that have the marketing muscle to successfully advertise, promote and distribute those products.

- **Capacity and scale:** Sometimes you can take the excess capacity that your company has in production, sales or distribution and apply that capacity directly to a new business area. That way, you reap the benefits of a larger scale of operations and use your resources more efficiently. Many car dealerships around the UK, for example, reached out in the 1980s to show, sell and service Toyotas and Hondas, permanently adding them to their British car lines. Now, of course, that's all that UK motor dealerships have to offer, so their new products eventually became their main and only products.
- **Financial considerations:** Persistent demands on your company's revenue, cash flow or profits may inevitably point you in a new business direction. Although a financial opportunity by itself offers a fairly flimsy link to your existing products and markets, a new business may – just may – be justified on the basis of financial considerations alone. Large tobacco companies, for example, use their huge cash reserves to diversify into unrelated business areas that have brighter, smoke-free futures.

The temptation to set off in new directions and diversify into new businesses, creating brand-new products for brand-new markets, has bewitched and bothered business planners for decades. Unfortunately, the failure rate for new products can be as high as 75 per cent. And the most perplexing part of the puzzle is the fact that in the beginning, everything looks so good on paper.

New directions create a range of hazards to catch out the unwary:

- Campbell Soup Company thought that it had a winner when it decided to launch a family of juice drinks for kids. But its Juice Works brand had trouble, in part because so many competitors had better brand-name recognition in the juice business.
- Federal Express set out to create the future of immediate document delivery by introducing a new computer network-based product. But customers turned to FedEx to send hard copy, not email, and the company got zapped by its Zap Mail service.
- Laura Ashley, co-founder with her husband Bernard of the firm of the same name, never liked the concept of fashion, insisting instead that her clothes and furnishings were designed to endure. In the 1960s, the company's fresh cotton print dresses offered a clear alternative to the miniskirts of Mary Quant. In the late 1980s, following Laura Ashley's tragic death, the company made the mistake of trying too hard to get with it, downplaying its heritage, neglecting its long print tea-dresses and Viyella checks. The flirtation with fashion was a disaster, heralding a decade or so of revolving doors at management level, and strategic twists and turns that make fascinating, if depressing, case study material for MBA classes the world over. After employing 11 chief executives in 14 years, the business is still a shadow of its former self. Its 2015 accounts show profits of £23.5 million on sales of £303 million.

A few companies, however, manage to succeed with new products and markets time and time again. Think Tesco, and you could be forgiven for thinking of value food in the UK. But the company has successfully introduced thousands of non-food products in the past decade – everything from fashion clothing to microwaves; they even have a substantial personal finance business, and perhaps the world's only profitable Internet home delivery service. Tesco's stated goal is to bring value, choice and convenience to customers – notice that food isn't mentioned here. It's a goal it pursued with vigour in Asia, Central and Eastern Europe, and the US, only to hit the buffers in 2015 when Tesco revealed that it had made the biggest loss in high-street history.

### Understanding the adoption cycle

Customers are usually not hanging around hoping for new products or services to arrive so they can rush out to buy them. Word spreads slowly as the message is diffused throughout the various customer groups. Even then, you notice that generally the more adventurous types first buy into new ideas. Only after these more adventurous customers have given their seal of approval do the 'followers' come along. Research shows that this *adoption process* , as it's known, moves through five distinct customer characteristics, from innovators to laggards, with the overall population being different for each group.

Suppose you've identified the market for your Internet gift service. Initially your market has been confined to affluent professionals within five miles of your home to keep delivery costs low. So if market research shows that there are 100,000 people that meet the profile of your ideal customer and they have regular access to the Internet, the market open for exploitation at the outset may be as low as 2,500, which is the 2.5 per cent of innovators.

This adoption process, from the 2.5 per cent of innovators who make up a new business's first customers, through to the laggards who won't buy from anyone until they've been in business for 20 years, is most noticeable with truly innovative and relatively costly goods and services. The general trend, though, is true for all businesses. Until you've sold to the innovators, you can't achieve significant sales. So, an important first task is to identify these innovative customers. The moral is: the more you know about your potential customers at the outset, the better your chances of success.

One further issue to keep in mind when shaping your marketing strategy is that innovators, early adopters and all the other sub-segments don't necessarily use the same media, websites, magazines or newspapers, or respond to the same images and messages. So you need to market to them in very different ways.

## Managing Your Product Portfolio

When you decide that it's time to branch out into new products and markets or to diversify into new businesses, you're going to have to learn how to juggle. You no longer have the luxury of doting on a single product or service; now you have more than one product and market to deal with. You have to figure out how to keep every one of your products in the air, providing each one with the special attention and resources that it needs, depending on which part of the product life cycle it's in.

## *Considering strategic business units*

Juggling usually requires a bit of preparation, of course, and the first thing that you want to find out is how many oranges and clubs – or products and services, in this case – you have to keep in the air at one time. It's easy to count oranges, and counting clubs isn't tough, either. For products and services, though, the following questions tend to pop up. Often, these questions have no right answer, but just taking time to think through the issues helps you better understand what you offer:

- Just how many products or services does your company have?
- When you add another feature or an option to your product, does the addition essentially create a new product that requires a separate business plan?
- When you have two separate sets of customers using your service in different ways, do you really have two services, each with its own business plan?
- When you offer two different products to the same set of customers, each of which is manufactured, marketed and distributed in much the same way, are you really dealing with one larger product area and a single business plan?

General Electric (GE) struggled with these questions in the late 1960s. The company had grown well beyond the original inventions of its founder, Thomas Edison; it wasn't just in the electric light bulb business any more. In fact, it was a diversified giant, with businesses ranging from appliances and aircraft engines to television sets and computers. The company had to decide the best way to divide itself up so that each piece was a manageable size and could be juggled with all the other pieces.

The managers at GE hit on the clever idea of organising the company around what they called strategic business units. A *strategic business unit* (SBU) is a piece of your company that's big enough to have its own well-defined markets, attract its own set of competitors, and demand tangible resources and capabilities from you. Yet an SBU is small enough that you can craft a strategy with goals and objectives designed to reflect its special business environment. By using the SBU concept, GE transformed nearly 200 separate, independent product departments into fewer than 50 strategic business units, each with its own well-defined strategy and business plan.

But even the strain of so many SBUs got to GE eventually, and in January 2016 it sold its home appliances business to Haier for $5.4 billion and its financial and lending business to State Street Corporation for $485 million. In total it set out to divest itself of what it calls non-core business activities to raise some $200 billion.

TIP

Consider ways to reorganise your own company around strategic business units. Each time you outline a separate business plan, you identify a potential SBU. How do you get started? Because strategic business units often refer to particular product and market areas taken together, begin with the following steps:

1. **Break your company into as many separate product and market combinations as you can think of.**

2. **Fit these building blocks back together in various ways, trying all sorts of creative associations of products and markets on different levels and scales.**

   Think about how each combination may work in terms of creating a viable business unit.

3. **Keep only those combinations of products and markets that make sense in terms of strategy, business planning, customers, the competition and your company's structure.**

4. **Step back to determine how well these new SBUs mesh together and account for your overall business.**

   If you don't like what you see, try the process again. Don't make the changes for real until you're satisfied with your new organisation.

## *Aiming for the stars*

Rather than juggle a set of who knows how many ill-defined products, practise your juggling technique on the SBUs that you identify instead.

Start by dividing your SBUs into two basic groups, depending on the direction of their cash flow: put the ones that bring money into your company on one side and the ones that take money out on the other side. Maybe you're surprised that you have two sides here. Because every product goes through a life cycle that's likely to include an introduction stage, growth, maturity and then decline, different SBUs naturally have different cash-flow requirements. You must invest in products during their introduction and growth phases, and your mature products end up paying all the bills. So as a successful juggler, you always need at least one mature SBU aloft to support the SBUs that are coming along behind.

Some of this juggling stuff may sound familiar if you've ever tried to manage your own personal savings or retirement accounts. Every financial adviser tells you the same thing: spread your investments out to create a more stable and predictable set of holdings. Ideally, financial advisers want to help you balance your portfolio based on how much money you need to earn right away and what sort of nest egg you expect to have in the future. Given your financial needs and goals, planners may suggest buying blue-chip stocks and bonds that generate dividends right away, and also investing in more speculative companies that pay off well down the road.

Your company's SBUs have a great deal in common with a portfolio of stocks and bonds – so much, in fact, that the SBU juggling that we're talking about is called *portfolio management* . To manage your own SBU portfolio as professionally as financial experts track stocks and bonds, you need some guidance, which is where portfolio analysis comes in. *Portfolio analysis* helps you look at the roles of the SBUs in your company and determine how well the SBUs balance one another so that the company grows and remains profitable. In addition, portfolio analysis offers a new way to think about strategy and business planning when you have more than one strategic business unit to worry about.

You can make your first attempt at simple portfolio analysis with two SBU categories: those that make money and those that take money. Then all you have to do is make sure that the first category is always bigger than the second. But the two categories don't give you much help in figuring out what's going to happen next. Fortunately, the people at the Boston Consulting Group came up with an easy-to-use portfolio analysis tool that provides some useful planning direction.

### *Splitting SBUs into four groups*

The Boston Consulting Group's Growth-Share Grid (see Figure 2-3 ) directs you to divide your SBUs into four groups.

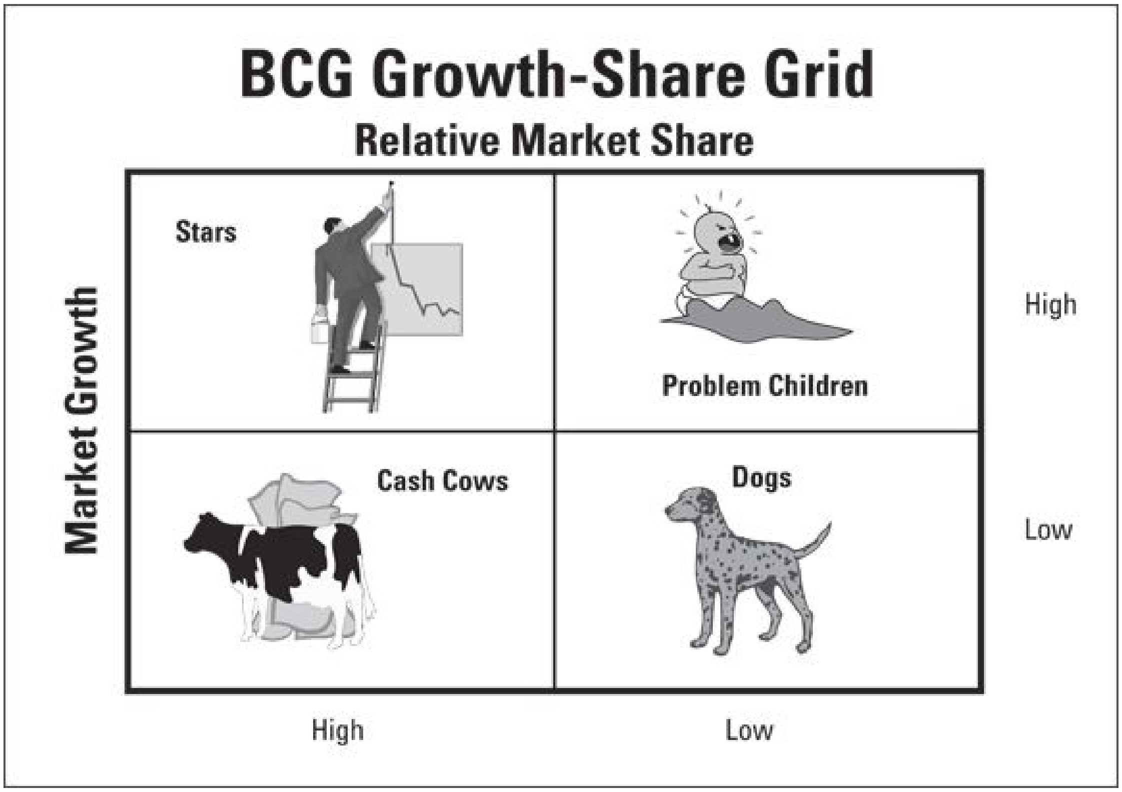




**FIGURE 2-3:** The Growth-Share Grid divides your company's SBUs into four major groups.

You base your portfolio analysis on two major factors: market growth and market share:

- **Market growth:** Is the SBU part of a rapidly expanding market, or does it fall somewhere in a slow- or no-growth area? You use market growth to define your portfolio because it forces you to think about just how attractive the SBU may be over the long haul. The exact point that separates high-growth and low-growth markets is rather arbitrary; start by using a 10 per cent annual growth rate as the midpoint.
- **Relative market share:** Does your SBU command a market-share advantage over its nearest competitors, or does its market share place it down the list relative to the competition? You use relative market share as a major characteristic to define your SBU portfolio because all sorts of evidence suggests that a strong market-share position is closely tied to the profitability of the SBU. Separate your SBUs into those where you have the highest market share and those where you don't.

Here's a review of the types of SBUs:

- **Problem children:** *Problem children* are SBUs that have relatively low market share in high-growth markets. Problem children often represent newer businesses and are sometimes referred to as *question marks* , because you aren't quite sure which path these SBUs may take. Because problem children are in expanding markets, these SBUs require lots of cash just to tread water, maintaining what market share they already have, but their relatively low sales tend to generate little or no revenue in return. If you can substantially increase their market share over time – and that means shelling out even more cash – problem children can blossom into stars. If not, you may have to give them up.

- **Stars:** *Stars* are SBUs that have a dominant market-share position in high-growth markets. Every SBU wants to be a star. Stars usually have an expensive appetite for the cash to fund continual expansion and to fend off competitors that are eager to get a piece of the turf. But their market-share advantage gives these SBUs an edge in generating revenue, high margins and profits. On balance, stars usually support themselves, both producing and consuming large amounts of money. However, you shouldn't hesitate to step in and support a star SBU if additional resources are required to maintain its market-share lead.
- **Cash cows:** The name *cash cows* says it all – these SBUs have a major market-share position in low-growth markets. Because of their market-share advantage, these SBUs generate a great deal of cash, and the best part is the fact that they don't require much in return. Their low-growth markets usually are mature, and the products are already well established. The bottom line: you can milk cash cows to produce a cash surplus and then redirect that cash to fund promising SBUs in other quadrants.
- **Dogs:** *Dogs* are SBUs that deliver low market share in low-growth markets – and little else. Although many of us are dog lovers, it's hard to love this particular breed. Revenue and profits usually are small or non-existent, and the SBUs are often net users of cash. Although they require periodic investments, these marginal businesses usually never amount to much, so it may be best to turn your attention to more-promising SBU candidates.

### *Building your grid*

It's time to put all the pieces together so that you can construct a Growth-Share Grid to represent your own portfolio of strategic business units. Ideally, of course, you see mostly stars and cash cows, with enough problem children (the question marks) to ensure your company's future. Ideally, you have few dogs to contend with.

But the world isn't always ideal. Fortunately, you can also use the Growth-Share Grid as a tablet to sketch out what you plan to do with your SBUs to balance them in the future. Here's what you do:

1. **Sort through your company's SBUs, and get ready to put them in a blank Growth-Share Grid.**

   To see the grid format, refer to Figure 2-3 .
2. **Place each SBU in its proper quadrant, given what you know about market growth and the SBU's relative market share.**
3. **Draw a circle around each SBU to represent how big it is in relation to your other SBUs.**

   Base the size of your SBUs on revenue, profits, sales or whatever measure is most convenient.

4. **For each SBU in the grid, forecast its movement in terms of overall market growth and market-share position.**

   Use a timeframe that's appropriate for your industry and its rate of change.

5. **To capture this forecast, draw arrows indicating the direction of movement and where you plan to have each SBU end up in the future.**

   Arrows that point outside the grid indicate that you plan to get rid of the SBUs in question.

WARNING The BCG Growth-Share Grid, with its quirky cast of characters and its black-and-white view of the world, is hard to resist, because it makes the complex, difficult job of juggling several businesses seem to be almost effortless. After it first caught on in the early 1970s, however, the model became so widely overused and misapplied that the entire business of understanding business portfolios went out of fashion. Today, of course, it's clear that portfolio analysis tools have their place, but they have to be used sensibly. As the saying goes, if something looks too easy to be true, it probably is.

Before you start moving your SBUs around the Growth-Share Grid like pieces on a chessboard, remind yourself that the following strings are attached:

- Market growth is singled out as the only way to measure how attractive a market is and to determine whether or not you'd like to be in business there. But growth isn't the only interesting variable. Markets may turn out to be attractive because of advances in technology, changes in regulation, profits – you name it.
- Relative market share alone is used to describe how competitive you are and how profitable your company is likely to be. But market share is really relevant only when you're competing on the basis of size and sales volume. There are other ways to compete, including making your product unique in some way, focusing on a particular group of customers, or concentrating on service.
- The SBUs in the Growth-Share Grid are linked only by the flow of cash in and out of the different businesses. But there are many other ways to think about how strategic business units may relate to one another and function together, including views that stress the competition or focus on market risk factors.
- WARNING The differences between a star and a cash cow (or a problem child and a dog) are arbitrary and subject to all sorts of definition and measurement problems, so without careful analysis and a dose of good judgement, it's easy to cast your SBUs in the wrong roles. You may end up abandoning a problem child too soon, for example, because you think that the SBU is a dog, or you may neglect and hurt a star SBU by assuming that it's a cash cow that you can milk for money.

# Extending Your E-Penetration

The online world has come a long way since eBay and a handful of other brave souls blazed the trail. Today, a visible place in cyberspace is all but essential if you want to make any impact on the wider business world. Alongside the greater use of the Internet, just as with computers, the price of getting online is dropping sharply and the power and quality of what those fewer bucks will buy is immeasurably improved.

Not all business sectors or countries are penetrated to the same extent by the Internet; in Norway, 90 per cent of the population has access to online banking sites, while for Bulgaria the figure is 5 per cent. The dating industry, once the exclusive domain of newspaper small ads, is now dominated by 6,000 online dating websites.

The bricks-and-mortar and online aspects of business can have sufficient points of difference to warrant considering them separately. You only have to think of opening hours, for example, where being open all hours is practical for an online presence and probably impossible and almost certainly uneconomic for a business such as a high-street shop.

So you need to run through all of this chapter twice – once for your bricks (your real-world business) and once more for the clicks (your online activities); the dynamics are different. This area is so vital that two whole chapters are devoted to it – refer to Chapters 6 and 7 in Book 5.

# Buying Out Competitors

One strategy that encompasses all of those discussed earlier in this chapter is an acquisition. When economic growth is virtually static, or if you want to achieve really dramatic growth, then buying someone else's business can be a very attractive option.

Each year about 2,000 private companies change hands in the UK alone. Currently the average size, in turnover terms, of the companies bought and sold is under £7 million per annum, with many having sales below £0.5 million. Forty-five per cent of these acquisitions were viewed as wholly amicable. There was a willing buyer and a willing seller, and no other parties were involved. Another 45 per cent were classified as partly contested, either because there were several interested buyers, or because there was resistance within the vendor to being taken over.

WARNING Even when these acquisitions took place under friendly or fairly friendly conditions, only 55 per cent were eventually rated as successful or very successful by both buyers and sellers. So buying a company is certainly not always a sure-fire winning strategy.

Use a seven-point plan – based on issues covered in the following sections – to make sure that you end up with the most successful acquisition, merger or joint venture you can.

## Knowing why you want to buy

Big companies end up on the takeover trail for matters of management ego as much as corporate strategy. Over 40 per cent of big companies listed 'sending signals to the City' as their principal reason for buying. A further 35 per cent put it down to the 'chairman's insistence'. Not surprisingly, many acquisitions are financially unrewarding or worse. Sound reasons for acquisitions include:

- To increase market share and eliminate a troublesome competitor
- To broaden your product range or give you access to new markets
- To diversify into new markets, acquiring the necessary management, marketing or technical skills to enable you to capture a reasonable slice of the market relatively quickly
- To get into another country or region
- To protect an important source of supply that may be under threat from a competitor
- To acquire additional staff, factory space, and warehousing and distribution channels, or to get access to additional major customers more quickly than by starting up yourself

TIP Produce a written statement explaining the rationale behind your reason to buy – before you start looking for companies to buy – or otherwise you may end up pursuing a 'bargain' that has absolutely nothing to do with your previously defined commercial goals just because it seems cheap. It's also worth remembering that companies available at knockdown prices are likely to need drastic surgery. So unless you fancy your chances as a company doctor, stay well away.

## *Understanding what you want to buy*

It takes over one man-year of work, on average, to find and buy a company. The more accurately you describe your ideal purchase, the simpler, quicker and cheaper your search will be. Just imagine trying to buy a house without any idea where you wanted to live, how much you wanted to spend, how many bedrooms were needed, whether you wanted a new house or a listed building, or if you wanted a garden. The search would be near impossible to organise, it could take forever and the resulting purchase would almost certainly please no one. The same problem is present when buying a company. The definition of what you want to buy should explain:

- The business area/products/service the company is in.
- The location of the target company.
- The price range and the cash you have available.
- The management depth and the management style you're looking for in the company.
- The minimum profitability and return on capital employed you can accept. Remember that if the company you plan to buy only makes 1 per cent net profit after tax while you make 5 per cent, and you're of equal size, the resultant profit margin will be 3 per cent [5 plus 1, then divided by 2]. This may make the combined business look worse rather than better.
- The image compatibility between your company and any target.
- The scope for integration and cost saving.

## *Starting to look*

Once you have a profile of the sort of company you would like to buy, you can begin to assemble your shopping list. Three sources are of particular use:

- **FAME (Financial Analysis Made Easy)** is a powerful database that contains information on 3.4 million companies in the UK and Ireland.

  Typically, the following information is included:

  - Contact information, including phone, email and web addresses plus main and other trading addresses
  - Activity details
  - 29 profit and loss account and 63 balance sheet items
  - Cash flow and ratios
  - Credit score and rating
  - Security and price information (listed companies only)
  - Names of bankers, auditors, previous auditors and advisers
  - Details of holdings and subsidiaries (including foreign holdings and subsidiaries)
  - Names of current and previous directors, with home addresses, and shareholder indicators, heads of department and shareholders

  You can compare each company with detailed financials with its peer group based on its activity codes, and the software lets you search for companies that comply with your own criteria, combining as many conditions as you like. FAME is available in business libraries and on CD from the publishers, who also offer a free trial ( www.bvdinfo.com/en-gb/our-products/company-information/national-products/fame ).
- **Companies House** ( www.gov.uk/get-information-about-a-company ) is the official repository of all company information in the UK. Their WebCHeck service offers a free-of-charge searchable company names and address index, which covers 2 million companies. You can use it to search for a company either by its name or its unique company registration number. You can use WebCHeck to purchase a company's latest accounts, giving details of sales, profits, margins, directors, shareholders and bank borrowings at a cost of £1 per company.
- **BusinessesforSale.com** ( www.businessesforsale.com ) has a database of over 65,000 businesses for sale and 900,000 registered business buyers. The site is searchable by country, county, size, business sector and price.

## *Investigating and approaching*

After you gather your shopping list of prospective purchases, you need to arm yourself with everything you can find out about them. Visit their websites; get their literature, samples, copies of their advertising and press comments; and, of course, get their accounts. Then go out and see their premises and as much of their operation as you're able to. If you can't get in, get one of your sales people in to look the business over for you. This investigation will help you to both shorten your shopping list, and put it into order of priority. Now you're ready for the approach.

Although you're technically *buying* , psychologically you would be well advised to think of acquiring a company as a *selling* job. As such, you can't afford to have any approach rejected either too early or without a determined effort. You have three options as to how to make the initial approach and each has its merits. You can:

- Telephone, giving only the broadest reason for your approach – saying perhaps you wish to discuss areas of common interest.
- Write and be a little more specific on your purpose, following that up with a phone call to arrange a meeting, perhaps over lunch.
- Use a third party such as an accountant, merchant bank or consultant. Reasons of secrecy may make this method desirable. If executive time is at a premium, there may be no other practicable way.

The first meeting is crucial and you need to achieve two objectives. First, you must establish mutual respect, trust and rapport. Nothing worthwhile will follow without these. Then you need to establish in principle that both parties are seriously interested. Time scale, price, methods of integration and other matters can all be side-stepped until later, except in the most general sense.

## *Valuing the business*

Once you've found a business that you want to buy, and that's probably for sale, you now need your accountants to investigate the business in depth to see exactly what's on offer. This can take several weeks, and is a little like having a house surveyed. You need to remember that accounts are normally prepared on the *going concern* basis, which implies the company is going to continue trading much as before. This means that the historical cost of fixed assets such as buildings, land, machinery and so on can appear in the balance sheet, rather than the market worth. After all, until you came along they hadn't planned to sell their fixed assets, but now the figures will have to be recast using different principles.

Ultimately, what you're buying is either extra profit or, perhaps, lower costs in your own business. You have to decide how much that is worth. Public companies usually have general rules for each sector. For example, much of the retail sector is valued on a price/earnings ratio (P/E) of 12, which means retailers are seen as being worth 12 times last year's net profit. A private company in the same sector would only be worth two-thirds that figure, as their shares are less easily bought and sold. The worth of the assets in the business would also be important, and whatever the nature of the business, you're usually buying people – their knowledge and skills – unless of course you're simply *asset stripping* (buying a business primarily to sell its assets rather than to continue to run it).

TIP

Prices paid for private companies are monitored in a three-monthly index prepared by accountancy firm BDO Stoy Hayward ( www.bdo.co.uk/news/private-company-price-index-pcpi ). Based on completed acquisitions, the index tracks the ratio between the purchase price of private companies sold during a three-month period and their historical earnings.

The P/E ratio of the index of private companies is usually about 20 per cent lower than the trading P/E multiple of companies in the FT Index for the same period. This reflects the value placed on liquidity. Valuing business is no great science, just a rather messy art. At the end of the day you can always work out if it would be cheaper to start up from scratch yourself. That will give you an outer figure for your negotiations. Any higher purchase price wouldn't represent good value, as you could start up yourself for less money.

## Limiting the risks

Buying a business is always risky. If you've done your homework and got the price right, with any luck the risks will be less. Some other things you can do to lessen the risks include the following:

- **Set conditional terms:** For example, you can make part of the price conditional upon a certain level of profit being achieved.
- **Handcuff key employees:** Not literally, you understand, but if most of the assets you're buying are on two legs, then get service contracts or consultancy arrangements, either of which will get a degree of commitment in place before the deal is signed, so you can be sure they'll be around for a while at least.
- **Insert non-competition clauses:** Make sure that neither the seller nor his key employees can set up in competition, taking all the goodwill you've just bought.
- **Get tax clearances:** Obviously you want to make sure any tax losses you're buying, or any tax implications in the purchase price, are approved by HM Revenue and Customs (HMRC), before committing yourself.
- **Insist on warranties and indemnities:** If, after you've bought, you find there is a compulsory purchase order on the vendor's premises and the patent on his new product is invalid, you would quite rightly be rather miffed. Warranties and indemnities set out those circumstances in which the seller will make good the buyer's financial loss. So anything crucial that looks worrying, you can try to include under this heading. Not unnaturally, the seller will resist, but you need to be firm on key points.
- **Enter into a non-disclosure agreement (NDA):** This agreement ensures that neither party can reveal or use for any commercial advantage information revealed during the deal process. This way if the deal falls through, no harm is done to the buyer's or the seller's businesses and reputation.
- **Carry out full due diligence:** You wouldn't usually buy a house without getting a survey done, so if you're going to spend even more to but a business, you should get it checked out first. Get experts to check out its finances, products, services, staff and so on to make sure you aren't acquiring any hidden liabilities as well as assets.

## Managing the acquisition

However well-negotiated the deal, most acquisitions that go wrong do so because of the human factor, particularly in the first few weeks after the deal is made public. Some important rules to follow are:

- Have an outline plan for how to handle the 'merger', and be prepared to be flexible. Interestingly enough, only one buyer in five has a detailed operational plan of how to manage their acquisition, but 67 per cent of those being bought believe the buyer has such a plan, so it's psychologically important.

- Let business go on as usual for a few weeks or months dependent on the size and scale of the business, as you find out more about the internal workings of the company. Then you can make informed judgments on who or what should go and who should remain in post. Ninety per cent of successful acquisitions follow this rule.
- Hold management and staff meetings on the first day after the takeover to clear as much misunderstanding as you can. Continue to hold regular meetings and provide updates as plans develop. Do as much of this yourself as you possibly can.
- Never announce takeovers on a Friday. Staff will have all weekend to spread rumours. Wednesdays are best – just enough time to clear up misunderstandings, followed by a useful weekend breathing space.
- Make cuts/redundancies a once-only affair. Cut deep, and then get on with running the business. Continuous sackings sap morale, and all the best people will leave before it's their turn.
- Set limits on authority and reporting relationships, and put all banking relationships in the hands of your own accounts department, as quickly as possible.

# Chapter 3

# Improving Performance

**IN THIS CHAPTER**

**Examining your internal systems**

**Holding on to customers**

**Cutting costs and checking your market position**

**Setting budgets**

An unpleasant truism in business, and in much else, is that after resources are allocated they become misallocated over time. Another way of looking at this problem is to say that just because something 'ain't broke', it doesn't mean you can't make it perform better still. To get your business to grow and keep growing requires a continuous effort to improve every aspect of that business.

In this chapter you find out how to boost your business by keeping your customers happy, improving your efficiency and effectiveness, and increasing and expanding your business.

## *Checking Your Internal Systems*

In order to improve performance, you have to have systems in operation that help you measure performance in the first place.

A good test of whether you're allocating enough time to the task of improving performance is to keep a record of how you spend your time, say, over a month. As well as recording the work you do and the time you spend on each major task, put the letter R for routine, S for strategic or I for improving performance next to the task:

- **Routine** tasks include something like meeting a customer or the bank manager, delivering a product or service, or taking on a new employee.
- **Strategic** tasks include considering a major shift of activities, say from making a product to just marketing it, forming a joint venture or buying out a competitor.
- **Improvement** activities include all the elements discussed in this chapter – activities focused on getting more mileage, lower costs or higher yields out of the existing business.

Most owner-managers spend 95 per cent of their day on routine tasks and tackle improvement and strategic issues only when they hit the buffers. For example, most entrepreneurs don't worry too much about cash until it runs out. Then they pick up the phone and press customers into paying up. What they should have done, however, is introduce new procedures for collecting cash *before* the crunch.

REMEMBER If you’re not spending at least 30 per cent of your time on improving your business and strategic issues, you’re likely to be caught out by cash flow or other worries.

TIP A good way to test whether you’re doing enough to keep on top of your markets is to conduct a SWOT analysis. Check out Chapter 5 of Book 1 for more on this.

# Retaining Customers

Businesses spend an awful lot of time and money on winning customers and nothing like enough time and money on keeping them. This behaviour is as pointless as pouring water – or perhaps molten gold would be a better material to keep in mind – into a bucket with a big hole in the bottom. You need most if not all of the flow to keep the bucket partly full. However fast the water (or gold!) flows in, it flows out just as quick.

Virtually all managers agree that customer care is important. A recent survey of major British companies showed that 75 per cent had recently instituted customer care quality schemes. Sadly, another survey, conducted by American consultancy company Bain, also revealed that less than a third of those companies saw any payback for their efforts in terms of improved market share or profitability.

Bain suggests that the reason companies are disappointed with their attempts to improve customer care is that they don’t have anything tangible to measure. To help overcome that problem, it suggests that managers focus on the Customer Retention Ratio, a Bain invention. For example, if you have 100 customers in January and 110 in December, but only 85 of the original customers are still with you, your retention rate is 85 per cent. Bain’s study demonstrated that a 5 per cent improvement in retention had a fairly dramatic effect on clients. For a credit card client, it boosted profits by 125 per cent; for an insurance broker, a 5 per cent increase in profits occurred; and a software house benefited from a 35 per cent improvement in profits. Bain claims that the longer customers stay with you, the more profitable they become. The next section explains why.

## Realising why retaining customers matters

Studies and common sense indicate several principal reasons why retaining customers is so vital:

- Acquiring new customers costs more than retaining the ones you have. What with market research, prospecting, selling time and so on, acquiring a new customer costs between three and seven times as much as retaining an old one.

  This is nothing more than the old military maxim applied by Montgomery, that attacking forces need several times the strength of the defenders to guarantee success.
- The longer you retain a customer, the more years you have to allocate the costs of acquiring that customer to. By spreading the costs of acquiring new customers over ten years, instead of one or two, the annual profit per customer is higher. Suppose it costs you £500 to get a new customer,

and that customer makes you £1,000 profit each year you keep her. If you keep the customer one year, your annual profit is £500 (£1,000 minus £500). However, if you keep the customer ten years, your annual profit is £950 (£500 divided by 10 equals £50, then subtract £50 from £1,000). Customers who stay tend, over time, to make you more profit.
- Regular customers cost less to serve than new customers. Insurance and underwriting costs as a percentage of sales fall by 40 per cent for renewal policies, for example. You don't incur up-front costs again.
- Long-term customers are often willing to pay a premium for service. They're also less prone to check your competitors because they know and like you.

Avoiding the consequences of losing customers is a powerful motivator for keeping in your customers' good graces. Some of those consequences are:

- Dissatisfied customers tell between 8 and 15 others about their experience. Just avoiding this negative publicity has a value.
- Your former customers are fertile ground for your competitors. If you keep your customers, your competitors have to offer inducements to dislodge those customers, and this is expensive and time-consuming.

## *Working to retain customers*

Use these five rules to make sure that you retain customers and so improve your profit growth:

- Make customer care and retention a specific goal, and reward people for keeping customers, not just for getting them in the first place.
- Find out why you lose customers. Don't just let them go – either send them a follow-up questionnaire or get someone other than the sales person concerned to visit former customers to find out why they changed supplier. You may be surprised how pleased people are to tell you why they didn't stay with you, if you explain that it may help you serve them better the next time.

  TIP QuestionPro, a web-based service for conducting online surveys, has a number of customer satisfaction survey templates that you can download for free (go to `www.questionpro.com/akira/showArticle.do`). Also see Chapter 6 in Book 1 for more ideas.
- Research your competitors' service levels as well as their products. If practical, buy from them on a regular basis. If you can't buy from competitors, keep close to people who do.
- If one part of your organisation is good at caring for customers, get people there to teach everyone else what they do.
- Recognise that the best people to provide customer care are those who work directly with customers. But this means that you have to train them and give them the authority to make decisions on the spot. Aloof or indifferent employees don't convince customers that you really want to keep their business.

Retaining customers isn't the passive activity it sounds. The next sections offer concrete ways to keep your customers happy.

### Monitoring complaints

One terrifying statistic is that 98 per cent of complaints never happen. People just don't get round to making the complaint, or worse still, they can find no one to complain to. You'd have to be a hermit never to have experienced something to complain about, but just try finding someone to complain to at 8 p.m. on a Sunday at Paddington Station and you get a fair impression of how being in the Gobi Desert feels.

You can never be confident that just because you're not hearing complaints, your customers and clients aren't dissatisfied and about to defect. Not making complaints also doesn't mean that they may not run around bad-mouthing you and your business. Remember that on average people share their complaint with a score of others, who in turn are equally eager to share the bad experience. The viral effect of email has the potential to make any particularly juicy story run around the world in days if not hours.

TIP Set up a system to ensure that your customers have ample opportunity to let you know what they think about your product or service. This may involve a short questionnaire, a follow-up phone call or an area on your website devoted to customer feedback. As a bonus, you may find you get some great ideas on how to improve your business.

REMEMBER Ninety-eight per cent of customers who have a complaint are prepared to buy from you again if you handle their complaint effectively and promptly. Not only do they buy from you again, but also they spread the gospel about how clever they were in getting you to respond to their complaint. Nothing makes people happier than having something to complain about that ends up costing them next to nothing.

## GIVING CUSTOMERS OPPORTUNITIES TO COMPLAIN

One entrepreneur who's more than aware of the problems (and incidentally opportunities) presented by complaints is Julian Richer, founder of the retail hi-fi chain Richer Sounds. His maxim is that his staff should maximise customers' opportunities to complain. The operative word in that sentence is *opportunities* , which you shouldn't confuse with *reasons* . In order to put this policy into effect, Richer uses a range of techniques. The whole customer satisfaction monitoring process starts from the moment customers enter one of his retail outlets. A sign near the door invites people to ring a bell if they've had particularly good service or help while in the shop. That help may be simply getting some great advice, or finding a product they want to buy at a very competitive price.

Customers find that when they get their hi-fi equipment home, it contains a short questionnaire on a postcard asking them for their immediate post-purchase feelings. Does the product work as specified, is it damaged in any way, were they delighted with the service they received? The postcard is addressed to 'Julian Richer, Founder' and not, as is the case with so many other big businesses, to 'Customer Services, Department 126754, PO Box, blah blah blah'.

Richer does surveys on customer satisfaction and encourages his staff to come up with their own ideas for monitoring customer reactions. In fact, he insists that they hit minimum targets for getting customer feedback. Silence on the customer satisfaction front isn't an option for management in his business.

### Setting customer service standards

*Customer service* is all those activities that support a customer's purchase, from the time they become aware that you can supply them with a particular product or service, to the point at which they own that product or service and are able to enjoy all the benefits they were led to believe were on offer.

The largest part of the value of many products and services lies in how the company delivers customer service. This is also the area most likely to influence whether customers come back again or recommend you to others. Customer service works best when:

- Customers are encouraged to tell you about any problems.
- Customers know their rights and responsibilities from the beginning.
- Customers know the circumstances under which they're entitled to get their money back and how to take advantage of other rights.
- Customers feel in control. You're far better advised to provide a full refund if the customer is dissatisfied than to demand that the customer come up with a good reason for the refund. A refund, or any other recourse you offer, needs to be prompt.

Repeat business is another key profit maker. Repeat business comes from ensuring that customers are completely satisfied with and ideally pleasantly surprised by the quality of your product. Repeat sales save unnecessary expenditure on advertising and promotion to attract new customers.

TIP As standards of living rise, quality, convenience and service are going to become even more important relative to price. An investment in a strategy of quality customer service now is an investment in greater future profitability. You need to have a model to follow for effective customer service, so consider using mystery shopping as a way to keep tabs on your customer service standards.

Customer service is often the difference between keeping customers for life and losing customers in droves. You and your staff have to deliver outstanding customer service at all times. In order to do this, everyone has to know what the important elements of good customer service are, and everyone needs to incorporate those elements into their everyday customer interactions.

REMEMBER The key elements of your customer service plan should include:

- **Initial contact:** The customer's first contact with staff creates a lasting impression and can win and sustain customers. All your staff need to be aware of how to handle enquiries quickly and competently. They should know how to leave potential customers feeling confident that their requirements can be met.
- **Information flow:** Keeping customers informed of where their orders are in the process influences their feelings about the way you do business. Your action plan needs to specify each step of your process – quotation; order confirmation; delivery notification; installation instructions. A regular flow of information throughout this period makes your customers feel that they matter to you.

TIP A good practice adopted by many companies is to allow the customer to track the progress online via an order tracking number and a dedicated portal on the website.

- **Delivery:** Delivering the goods or service is a key part of customer service. Your product needs to be available in a timely manner, delivery lead times must be reasonable and the delivery itself must be in a way that meets the customer's requirements.
- **After-sales support:** Good coverage in areas such as maintenance, repairs, help lines, upgrade notifications, instruction manuals, returns policies and fault tracing help customers feel that you care about their total experience with your products and business.
- **Problem solving:** Often the acid test of customer service, your staff need to be able to recognise when a customer has a real crisis and what your procedure is for helping them.

High customer service standards enable many firms to charge a premium for their products. Yet in many ways, good customer service can be a nil-cost item. After all, answering the phone politely takes as much effort as doing so with a surly and off-putting tone. So improved customer service is one route to increased profitability.

### *Rewarding loyalty*

The reasons that loyalty improves profitability are:

- Retaining customers costs less than finding and capturing new ones.
- Loyal customers tend to place larger orders.
- Loyal customers don't always place price first, but new ones usually do.

So what works and what doesn't when it comes to keeping customers loyal? One idea that hasn't lived up to its promise is customer loyalty cards. When they were launched, retailers made big claims about how they were going to gather tons of invaluable data about customers. But mostly they possess just huge virtual warehouses of information that hasn't been used. Analysing the buying habits of millions of shoppers as their cards are swiped at the till can be prohibitively expensive and few companies have used much of the data gathered to make their customers feel special and hence want to stay loyal.

Asked to give reasons for loyalty, the top five elements consumers list are:

- Convenience
- Price
- Range
- Customer service
- Quality

What this means is that you have to get your basic marketing strategy right and understand what your customers want and how much they're prepared to pay. If that's wrong, no loyalty scheme is going to keep them on board. Customer service and quality are about getting things right first time, every time. So always under-promise and over-deliver.

TIP Some simple loyalty schemes do work when the customer sees the benefit of being loyal fairly quickly. Most coffee shop chains operate a simple card stamp loyalty scheme. In Caffè Nero, buy nine drinks and get your card stamped, and then your next drink is free.

TIP Care and help lines and dedicated areas of your website, where customers are encouraged to call and visit for advice, information or help with problems, help to keep customers loyal and make them more likely to buy from you in the future. If the line is a freephone service, it's even more effective. Keeping in touch with customers can also bind them more securely. Questionnaires, newsletters, magazines, letters about incentives, customer service calls, invitations to sales events and 'member get member' schemes are all ways of achieving this result.

# Improving Productivity

Improving productivity is a constant requirement for a growth-minded business, not simply an activity during periods of economic recession (when it is still, nonetheless, important). You need to improve productivity by acting on both your costs and your margins.

You can increase margins by changing the mix of products and services you sell to focus on those yielding the best return, or by raising your selling price. Cutting costs has the merit of showing quick and certain returns.

## Trimming expenses

You need continually to keep expenses under tight control and balance them against the requirements for good quality and good service. In particular, you need to separate and act on your variable and fixed costs.

*Variable cost* cutting is always in evidence in a recession; witness the automotive and banking staff cuts in the early 1990s, in 2002–2003 and with a vengeance in 2009–2010. Cutting variable costs includes such things as wages and materials that are directly related to the volume of sales.

Cutting fixed costs such as cars, computers and equipment – costs that don't change directly with the volume of sales – shouldn't include scrapping investments that may bring economies of scale and extra nimbleness in the future (like flexible-manufacturing facilities, where, for example, Peugeot has invested in product lines that can turn out two models of vehicle at once). Equally, alliances between firms, aiming to reduce fixed-cost investments, can be advantageous. In the soft drinks industry, Perrier provided distribution for Pepsi in France, at least for five years until Pepsi felt they had not worked hard enough to promote their brand. Bulmers reciprocated for Perrier in England for 13 years until CCSB (Coca-Cola and Schweppes Beverages) took on the task. In both cases, the goal was to avoid the need for extra investment in warehousing and transport.

Focusing attention on the 20 per cent of items that make up 80 per cent of your costs probably yields your biggest savings. This 80/20 rule is helpful in getting costs back into line – but what if the line was wrong in the first place?

## Increasing margins

To achieve increased *profit margins* , which is the difference between the costs associated with the product or service you sell and the price you get in the market, you need first to review your sales. This requires accurate costs and gross margins for each of your products or services. Armed with that information, you can select particular product groups or market segments that are less price-sensitive and potentially more profitable.

TIP No one rushes out to buy expensive, overpriced products when cheaper alternatives that are just as good are readily available. The chances are that your most profitable products are also the ones that your customers value the most. Start your efforts to increase margins by concentrating on trying to sell the products and services that make you the most money.

Pricing is the biggest decision your business has to make, and one it needs to keep constantly under review. Your decision on pricing is the one that has the biggest impact on company profitability. Try the consultants' favourite exercise of computing and comparing the impact on profits of a 5 per cent:

- Cut in your overheads
- Increase in volume sales
- Cut in materials purchased
- Price increase

All these actions are usually considered to be within an owner-manager's normal reach. Almost invariably, the 5 per cent price increase scores the highest, because it passes straight to the net profit (the bottom line). Even if volume falls, because of the effect that price has on growth margin, you usually gain more profit from selling fewer items at a higher price. For example, at a constant gross margin of 30 per cent with a 5 per cent price increase, profits are unchanged even if sales decline 14 per cent. Yet if prices are cut 5 per cent, an extra 20 per cent increase in sales is needed to make the same amount of profit.

Frequently, resistance to increasing prices, even in the face of inflationary cost rises, can come from your own team members, eager to apportion blame for performance lapses. In these instances, making detailed price comparisons with competitors is important.

## Working smarter

Making more money doesn't always have to mean working longer hours. You can just work smarter – and who knows, you may even end up working fewer hours than you do now and still make more money.

TIP One way to get everyone's grey matter working overtime is to create 'smart circles', comprising people working in different areas of your business who you challenge to come up with ideas to make the business better (and smart rewards, which include extra resources, holidays and recognition for their achievements, rather than cash). You can formalise the process of encouraging employees to rethink the way they work and reward them in a way that makes their working environment better still.

## *Rewarding results*

If you can get the people who work for you to increase their output, you can improve productivity. The maxim ‘What gets measured gets done and what gets rewarded gets done again’ is the guiding principle behind rewards, and setting objectives is the starting point in the process.

The objectives you want people to achieve in order to reward them beyond their basic pay need to be challenging but achievable too, which is something of a contradiction in terms. Problems start to arise as soon as professional managers and supervisors come on board with experience of working in big companies. They, and probably you, tend to take objectives and the ensuing budgets very seriously. You have to hit the budgets, so it makes sense to pitch them on the conservative side.

But in a small business, growth and improvement percentages have the potential to be much greater than in larger firms. A big business with a third of its market can only grow very quickly by acquisition or if the market itself is growing very fast. A small firm, on the other hand, can grow by very large amounts very quickly. Moving from 0.01 per cent of a market to 0.02 per cent is hardly likely to upset many other players, but it can represent a doubling in size for a small firm. However, exceptional performance, even in a small firm, is attainable only with breakthrough thinking and performance. The question may not be how to grow the business by 20 per cent a year, but how to grow it by 20 per cent a month.

Nevertheless, if you set goals too aggressively people may leave. Even, perhaps especially, great performers balk if the hurdle is put too high.

TIP

One way to get the best of both worlds is to have a performance band rather than just one number. The reward for achieving a really great result should be massive, but if the employee misses this high goal slightly, you reward her as if the goal had been set at the level she reached. The reward is proportionately smaller, so your rewards budget still balances. This technique can work as an ‘inspiration dividend’. You can persuade teams to set higher goals than they may otherwise have set, and even if they miss them, the year-on-year improvements can be stunning.

### REWARDING EXCELLENT RESULTS

Nick White’s Ecotravel company sends people to off-the-beaten-track exotic locations and to conservation areas where money goes into research projects. Ecotourists who book with Ecotravel pay to see animals in conservation areas, and a proportion of the money they spend on the holiday goes directly to conservation projects.

White expanded the business slowly until he hit on the idea of introducing a ‘rewarding excellence’ initiative, when he saw sales shoot up by 40 per cent in just six months. The basis of the reward is an accelerating bonus. If the company hits its sales targets, staff share in a 5 per cent bonus. If it exceeds targets, the bonus rates rise too. For every 20 per cent of achievement above target, the bonus rate goes up 1 per cent. Targets are reset each year using a similar formula, but starting from a new and higher base level.

# Chapter 4

# Franchising for Growth

**IN THIS CHAPTER**

**Looking at franchising opportunities**

**Examining the pros and cons**

**Establishing the pilot**

**Seeing how to find prospective franchisees**

**Mastering a master franchise**

If your business concept looks as though it can be replicated in several other places, you have a number of choices. The most obvious is to open up more branches. But you can consider a faster, and in some ways safer, route by franchising your business for others to roll out and share the risk.

Franchising is a great way into business, as a start-up, and a great way to grow a business, too – as a model to follow later when you're looking for some serious growth opportunities. Over 700 different types of franchise are on offer somewhere in the world and 44,200 franchise units operated in the UK in 2016, so you can almost certainly find one that suits your needs and aspirations.

## *Defining a Franchise*

*Franchising* is a marketing technique used to improve and expand the distribution of a product or service. The franchiser supplies the product or teaches the service to you, the franchisee, who in turn sells it to the public. In return for this, you pay a fee and a continuing royalty, based usually on turnover. The franchiser may also require you to buy materials or ingredients from it, which gives it an additional income stream. The advantage to you is a relatively safe and quick way of getting into business for yourself, but with the support and advice of an experienced organisation close to hand.

A *franchise agreement* is just like any business contract, in that it sets out what each party is expected to do and what can happen if he doesn't.

The main ingredients of a franchise agreement are:

- Permission to use a business name and so be associated with that bigger enterprise
- The right for the franchiser to set and enforce business and product standards, such as the use of ingredients, cooking processes, opening times, staff uniforms and so forth
- An obligation for the franchiser to provide help, training and guidance in all aspects of operating the business
- A definition of the way in which the rights to operate the franchise are to be paid for, for

example royalties on sales, initial purchase fee, marketing levy, mark-up on goods and services provided and so forth

- An assigned territory that defines where you can trade and what customers you can attract (like post code, town, and county)
- The duration of the franchise agreement

WARNING A standard franchise agreement is available from the British Franchise Association (BFA). Their standard agreement, though helpful, doesn't cover everything you need to know to make a sound decision. For example, though running a pilot scheme is a condition of membership of the BFA, that in itself is no guarantee that the business model is fully tried and tested. Nor does the BFA standard contract mention that the business, when set up, is the property of the franchisee, or warn the franchisee of the degree of control the franchiser may subject him to. Further, it gives no indication of the extent of the backup services that the franchisee may reasonably expect to get for his money. In other words, the BFA definition isn't a sufficient standard against which to check the franchise contract.

The British Franchise Association expects its members to follow its code of practice, and you can find out more on its website: www.thebfa.org .

# Considering Your Franchise Options

You have two possible strategies for harnessing the power of franchising to your business:

- You can consider taking on a franchise or master franchise that's complementary to your existing business.
- You can franchise your own business concept, taking on self-employed franchisees instead of hired-in managers to run your new branches or outlets.

Adding a franchise to your own business is a safer way to grow than franchising your own business idea. After all, after a franchise is up and running you can see how well it works. You can assess the franchise's track record, and though no guarantee of success exists, at least the franchise has ironed out many of the unknowns associated with any new venture. The following sections outline the two routes to deploying this growth strategy.

## Adding a franchise

A few years back Harrods, London's up-market department store, opened the first British outlet of Krispy Kreme Doughnuts. For Harrods, the sale of doughnuts is complementary to its other food and beverage sales, so the addition represents pure extra revenue. For Krispy Kreme, the venture represents a chance to enter the British market, which it believes is ripe for development with no dominant doughnut brand in the market.

The aim in adding a franchise to your existing business is to leverage, as the business gurus say, your customer or resource base, in order to get more sales per customer or square metre of space.

So if your customers are buying chocolate, sweets and stationery from you, adding a freezer with ice cream is no big deal. Chances are that the ice cream supplier is so keen to extend its distribution that it throws in the freezer cabinet for free. You’re taking someone else’s business model, product and support systems and bolting them on to your business to add turnover and profits.

### *Taking out a master franchise*

Instead of just adding a franchise to complement your business, you can consider rolling out a chain of franchises. That involves taking a master franchise for a country or region. You can also look on this as a strategy for rapidly expanding your own business, if you can put it into a franchise format. You can find out more about that aspect of expansion in ‘Rolling Out the Franchise ’, later in this chapter.

TIP You can find out more about taking on a master franchise from the Master Franchise Centre ( `http://themasterfranchisecentre.com/region/western-europe` ), Franchise Europe ( `www.franchiseeurope.com/master-franchises/` ) and Franchise Direct ( `www.franchisedirect.co.uk/masterfranchises` ).

## *Weighing the Advantages and Disadvantages*

From the franchiser’s point of view, one huge financial advantage is that you don’t have any direct investment in any of your franchises. The franchisee owns the inventory and equipment.

Because of the shortage of prime sites, one growing trend is for franchisers to acquire leases on behalf of franchisees, or at any rate to stand as guarantors. Nevertheless, the effect on the liquidity of the franchiser, in contrast to expansion by opening branches, is enormous.

However, you do face heavy start-up costs in piloting the franchise and in setting up and maintaining training if you do the job properly. Thereafter, you incur further costs in providing a continuing service to franchisees in such matters as research and development, promotion, administrative backup, and feedback and communication within the network.

WARNING As a franchiser, you’re dependent on the willingness of the franchisee to observe the rules and play the game, and any failure of the franchisee to do so is equally and perhaps more damaging to you and to other franchisees than it is to the wayward franchisee.

WARNING There is anecdotal evidence that franchises have a better survival rate than other start-up business. It’s quite easy to see why this argument is plausible – the business model has already been tried and tested in numerous other locations. But the facts are far from conclusive, and in any event the data (no matter what it indicates) probably doesn’t matter at the level of the individual franchise buyer (for more information, see www.franchiselawsolutions.com/franchisee-university/pdf/Franchise-Success-Study.pdf ).

# Doing the Pilot

After you've developed a franchise concept, you need to run a pilot operation for at least a year. Someone as similar to the intended typical franchisee for the chain as is practical should run the pilot. The aim isn't just to test the business concept – what investment is needed, when break-even will be achieved – but also to see whether you've described the operating systems well enough for people outside the founding business organisation to run them.

Take as an example a fast-food outlet offering slimmers' lunches. You already own a couple of outlets for which you've found a catchy name, Calorie Counter. You've established a standard image in terms of decor, layout, tableware, menus and graphics, and your staff members have a stylish uniform. Your gimmick is that on the menu every dish has a calorie rating and a breakdown of the fibre and salt content, and along with their bill customers get a calorie and fibre count for what they've bought. You also have some recipes that you've pioneered.

In the year since you opened, you've ironed out most of the start-up bugs and discovered a lot about the catering, accounting and staffing problems in running a business of this kind.

The indication is that demand exists for more restaurants like yours, but you have neither the capital nor the inclination to take on restaurant managers. Being a thorough sort of person, you've documented every aspect of running your restaurant, covering everything from recipes, ingredients and cooking times, to opening hours, wages, incentives and dress code. You've also standardised your accounting system and linked the electronic till to your raw material and stock systems, so that you can order key ingredients automatically. From your experience in opening two of your own restaurants, you know how and where to advertise, how much to spend and how sales demand is likely to grow in the early weeks and months. You've captured all this knowledge in a sort of manual, which you propose to use as a guide for whoever you select to open your next outlet.

You're now ready to run your first pilot franchise. This involves using your manual and procedures with a real live franchisee. True, you may have to give the franchisee some incentive to join you in the risk. But whatever you end up negotiating, as long as it gives you the benefits of franchising that are listed in the preceding section, you're ahead of the game.

When your pilot franchisee gets under way, you have the opportunity to test your manual in action. You, after all, invented the business, so you should know what to do in every situation – but seeing whether a green franchisee straight off the street can follow your 'map' and get a result is the acid test.

Put what you find out from the pilot into a revised franchise manual, sort out your charging and support systems, and you're ready to start to roll the franchise out.

# Finding Franchisees

Sorry, but the last sentence in the previous section was a bit misleading. Despite having a great business, a robust and proven business manual and a couple of pilot runs under your belt, you aren't quite ready to roll the franchise out around the world, or even around your neighbourhood. The most recent NatWest/British Franchise Association survey (they do one every year and have done for the last 20) asked franchisers what they consider to be the biggest barrier to the growth of the number of franchises they operate. By far the greatest number of respondents – 41 per cent – said that it was the lack of suitable franchisees; that is despite the fact that in 2015, the profitability levels were the highest ever recorded.

Visit any franchise exhibition – and you visit many if you're serious about growing in this way – and the thousands of people milling around the stands and in the seminar rooms may convince you that no lack of interest exists among the general public to taking up a franchise.

TIP Finding potential franchisees isn't a problem. You can meet franchisees at any of the dozen or so franchise exhibitions held around the country each year. The BFA diary page ( www.thebfa.org/events/seminars ) gives details of dates and venues. Attend as many of these exhibitions as you can and you should have applicants coming out of your ears.

Yet turning that latent demand into done deals isn't so easy. One international franchise chain offers franchises to only 30 per cent of the people it interviews, and it interviews only a small fraction of the number of people it sees at exhibitions.

This begs the obvious question: what sort of person makes the ideal franchisee? Well, looking at past career patterns may not be much help. Chemex, a 104-outlet cleaning products franchise chain, lists a postman, a sales manager, a buyer, a farmer and a shipping agent as the occupations of their most successful franchisees. Menchie's, a frozen yogurt chain, cites everyone from cops, engineers, stay-at-home mums and experienced franchise owners to neurologists, teachers, dentists and executives as great franchisees in their chain. They go on to claim that there is 'no single background or education level which determines success'.

TIP Franchisers say that they have the most success with franchisees who are motivated, are able to work hard, have some management aptitude, have good communication and people skills, and are *not* too entrepreneurial. They aren't looking for people with relevant industry skills and experience, because they want to inculcate candidates into their own formula.

Look at Chapter 2 in Book 3 for some tips on how to recruit and select great people.

## Rolling Out the Franchise

So now that you have a proven formula and a steady stream of candidates, you really are ready for the big roll-out. Carefully select locations and areas that most closely fit your business model. For example, the Hard Rock Café model is known as a capital city business. In other words, room exists for only one in each major international city. ProntaPrint, on the other hand, can accommodate an outlet in each major business area within a city, or a single outlet in any major town with a population over around 30,000 people.

REMEMBER Your equation depends on your customer profile. A bookkeeping or fast-print outlet may find the going tough in a seaside town with 20,000 pensioners and 10,000 holidaymakers.

# Chapter 5

# Funding Expansion

**IN THIS CHAPTER**

- **Working within the new normal after accepting investment**
- **Looking at future rounds of investment**
- **Going public**
- **Exploring alternative sources of finance**

Getting your business up and running and funded in the early stages is pretty hard work, and keeping that momentum going so that you achieve your growth goals and milestones is even harder work. If you've taken on equity, you have more people involved in your business, all demanding your time and business information on a regular basis.

When the economy is good, your growth seems easier, and all forms of finance are generally more plentiful and easier to acquire. When times are tough, your business skills and prudent financial management will be tested.

As you grow your market share and expand your team, be mindful of what you ultimately want to achieve, be that selling shares in your company on the stock exchange, merging it with another business, having your senior management team buy you out or selling to a big industry player, leaving you to put your feet up and take a well-earned break.

This chapter explores some of the options for growth funding and the challenges of having investors on board.

## *Dealing with Financiers Post-Investment*

When you come down from the natural high that's associated with procuring investment and knowing that you'll be able to get started on creating the business of your dreams, you may experience a bit of a bump when your feet touch the ground again, as it slowly dawns on you that you're no longer the only owner of your business.

Instead of having the luxury of gradually getting used to your new working conditions post money, you're given a new set of rules on day one – you go from fairly free and easy to much more structured and formal. The new *shareholder agreements* , which set out shareholder rights and obligations, and *articles of association* , which set out the purpose of your company, as well as the duties and responsibilities of company directors, are filed at Companies House. You formalise the paperwork to finalise the transition of power, and find a few new directors are staring you in the face.

TIP Keep in mind that your new partners/advisers/directors are well-meaning and well-intentioned, and have both your and their best interests at heart. So trust the process and make a mental note to be better prepared when it happens again in the next round of funding.

## *Sharing your business*

When Alex Stephany of Just Park (which has Index Ventures and 3,000 other investors via Crowdcube as shareholders) was asked about his attitude towards sharing the business, he replied with a measured, logical answer, and with no ego whatsoever: ‘It’s what’s best for the business.’ We suggest taking a leaf out of his book, accepting what you’ve done and getting on with making it the best decision you could make for the future of your business.

REMEMBER With other people having a stake in your business, you can expect more rigorous reporting and compliance procedures than you may be used to. As with most things in life, some of it will be acceptable and easy enough, but some of it will be very new to you, take time to learn and won’t always be something you want to be told to do. It’s not all smooth sailing, and there will be times when sharing ownership will test your patience, your skills and your professionalism.

As the entrepreneur at the helm of this newly funded company, you need to take on some new skills and tasks pretty quickly:

- **Establish procedures for good investor relations.** A good deal of your time will now be spent on regularly scheduled board meetings and reporting to active as well as less active investors. At the same time, you’re working to move the company forward in line with the vision and strategy agreed between you and your investors in the run up to investing.
- **Accommodate a new board structure and directorships.** Your team may have been you and one other person or you and a few others; you now need to deal with a board, non-executive directors, possibly a new chairman and a new structure.
- **Accept input and involvement from your non-executive and investor directors.** Although everyone shares and supports the vision for the business, the level of influence you once had shifts away from you to create a new dynamic. Decisions that don’t go your way are a real possibility. This is particularly evident if things don’t go to plan and company performance is below what is expected, which has a direct impact on investors’ returns. Not surprisingly, they’ll want to have more of a say in how the ship gets back on course. If additional funds are required to get it back on track, then they’ll be even more involved.

Remember to consider your mechanisms and readiness to deal with board and investor conflicts.

TIP It's never too early to start planning for future funding. Think about whether your current funders will consider future investment rounds. If you're going to look to other funders in the future, think about how this will sit with your current lot and how to deal with that situation.

## *Bringing a valuable resource to the business*

After funds, one of the most important things an investor brings to your business is a contingent of experienced, business savvy, well-connected and ambitious individuals who want to see your business flourish and grow. They can take on a variety of roles, but the most common are:

- Chairman of the board
- Board members
- Non-executive directors

New shareholders may also be involved in appointing a finance director, if you don't already have one.

By taking on these roles, not only are investors able to keep a close eye on their investment, but they also show their commitment to your business and its growth. They often have the experience to make a smooth transition to this new regime, while simultaneously inspiring your team and motivating you to get on with hitting the milestones agreed in the aggressive growth you mapped out together. Their visibility is a help to you and your team and adds to your chances of success.

Your new advisers can also keep you on the straight and narrow with regard to increased governance and reporting requirements. Board meetings often take place once a month, and you'll spend a lot of your time on preparing paperwork and reports for these meetings. New board members or directors can provide you with guidance and templates to get you started, and help with the smooth running of the meetings and their resulting actions.

TIP Recording and keeping information on the discussions and results of board meetings is crucial to your next round of funding, as future investors will want to see this documentation as part of their due diligence.

Technically, *corporate governance* is the system by which companies are directed and controlled. The purpose of corporate governance, according to the ICAEW (Institute of Chartered Accountants in England and Wales) is to help bring about effective but prudent management that can deliver the long-term success of your business. The board of your company is responsible for ensuring that your company is behaving responsibly and prudently, and so your board plays a role in your corporate governance. Your shareholders get involved in governance by appointing directors to make sure that it happens – to the best of their knowledge.

TIP You can find information on the responsibilities of all directors and documentation for board meetings either on the Companies House website at www.gov.uk/government/organisations/companies-house or the Institute of Directors website at www.iod.com, where information and training is available for members.

## *The role of the board*

Generally your board applies a guiding hand to the running of the company, making sure that you, as the founder and CEO, along with the rest of your team, are performing well, and that the business is performing in line with its agreed articles of association and the goals and objectives set out with the investment. The board members have many and varied responsibilities and functions, among which are the following:

- Ensure that the business operates within the law and with the right level of governance.
- Make sure that the company's financial position is solid and operates as an active company with good financial checks and balances, and is able to meet short-term liabilities.
- Make sure that all contracts, salary agreements, and shareholder agreements and plans are legal.
- Chair the board meetings, ensuring that they run smoothly and efficiently.
- Report to shareholders on a regular basis.
- Assist with the next round of fundraising and additional finance needs, as appropriate and when required. The board should anticipate funding needs.

## *The role of non-executive directors*

A *non-executive director* is someone who's involved in strategic, planning or policy issues in your business. This director has a seat on the board, but is not part of the executive team, so she's not involved in making day-to-day decisions.

The roles of non-executive directors are varied and diverse, as are their backgrounds and skills, but they all contribute in a positive way to the growth of your business and your team. They:

- Bring an extensive and valuable network and book of contacts.
- Bring a fresh pair of eyes and a different perspective. Directors aren't always experienced in your particular industry, but they're definitely experienced business people.
- Bring a skill you may be light in or lacking – legal, human resources, some form of marketing or sales, for example.
- Act as a sounding board and learning platform for you and your senior team. They've been there, done it and bought the T-shirt, and they know how you're feeling.

REMEMBER *Investor directors* can fall into the category of non-executive directors, but, as they're part of the fund or have been nominated by the fund, they're not independent and so they have investor interest closest to their hearts and minds. When the going gets tough, you may wish they'd get going, but they won't. Work out how to manage them and expect them to put the investors' interests first.

WARNING If you're ever asked to become a non-executive director, you have in the eyes of the law the same liability as your fellow full-time executive directors. So even though you aren't in the business full-time and you don't know all the details of what's going on, you're just as liable if it goes wrong.

## Funding with debt

Businesses whose need for growth funding isn't great and whose current team, give or take a couple of new additions, is capable of implementing a growth plan that calls for non-equity arrangements, have the option of debt funding, which brings its own post-funding rules and requirements. (For more on debt funding, turn to Chapter 1 in Book 2.)

REMEMBER What can safely be said about both lenders and investors is that neither of them wants any surprises after they've given you the money. If you have any nasties on your radar, best to tell them sooner rather than later and deal with the consequences head on.

When it comes to debt, or lenders, make sure that you have a plan to pay off the loan, and make sure that you never go over your limits on any of the debt facilities or products you've agreed without getting approval first. Any red flags or warning signs about the way you manage their money can work against you.

WARNING Repayments are likely to be made by direct debit, and you will probably have some restrictions or covenants that you'll have to adhere to. For example, you may have to keep a certain amount of money in your account at all times. If you fail to meet these requirements, it will be evident in your account balance. If you've taken on debt to fund your expansion and growth, the lender will be monitoring your activity closely, making sure that you stick to your limits and you use the money for the purpose stated in your application. A lender keeps a constant eye on your account and can see when it's going south as quickly as you can.

# Investing in Future Rounds

Any company that has received investment, and is serious about generating a far better than average return for its investors and founders, knows the need to sustain a meaningful rate of growth and to plan for the next round of funding sooner rather than later.

Funding comes in many shapes and sizes, and a good chunk of it, whether it's debt, equity or alternative funding, can be used to fund growth. The trick is getting the right type of funding at the right time and on the right terms, in order to achieve additional growth without crippling the organisation.

## Looking at debt rounds and reasons

Depending on the type of business you have and the amount of money you need, debt can be a good option for growth funding.

For example, if you had equity funding initially, and your company outsources the manufacturing of chocolate drinks, you may be better off with straightforward debt to cover your stock purchases, some staffing and a bit of online marketing.

If you're thinking about taking on more equity, but you don't want to dilute your current shareholding arrangements, and you don't need a huge amount of money, you may prefer to look at *convertible debt* , which is debt that converts to equity at some later point in time.

Equally, if you're equity funded and need at least another million, but don't want to dilute your shareholding any further, you may consider *venture debt* , an arrangement in which some of the debt converts to equity at a certain time. With its quasi debt-equity products, venture debt may be just the ticket.

Chapters 1 and 2 in Book 2 go through the variety of funding options available to you.

## Equity rounds, reasons and investors – a typical growth journey

If equity is the right way for you to go, you need to consider many things besides the money, but your growth journey may look something like this:

- **Seed round:** You're figuring out your product or service, finding your market and building your customer base. You may take on a few employees, launch a new or revamped product and start to ramp up the numbers in your user base.
  - **Typical amount:** £100,000 to £1 million.
  - **Typical investors:** Angels, high-net-worth individuals and private individuals.
- **Series A:** You're starting to scale the business and testing and tweaking the business model to get it right for your market. This may include scaling distribution channels, expanding your locations and proving your business model works.
  - **Typical amount:** Anywhere from £1 to £10 million. In recent years, this round has become larger and earlier, blurring the lines between seed and series A funding.
  - **Typical investors:** Early-stage venture capitalists (VCs), possibly co-invested with angels who invested in your earlier round.
- **Series B:** You're starting to scale your growth, and usually – but not always – have good traction in the market and a proven business model that can stand up to adversity and scrutiny. You may need to take on staff, start exploring overseas opportunities to widen your customer base or make some small acquisitions.
  - **Typical amount:** Anywhere from £5 million to tens of millions.
  - **Typical investors:** VCs – may be led by early-stage VCs or some of your series A investors, with additional investment from later-stage VCs.
- **Series C:** To fund further accelerated growth – provide the additional capital needed to scale your business – you may go international for your funding by making an acquisition or by capturing more of your profit-making market at speed.

- **Typical amount:** Tens to hundreds of millions of pounds.
- **Typical investors:** VCs from earlier rounds, but can also be new private equity funds, hedge funds or other institutional funds (which can again change the level of control you have in your business and intensify your reporting and corporate governance).

# Considering a Public Listing

If you've explored and exploited all the other options for growth, and you're ready to take a very grown-up plunge, you may consider taking your company public, or applying to list your shares on a public stock exchange. An *IPO* (initial public offering) offers your shares for sale to larger and institutional investors and sometimes also to the general public. It's a seismic shift in the way your company operates, so it's not a decision to be taken lightly.

## Looking at reasons for an IPO

You may consider a public share offering for a number of reasons, which include:

- Financing your future growth
- Improving your balance sheet
- Opening up your investor base
- Creating an incentive scheme for employees using share option plans
- Providing an opportunity for current shareholders with restricted shares to convert them to more liquid shares, which are more readily converted to cash
- Raising funds to make an acquisition

WARNING Whatever the reason, if you've identified this as a milestone in your company journey and you're ready to raise equity funds in this way, prepare yourself for a lot of internal introspection into how well your company is really run – as well as for a very lengthy and expensive process. You may decide to abort the IPO if it looks like the timing is off or if something in the market happens to affect your listing, and you won't recoup the funds you spent preparing.

### Determining if your company is ready for an IPO

REMEMBER The decision to float your shares on the open market needs to be based in reality. The quality of your management team, a realistic assessment of how your business is performing, what the prospects for the future are and if it's the right time in the growth stage of your business to press *go* all need to be taken into account before you start the process.

Conventional wisdom says that a business that's achieved a certain amount of annual revenue, say £100 million, and has consistently been profitable is ready to withstand the process of an IPO with a valuation that’s high enough to be able to sell shares to a variety of investors without diluting its equity into an unrecognisable position in the process.

However, consider the following checklist to see whether your business ticks all the right IPO boxes:

- Do you have a strong, predictable and consistent revenue stream that your business can sustain, and an ability to take that income to an even higher plateau after the IPO?
- Can you stare yourself in the mirror and, hand on heart, know that you’ve cleaned up any area where you may have a chink in your corporate armour – like being overly dependent on one very large customer, or having some bit of kit that will soon become obsolete (the consequences of which will rain down on you after you go public)?

If you answer ‘yes’ to these questions, you may just conclude that you’re ready for an IPO.

## *Knowing where stocks are traded*

The UK has two main exchanges for trading stocks:

- **London Stock Exchange (LSE):** Founded in 1801, the LSE is located in the City of London and is the third-largest stock exchange in the world (when measured by market capitalisation). The LSE allows larger companies to access capital, increase their profile and obtain a market valuation, thus taking them on the full IPO journey. Your business must have been trading for at least three years, and depending on the listing, different rules apply to different percentages of shares.

  TIP Although it has more stringent requirements, the High Growth Segment gives your company the opportunity to fund its growth while preparing for an official listing. The main exchange has deeper pools of capital, more sophisticated benchmarking systems and a higher media and investment profile than AIM.
- **AIM (formerly the Alternative Investment Market):** AIM is based in London and is the LSE’s international market for smaller companies, allowing them to float shares with a more flexible regulatory system than the one applicable to the main market. A wide range of smaller businesses, including early-stage, venture capital–backed, as well as more established companies, join AIM seeking access to growth capital for expansion.

  AIM is the most successful growth market in the world. Since its launch in 1995, over 3,000 companies from across the globe have chosen to join it.

## *Preparing for an IPO*

Getting an IPO right and getting the timing right is a tricky process. You can help yourself by engaging in a bit of beating the bushes, or investor relations activity, and drumming up some interest even before you make the announcement. As time-consuming as this is, your IPO roadshow serves as a litmus test, helping you to gauge investor opinion as to whether or not you’ll get a good reception. It’s also your opportunity to interact with journalists, suppliers, customers and analysts, so make sure that you've got your strategy clear and you've planned your activities.

TIP You're also going to spend time with a whole lot of new advisers, lawyers, reporting accountants, corporate brokers, tax specialists and probably a financial relations public relations firm. There will be admission fees that depend on how much you raise and on-going annual fees for being part of this elite group. If you want to find out more about the London Stock Exchange, have a look on their website ( www.londonstockexchange.com/companies-and-advisors/listing/fees/fees.htm ).

Another method you can use for dipping your toe in the water is the *grey market analysis* , in which investors can trade shares in your company before its official IPO day, giving you an indication as to interest and also whether you've got the valuation right. This worked well for the Royal Mail and Twitter: both saw their opening day share values either very near or higher than the reading taken in the grey market; both had strong management teams and good growth strategies; and investors could see a good yield ahead.

TIP As you consider a public listing, make sure that you can tick off every item in this checklist:

- Your company financial performance is impressive and consistent, and shows a healthy balance sheet.
- You can articulate how your business is governed and what financial controls are in place.
- Your potential growth path is clear. You have a plan to cover the risks and how you'll mitigate them, and your plans look realistically impressive.
- You have a detailed business plan covering everything from your corporate strategy to your market overview, including your growth aims and objectives.
- You're able to explain what you're planning to do with the new funds that result from the offering.
- You and your team can explain and defend your business plan to investors, the press and analysts.

WARNING Although it may seem like a public offering is the only option to aim for and also the most desirable option for all concerned, that's far from the truth. An IPO isn't something to be entered into lightly. It's an extremely costly, time-consuming and stressful process, and one that few small- and medium-sized enterprises (SMEs) enter into each year in the UK.

## *Recognising the Rise of Alternative Funding and Online Platform Funders*

When it comes to lending, many entrepreneurs have found banks slow, hesitant and expensive. Because of this, and a new wave in accessible technology solutions, a different and great wave of innovation is underway in the financial services sector.

The boom in alternative, or non-bank, finance has been pronounced. Newer forms of borrowing – like crowdfunding – have now joined the mainstream marketplace alongside longer-standing specialist services like invoice financing and bonds, which are taking on new forms to reach their target audiences. New products and funders keep entering the market to provide fresh options in the space between banks and investors.

Although alternative finance is a relatively new form of funding, its recent growth and popularity mean that mainstream finance needs to move over and make room for this newish kid on the block; it looks like she's here to stay. It's an exciting time to be looking for – or offering – funding.

In the UK in 2015, £2 billion of support was provided by alternative products and services to over 10,000 small businesses. The number of these new funding knights able to come to your financial rescue is expanding to fill the gap left by the banking sector cutting its lending to entrepreneurs. This groundswell of growth is expected to continue with an estimated £5 billion of alternative finance projected to be delivered in 2016 alone.

Online funding platforms are just one type of alternative funding. *Platforms* are online services used both by financial intermediaries on behalf of their clients and directly by consumers to view and administer their investment portfolios. A business platform therefore allows lenders, investors and entrepreneurs to collaborate and process data and relationships in an efficient and transparent way.

Astonishing developments in technology and the increasingly pervasive aspect of the Internet and smartphones have ushered in an era of unprecedented growth in the online alternative finance industry. Some see platform and app-enabled funding as the industrial revolution of finance, creating a greater awareness of new and exciting finance options and a surge in business lending and investing, which aims to satisfy the finance needs of SMEs for working capital, growth funding, overseas expansion and the financing of business assets.

The Internet certainly provides a common meeting ground for investors and lenders looking for somewhere to invest their money for a good return, and businesses like yours looking for a welcoming online portal that offers an introduction to those who have money and want to part with it.

TIP Online platforms are particularly useful to companies at the smaller end of the SME classification. In the past, small businesses may have been overlooked or excluded by traditional funders, but they now have access to a diverse and plentiful source of appropriately sized funding options.

The platforms are jostling for position, carving out niche markets and coming up with increasingly innovative ways to enable successful transactions. Funding has come a long way from the nerve-racking face-to-face meeting with your local bank manager (or the shadier bail-out transacted down a metaphorical dark alley when a business owner found herself at a funding impasse).

REMEMBER We don't want to give you the impression that platforms have created a veritable free-for-all when it comes to funding. On the contrary, most platforms operate strict controls and criteria, meaning that some businesses are still excluded from raising funds. And, given the debacle leading up to the financial crash of 2008, perhaps that's not such a bad thing. After all, platforms are profit-making businesses, and if they don't protect their assets – their investors, lenders and borrowers or investees – they won't be around for long and they won't make much money.

For most platforms, you need to show a good trading track record, complete with financials and forecasts that put everyone at ease. Many businesses turned down by a traditional lender approach a platform, but many of them get turned down by the platforms for some of the same reasons.

Perhaps not surprisingly, sole traders don't fare as well as more established businesses, and it's entirely possible that some of those excluded from business funding will look to a platform for personal funding – which can then be ploughed into the business. Exact numbers are unavailable right now, but it's apparent that more and more entrepreneurial sole traders are using online platforms to access funding.

REMEMBER Both loan and equity-based crowdfunding platforms are regulated by the FCA (Financial Conduct Authority: www.the-fca.org.uk), which helps to protect investors. Peer-to-peer (P2P) lenders have to adhere to strict guidelines around capital, money and disclosure requirements. Investment-based platforms, both debt and equity, also fall under this umbrella.

The UK excels in platform funding, and recent changes in US law have opened up and widened the pool of potential US investors. You can also find significant European platforms, like the French Wiseed, which is a well-known, active crowdfunding platform along the lines of the UK's Crowdcube, and, as in the UK, this market is set to continue to grow.

## *Bank versus non-bank finance*

Although platforms pose a very real threat to mainstream banking organisations, a number of banks have gone for a collaborative versus a competitive approach, and you can now see Santander Bank and Funding Circle in alliance, and Metro Bank and Zopa tying up on the personal side.

There's a logical and natural referral mechanism at work here. More one-time odd couples may tie the knot and become collaborators rather than competitors as banks continue to refer their rejected or unsuitable business clients to other providers. From 2016, banks have been able to work with online information portals, such as Funding Options (www.fundingoptions.com), and others of a similar ilk, to make sure that SME customers get the right finance at the right time.

## Debt and equity online platforms

Online platforms come in both debt and equity guises, but they're often lumped together and referred to as the peer-to-peer market place (P2PL), so make sure that you know what you're looking at when you're shopping around. The chaos of alternative lending has been likened to the Wild West, but now it's settling down to be a progressive, law-abiding town, where you can grow your business and rest a bit easier at night.

A few types of platforms are:

- **Invoice financing platforms:** Lenders buy your invoices at a discounted price and then sell them back to you for a profit.
- **P2PL platforms:** The principle here is the same as traditional lending in that lenders offer your business money in return for you repaying the capital plus interest – the platform takes the place of the sweaty-palm-inducing meeting with bank managers. (Discover more in the next section.)
- **Crowdfunding platforms for debt and equity:** For debt, lenders purchase some form of a security, normally a bond, in return for capital and interest repayments. For equity, investors purchase shares in early-stage growth businesses, expecting to see business growth in the form of a good return on their capital and healthy dividend pay-outs.
- **Crowdfunding platforms for rewards:** Individuals pledge money in return for some form of product, service or activity reward.

You can find out more about crowdfunding in the upcoming section 'Crowdfunding platforms'.

WARNING Precise data on usage of funds and the overall impact on the businesses funded isn't readily available at this point, and the available data is open to speculation and interpretation. So, check your sources carefully and weigh the information. This lack of information is especially true for equity-based platforms; it's too early to see if the returns are as good as expected.

## Online peer-to-peer platforms

In the last few years, P2PL has become a fast-growing and vital source of finance for new and growing businesses. Many business owners, who had been turned down or given the run-around in the traditional funding markets, turned to their peers to raise funding for expansion, working capital needs and, to a lesser extent, asset purchase. Many used the funds to grow both turnover and profit, and although some businesses may have received funding elsewhere, their owners were game enough to try this new flexible form of funding. Lenders are primarily looking for a better return than they can get elsewhere, so it's a perfect synergy between the two sides of a very valuable coin for the continued growth of the UK economy as a whole.

P2PL portals:

- Are intermediaries between lenders and borrowers
- Manage their transactions online
- Carry out credit checks and due diligence on applicants

- Enable lenders to choose from clients seeking loans
- Provide a wider range of cheap unsecured loans than banks

TECHNICAL STUFF More than £300 million is lent to businesses every 12 months through these lending platforms in the UK, and that figure has been doubling each year. In fact, the recent boom in online P2PL loans has been so successful that high-street banks, corporate finance providers, pension funds and even government departments have also become lenders, getting on the platform bandwagon.

Britain is by far the best place in Europe to raise money in this way, with the sector growing at a rapid rate. In fact, the scale of P2PL in Europe is set to grow beyond €8,000 million in 2016 according to the latest research from the University of Cambridge Business School.

From your perspective, one of the main attractions of P2PL loans is that they're usually unsecured. Property or luxury assets aren't generally required as collateral for the loan, making it easier for you to apply if you're not asset rich. Despite this lack of security, the sites are regulated – which should be important to you.

Another positive for you is that P2PL portals make lenders compete to secure borrowers, which has the advantage of pushing interest rates down. The interest rate for the loan is determined by lenders competing in a reverse auction, within parameters set by due diligence on your borrower's ability to repay the loan.

Some P2PL portals are well established, while others are new on the financial block. They tend to have lower overheads than traditional banking institutions, so they have fewer costs to pass on to customers. Table 5-1 shows selected P2P platforms, their unique selling point (USP), when they started, where they are and who they loan to and how.

**TABLE 5-1 Select Peer-to-Peer Lenders**

| *Platform (URL)* | *Unique Selling Point* | *Target Borrower* | *Lending Model* |
|---|---|---|---|
| Assetz Capital (www.assetzcapital.co.uk) | Active in matching peers | Business | Auction |
| Funding Circle (www.fundingcircle.com) | Government backed as well as individual lenders | Business | Auction |
| FundingKnight (www.fundingknight.com) | Flexibility on funding options | Business | Auction |
| MarketInvoice (www.marketinvoice.com) | Funds often advanced within 24 hours | Business | Auction |
| RateSetter (www.ratesetter.com) | Customers set their own rates | Individuals | Market |
| ThinCats (www.thincats.com) | Businesses vetted by sponsors | Business | Auction |

Faster, easy-to-use, transparent transactions and, sometimes, better terms mean that these online lending platforms are fast becoming the first choice of small businesses looking to secure credit. As Stuart Law, chief executive of Assetz Capital, told the *Financial Times* in June 2015, 'In terms of business lending, you ain't seen nothing yet.'

TIP Is a P2PL right for you? Ask yourself whether you want a loan that's:

- Fast and easy to secure
- Cheaper and more flexible than a bank loan
- Managed online
- Available in a month

If your answers are mostly 'yes' – and why wouldn't they be? – then P2PL is probably worth checking out.

## LAST IN THE ALPHABET, FIRST OF P2P LENDERS: ZOPA

Zopa, the very first P2P consumer lending company, has been running for over a decade. During that time, it has delivered loans with a total value of more than £500 million. It's the largest player in the booming new market place for loans.

Funding Circle has been around since 2010, and it has developed a strong reputation for delivering loans to small businesses. Other portals that have proven their worth include RateSetter and Lending Works, and the P2P invoice finance platform `MarketInvoice` . The UK currently has 16 P2P platforms for business loans in the UK, with the total set to carry on rising.

Since 2012, the UK government (in the form of the British Business Bank) has been making public money available to small businesses in the form of loans through Funding Circle, so you have plenty of people enabling and willing this industry on.

Many lending platforms are members of the Peer2Peer Finance Association, which profiles their variety at www.p2pfa.info/p2pfa-members . You can also find a useful comparison page at www.p2pmoney.co.uk/companies.htm .

## *Crowdfunding platforms*

Keeping it simple, *crowdfunding* is a means of raising finance by harnessing the power and the funds of a large number of people who each put in a small amount of money in return for some kind of reward – either a financial stake in your business (equity) or some form of product or service. Most investors are looking for a strong return on their money, and most businesses are looking for seed capital or working capital as well as contacts and networks to tap into.

Crowdfunding isn't a new funding phenomenon. In fact, it has a long and varied history, appearing in different guises throughout time, but with the advent of modern technology, it's never been as popular and accessible as it is now. This format really took root in 2012–13, with significant uptake since its formation.

Crowdfunding typically follows one of the following formats:

- **Crowdsourcing:** Using the reward-based method of raising funds, businesses offer incentives in kind, discounts and restricted offers from their business instead of equity shares.
- **Debt-based crowdfunding:** Peer-to-peer platforms assess and score applicants seeking debt, and provide information to potential lenders who buy a debt security in return for interest and capital repayments.
- **Equity-based crowdfunding:** Popular with early-stage businesses, but also for the more established business, an investment is made in return for a share in your business.
- **Property crowdfunding:** This involves people buying shares in a property. It's sometimes, but

not often, used in business.

For your early-stage business, crowdfunding may be the answer to your prayers. For example, if your drinks business needs money and some more thirsty customers, crowdfunding can help you kill two birds with one stone; if you're a theatrical impresario in need of cash for your latest film or play, giving someone a ticket to fund the writing process may be, well, just the ticket for your venture! For your more established business that needs to attract a different market, raising awareness as well as income through crowdfunding can offer a solution.

People, and increasingly institutions, pool their money to get behind an idea or a business venture and invest. You may get the support of 10 people or 3,000 people, which offers a boost to your marketing efforts, and you find different sites for different types of crowdfunding. Crowdfunding attracts members of the public as well as angels and investor networks, further blurring the lines when it comes to equity investing in particular.

Crowdfunding is hugely transformational in the world of business funding because it reduces the cost of a transaction and gives people access to funding opportunities that weren't there before.

TIP Crowdfunding is a good place to channel anyone in your circle of friends and family who want to invest, particularly as you need to bring some of the crowd to get the momentum going.

REMEMBER As you consider equity crowdfunding, keep in mind how the process generally works:

1. **After you identify the best platform for your business, go online and upload some information on your business, following the guidance and prompts on the site.**
2. **Your proposal is reviewed to see if you meet the criteria and can go forward.**
3. **Based on feedback from the platform, you do further work on your funding application content.**

   You submit information, including financials and a pitch deck, to the site, where it will be checked and due diligence carried out.
4. **You upload your pitch video, customer testimonials and other relevant – or required – materials and are given a specific amount of time in which to raise a specific amount of money.**

   Your marketing and public relations (PR) machine kicks into action! Both you and the site launch into a comprehensive PR, social media, event-marketing and direct-marketing campaign aimed at attracting investors to your offer.
5. **You track your progress on the site, monitor what works and what doesn't,**

**and watch the funds go up and the clock tick down.**

6. **Hopefully, you're successful and you raise the specified amount – or more – in the given time frame.**

   The money goes into a separate account for safekeeping.

WARNING Many crowdfunding sites are conducted on an *all or nothing basis* , meaning that you have to raise your full amount or return, as in not keep, the amount you raised.

Fees are charged, and they vary in percentage points as well as stages. You may have up-front fees, a percentage of the money raised and a future percentage linked to the rising share value over time.

TIP A few housekeeping pointers to help you navigate crowdfunding sites – they:

- Ask you to prepare video appeals, incentivised offers and background information.
- Require you to build a PR campaign to drive potential donors or investors to your offer.
- Usually take a percentage of the sum raised.
- Sometimes require you to raise all your target amount and to forfeit funds if you don't raise the full target amount.

Table 5-2 lists some crowdfunding sites good for early-stage business projects.

## TABLE 5-2 Select Crowdfunders

| *Platform (URL)* | *Date Established* | *Fees to Company* | *Criteria* | *How It Works* |
|---|---|---|---|---|
| CrowdBnk ( www.crowdbnk.com ) | Summer 2013 | Success fee of 5% of funds raised; 2–3% of funds raised through card transactions; 1% of funds raised as legal fees, capped at £10,000 | Dependent on unique selling point, proof of concept, scalability, team, network, tax status, funding amount | Projects listed for up to 90 days |
| Crowdcube ( www.crowdcube.com ) | Feb 2011 | When you reach target, success fee of 6.5%; administration fee of £1,250; corporate services fee of £1,250 | Registered UK company; residents over the age of 18; have business plan and financial forecasts to upload | Submit and instantly publish pitches online with 30 days to reach funding target |
| Seedrs ( www.seedrs.com ) | July 2012 | 7.5% of funds raised | EU residents over the age of 18; process subject to UK law; funding up to £150,000 | You create a campaign to run over 60 days; Seedrs promotes it |
| SyndicateRoom ( www.syndicateroom.com ) | Sept 2013 | Flat fee on all funds raised through the platform, which includes set up of administration and nominee structure; a one-off legal | Minimum equity funding of £150,000; 25% of equity sought already committed | Pitch online with consultation of an existing lead investor |

| | | | | |
|---|---|---|---|---|
| | | and compliance fee | to site | |
| VentureFounders ( www.startupcrowdfunding.com/platforms/venturefounders ) | Aug 2013 | 6% on funds raised; 3% mentoring fee for 3 years of support plus fixed-sum one-off legal fee | Subjective selection criteria applied to UK businesses seeking to raise £150,000 to £2 million | In-person meeting followed by interactive Q&A with investors throughout a 90-day campaign |

You can find a complete list of crowdfunding sites in a directory that's produced by Nesta, at www.nesta.org.uk/crowdfunding , and at the UK Crowdfunding Association website at www.ukcfa.org.uk .

TIP Is crowdfunding right for you? Answer these questions to find out:

- Would customers pay in advance for your product or service?
- Can you offer incentives?
- Do you have good communication skills for video or presentations?
- Can you drive people towards your offer through marketing and partnership activity?
- Does the three months or more that this requires fit in with your plans?

If your answers are 'yes', crowdfunding donations may be a way for you to fund a new product or service.

### *Reward-based crowdfunding*

The best and cheapest money comes from your customers. Thousands of businesses each year make incentivised offers on crowdfunding sites. You can offer goods, services and special deals in return for contributions. It's an increasingly popular way to raise small sums of working capital for your new businesses or to develop new products for your going concern.

Gyms use donation sites to offer reduced-cost memberships to fundraise for new equipment. Product developers offer discounts on advance orders. Musicians raise cash for equipment by offering free tickets and a chance to meet the band. You essentially get your customers to help with your funding campaign.

For service businesses, consulting companies, and small manufacturers and creative companies, this is a particularly useful way to secure funds during the start-up phase because it involves low outgoings and payments before work commences, and the campaign helps to build a customer base.

### *Equity-based crowdfunding*

Some crowdfunding sites help you to raise funds in exchange for equity. Investors put their money into your business in exchange for receiving a share in it, and you open up your market to a new audience, as well as hopefully receiving a fresh injection of contacts and some guidance from your new investors.

WARNING According to Nesta's Understanding Alternative Finance report ( www.nesta.org.uk/sites/default/files/understanding-alternative-finance-2014.pdf ), it takes, on average, 125 investors to fund an equity deal. We know clients who wound up with 486 investors, which has an impact on your next round of funding, for better or for worse. If your next round is early-stage venture capital, for example, be aware that VCs may not want to deal with the aftermath of a crowdfunding campaign – cleaning up or clearing out those hundreds of people. Do your homework before you post your campaign.

TIP Some platforms use a *special purpose vehicle* , which is a separate legal entity formed to house all the shareholdings with one single representative, for aggregating investors. Seedrs is one example.

As with reward-based sites, you'll be expected to produce a pitch video and to mount a fairly aggressive public relations or PR campaign, so take into consideration the amount of time, money and effort this involves.

# *Looking at Differences in Digital Funding*

In 2014, the Financial Conduct Authority (FCA) defined its stance for 'lend to save' (also known as P2P lenders), putting strict systems in place to protect all parties. The online equity-based crowdfunders (refer to the preceding section) also fall under the FCA's guidelines, helping to protect consumers using such platforms. FCA guidelines also protect some of the digital lending platforms that don't ask for security, that are funding aggregators – so not direct lenders – or that are lenders themselves and fall under FCA rules.

## *Considering the risks*

As with any platform, it pays to do your homework and know what the business model is, who you're actually borrowing the money from, what the penalties for late payment are and what the real cost of the money is.

REMEMBER You have no guarantee that your business will get approval to receive funding, so it's best not to be too cocky and to think that it's a done deal, especially if you're going for a lower amount (say £50,000), which may be done entirely on the platform and not require any human interaction, and so provide no opportunity for you to plead your case.

If you have tight timeframes and are relying on this money, you may want to consider seeking advice from a professional who helps in the preparation of these online applications, helping you to get it right the first time.

TIP Loan funding agreements, be they large or small, all have some things in common, and one is small print. Be sure you read it so you know what you're signing. What happens if you default on the loan? What are you promising? What's the repayment schedule? What happens to the debt if you leave the business or you exit the business in a trade sale? Ask all the same things you'd ask if you went into a bank to get a loan. You can easily forget to find out basic information if you're doing an online application.

## *Living with the higher costs*

In exchange for a potentially ten-minute decision on your loan, you may be paying a higher percentage of interest than you'd have to elsewhere. You may be making repayments every day, every week or every month. It's very easy to ignore these important things when you're desperate for the money.

WARNING Once you have the money, assuming you're lucky enough to get it, keep in mind what you borrowed it for in the first place. You had a need and a gap, so don't go spending it frivolously or all at once, and make any necessary changes in your business to strengthen your financial position. If you blow it all at once, you still need to pay it back – your liability doesn't go away overnight.

Table 5-3 shows some major players in the digital lending field, the services they provide, how much money they offer and the requirements they demand.

### TABLE 5-3 Key Unsecured Digital Lenders

| *Provider (URL)* | *Services* | *Amount* | *Criteria* |
|---|---|---|---|
| Boost Capital ( www.boostcapital.co.uk ) | Small business loan programme for business owners predominantly in the service industry; funds received within 5 days | £3,000 to £500,000 | Trading for at least 9 months; positive daily bank balance; acceptable credit; no excessive tax liens, open judgements or bankruptcies |
| Ezbob ( www.ezbob.com ) | Financing through a web portal for small to medium businesses in as little as 10 minutes | Up to £120,000 | Over 18 years old; UK-registered company; valid business debit card; application submitted by director/owner/partner; minimum annual turnover of £10,000; 12 months registered as a UK business |
| Funding Circle ( www.fundingcircle.com ) | Government-backed lending alongside thousands of private individuals and institutions within about a week | £5,000 to £1 million | Annual turnover of at least £50,000; at least 2 years of filed accounts; for limited companies, non-limited companies, LLPs, sole traders or partnerships |
| FundingKnight ( www.fundingknight.com ) | Matches investors and selected British businesses via an online platform, alongside thousands of private individuals and institutions | £25,000 to £1 million | Trading for 2 years with at least 1 year of filed accounts including P&L and balance sheet; 12-month cash-flow forecast; schedule of all other loans; copies of last 3 bank statements; statements of assets & liabilities |
| TradeRiver Finance ( www.traderiverfinance.com ) | Releasing working capital to businesses | Typical limit of £100,000 | Business registered in UK; at least 2 years of trading history; creditworthy; revenue exceeds £500,000 |
| UK Bond Network ( www.ukbondnetwork.com ) | Delivering bespoke financing options over a term of between 1 and 3 years via a unique bond auction platform | £500,000 to £4 million | No minimum trading period; no minimum asset cover; no minimum revenues; security preferred but personal guarantees not necessary; issuers can be private as well as listed companies |

# Chapter 6

# Becoming a Great Manager

**IN THIS CHAPTER**

**Seeing why you need a team and how to build one**

**Providing coaching and training**

**Taking stock of performance**

**Developing the right leadership style**

**Measuring the level of morale**

In business, one of the simplest profit calculations is profit per employee. Until you become a massive company with more than 500 employees, each employee you add increases your profit. Still, you needn't worry too much about what happens when you have 500 employees on your hands. Well, not in this book, anyway.

But employees aren't a trouble-free resource. To maximise the employee–profit ratio, you have to manage your employees so that they produce quality work for you. You have to build them into teams, and lead and manage them to prepare them for the roller-coaster life of change that is the inevitable lot of a small, growing business.

In this chapter, you discover the tools you need to become a successful and effective manager.

## *Building a Team*

Teams are a powerful way to get superb results out of even the most average individual employees. With effective teamwork, a small firm can raise its efficiency levels to world-class standards. Some small firms have built their entire success around teams.

### *Identifying a successful team*

REMEMBER A group of people working together isn't necessarily a team. A successful sports team has the right number of players for the game, each with a clearly defined role. The team has a coach, to train and improve players' performances, and measurable goals to achieve in the shape of obvious competitors to beat. Contrast that with the situation that usually prevails in a typical small firm. The number of players is the number who turn up on a particular day, and few have specific roles to play. Some are trained and properly equipped, and some aren't. For the most part, the business's objectives aren't clearly explained to employees, nor are any performance-measuring tools disclosed. Most of the players in the home team are highly likely not even to know the name or characteristics of the enemy against whom they're competing.

Clearly, a successful sports team and a disorganised group of co-workers have little in common, but you can clearly see what you need to do to weld people at work into a team.

Successful teams have certain features in common. They all have:

- Strong and effective leadership
- Clear objectives
- Appropriate resources
- The ability to communicate freely throughout the organisation
- The authority to act quickly on decisions
- A good balance of team members, with complementary skills and talents
- Defined roles
- The ability to work collectively
- A size appropriate to the task

REMEMBER However talented the soloists are in a small business, in the end orchestras are what make enough noise to wake up slumbering customers and make them aware of your virtues as a supplier. But teams don't just happen. However neat the curricula vitae and however convincing the organisational chart, you can't just turn out a team-in-a-box. The presumption that people are naturally going to work together is usually a mistake. Chaos is more likely than teamwork.

## *Founding principles*

Successful teams share common principles, as outlined in the following list:

- **Balanced team roles:** Every team member must have a valuable team role. Experts in team behaviour such as Dr Meredith Belbin have identified the key team profiles that are essential if a team is to function well (you can find full details on Belbin's widely used team role evaluation system at www.belbin.com or by calling 01223 264975). Any one person may perform more than one of these roles. But if too many people are competing to perform one of the roles, or if one or more of these roles is neglected, the team is unbalanced. Its members then perform in much the same way as a car does when a cylinder misfires.
- **Shared vision and goal:** The team members must have ownership of their own measurable and clearly defined goals. This means involving the team in business planning. It also means keeping the communication channels open as the business grows. Those in the founding team knew clearly what they were trying to achieve and, because they probably shared an office, they shared information as they worked. But as the group gets larger and new people join, you have to help the informal communication systems work better. Briefing meetings, social events and bulletin boards are all ways to get teams together and keep them facing the right way.
- **Shared language:** To be a member of a business team, people have to have a reasonable grasp of the language of business. Extolling people to improve return on capital employed or reduce debtor days isn't much use if they have only the haziest notion of what those terms mean, why they matter or how they can influence the business's results. So you need to develop rounded

business skills across all the core team members through continuous training, development and coaching.
- **Compatible personalities:** Although having different team profiles is important, having a team who can get on with one another is equally vital. Team members have to be able to listen to and respect the others' ideas and views. They need to support and trust one another. They need to be able to accept conflict as a healthy reality and work through it to a successful outcome.
- **Good leadership:** First-class leadership is perhaps the most important characteristic that distinguishes winning teams from the also-rans. However good the constituent parts, without leadership a team rapidly disintegrates into a rabble bound by little but a pay cheque.

You can't just pick people and put them into teams because of their particular professional or job skills. If the team is to function effectively, its balance of behavioural styles has to mesh too.

## *Coaching and Training*

Coaching and training are two ways to help individuals and teams improve their performance:

- A *coach* is a skilled and experienced person who watches an individual or small group performing a task. The coach shows them individually how they can improve their performance. The emphasis is on personalised instruction.
- *Training* is usually a more formal process, where the trainer has a set agenda for the event based on the knowledge required by the trainees. Everyone being trained goes through much the same process, at the same time.

Small firms are notoriously bad at recognising the need for training of any type. Over 40 per cent of small firms devote only one day or less to staff training each year. Only 13 per cent invest five days or more in training. Amateur football teams spend more time in training than the average small firm, so the fact that few teams in that firm ever realise their true potential, or come anywhere near becoming professionals, is hardly surprising.

And yet all the evidence suggests that training pays a handsome and quick return.

REMEMBER The choices a small firm has for training are:

- **On-the-job coaching:** This is where people learn from someone more experienced about how a job should be done. The advantages are that this kind of coaching is free and involves no time away from work. It should also directly relate to an individual's training needs. However, the coaching is only as good as the coach, and if the coach is untrained you may end up simply replicating poor working standards.
- **In-house classroom training:** This is the most traditional and familiar form of training. Some, or all, of your employees gather in a 'classroom', either on your premises or in a local hotel. You hire in a trainer or use one of your own experienced staff. This method provides plenty of opportunity for group interaction, and the instructor can motivate the class and pay some attention to individual needs. The disadvantages, particularly if you hold the training away from

your premises, are that you incur large costs that are more to do with hospitality than training, and for a small firm, releasing a number of employees at the same time is time-consuming and difficult.

- **Public courses:** These are less expensive than running a training programme in a hotel. You can also select different courses for different employees and so tailor the training more precisely to their needs. However, most public courses are generic and the other attendees are more likely to come from big business or even the public sector, so much of what is covered may be of little direct relevance to your business. Quality can be patchy.
- **Interactive distance learning:** This kind of training can be delivered by a combination of traditional training materials, teleconferencing and the Internet, and email discussions. You miss out on the personal contact, but the costs are much lower than traditional training. Most of the learning programmes are aimed at larger firms, so some material may not be so relevant.
- **Off-the-shelf training programmes:** These come in packaged kits, which may consist of a training manual, a video and/or a CD-ROM. Once again, the cost is lower than for face-to-face training, but you miss out on a professional trainer's input.
- **College courses:** Many universities and business schools now offer programmes tailored to the needs of small firms. Professional instructors who understand the needs of small firms deliver these courses. They're relatively expensive, but can often be very effective.
- **Government initiatives:** Governments have an interest in encouraging training in small firms. As well as providing information on where their training schemes are being run, governments often provide training grants to help with the costs.

TIP To make sure that you get the best out of your training, follow these guidelines:

- Introduce a routine that ensures that all employees attending training are briefed at least a week beforehand on what to expect and what you expect of them.
- Ensure that all employees discuss with you or their manager or supervisor what they got out of the training programme – in particular, did it meet both their expectations? This should take place no later than a week after the programme.
- You or the manager need to check within a month, and then again at regular intervals, to see whether your employees' skills have improved, and that they're putting those skills into practice.

Evaluate the costs and financial benefits of your training and development plans, and use this information to help set next year's training budget.

TIP Courses are often delivered via MOOC (Massive Open Online Course) platforms. These courses are free for everyone, but some courses charge a fee for a verified certificate (you can still participate for free, however).

The two main MOOCs are:

- **Coursera** ( www.coursera.org ): Founded at Stanford in 2012, Coursera's mission is to 'provide universal access to the world's best education'. It is 'an education platform that partners with top universities and organisations worldwide, to offer courses online for anyone to take, for free'. Over a hundred universities offer lecture courses through Coursera, including Stanford, IE Business School, Yale, Princeton, Northwestern, Rutgers, Duke, Copenhagen, Tokyo, HEC Paris, Columbia and Ludwig-Maximilians-Universität München.

- **edX** (www.edx.org): Founded by the Massachusetts Institute of Technology (MIT) and Harvard University in May 2012, edX provides over 400 courses from universities including MIT, Harvard, Berkeley, Caltech, Georgetown, Paris-Sorbonne, Peking, IIT Bombay, Rice, Kyoto, Columbia, Australian National and Cornell. edX's goal is to 'offer the highest quality courses from institutions who share our commitment to excellence in teaching and learning'.

TIP Many other MOOC course providers (often universities) that participate in Coursera or edX programmes also run their own MOOCs through their websites. However, such offerings aren't easy to find. A better route to supplement MOOC lectures and courses is to use the Multimedia Educational Resource for Learning and Online Teaching (MERLOT; www.merlot.org – click on the 'Search Merlot' tab). The MERLOT project began in 1997 at the California State University Center for Distributed Learning. For budding students, the search facility is all you really need to know about.

# Appraising Performance

Appraising the performance of both teams and individuals isn't primarily concerned with blame, reward or praise. Its purpose is to develop people and help them to perform better and be able to achieve their career goals. The result of an appraisal is a personal development plan.

The appraisal process lies at the heart of assessing, improving and developing people's performance for the future of the business. However, for an appraisal to be an effective tool, everyone involved needs to approach it seriously and professionally. The appraisal has to be a discussion between people who work together, rather than simply a boss dictating to a subordinate. It should be an open, two-way discussion for which both the appraiser and appraisee prepare in advance.

REMEMBER The ground rules for successful appraisals are:

- It should be results-oriented. The appraisal interview starts with a review against objectives and finishes by setting objectives for the year to come.
- It sets intermediate goals and objectives for new staff, even if you can't realistically set final goals. For example, challenge new sales people to acquire product knowledge and visit all the key customers, leaving actual sales achievement objectives until later in the year.
- The appraisal discussion should be separate from salary review. A discussion about salary is unlikely to encourage people to be open and frank, but an appraisal must be both those things.

The salary review and the appraisal must be seen as different events and, if possible, carried out at different times of the year.

- The appraisal format is a narrative rather than consisting of tick boxes and ratings schedules. It covers a discussion of achievements, areas for improvement, overall performance, training and development, and career expectations.

TIP Allow plenty of time for each appraisal interview (one and a half hours on average). The setting should be free from interruptions and unthreatening.

Carry out appraisals at least once a year, with more regular quarterly reviews – you need to review new staff after three months. Some owner-managers question the necessity of a formal annual appraisal when they feel that they're already appraising their team informally on a day-to-day basis. That approach is rather like trying to assess a business by its daily trading figures rather than its annual profit and loss account. The changes in behaviour and performance you're trying to assess happen over a longer time span and may not be easy to see on a day-to-day basis. Also, your daily assessments are likely to be influenced by pressures and feelings on the day and may not reflect the true longer-term picture.

Use appraisals to identify training needs and incorporate any deficiencies into a personal or company-wide training plan.

TIP The Advisory, Conciliation and Arbitration Service (ACAS; `www.acas.org.uk`) has a number of free-to-use appraisal documents can help you manage staff – go to Tools and Resources → Useful templates for letters, forms and checklists → Managing staff.

# *Developing a Leadership Style*

Most large organisations have grown up according to basic management principles. If you started your business career working for a bigger firm, or your present managers worked in such enterprises, you know the scenario. Managers in these organisations plan, organise and control in a way that produces consistent if unexciting results. The formula worked remarkably well for much of the 20th century, when all a successful company had to do to prosper was more of the same. But management that's all about maintaining order and predictability is ill-equipped to deal with change, which is the order of the day in the 21st century. To cope with change effectively, you need to be a leader as well as a competent manager – and young businesses are in greater need of leaders than they are of managers, at the outset at least.

## *Understanding leadership*

Leadership and management aren't the same, although many businesspeople fail to make the distinction. The late management professor Peter Drucker summed up the difference between leaders and managers thus: 'A leader challenges the status quo; a manager accepts it.'

In a world where product life cycles are shrinking, new technologies have an ever shorter shelf life and customers demand faster delivery and higher quality, the leader's job increasingly means defining and inspiring change within a company. By setting a company's direction, communicating this to its workforce, motivating employees and taking a long-range perspective, a leader adapts the firm to whatever volatile environment it does business in. In short, leaders become the change masters in their own firms.

TIP

Leaders also have a significant effect on the financial performance of the business. A good leader can easily add 10 to 15 per cent to the bottom line, and extraordinary leaders can double profits. (For more information, see www.forbes.com/sites/jackzenger/2015/01/15/great-leaders-can-double-profits-research-shows/#6b4b0d7b37fe ).

## *Delegating*

Overwork is a common complaint of those running their own business. They never have enough time to think or plan. But if you don't make time to plan, you can never move forward.

Delegating some tasks eases the stress. *Delegation* is the art of getting things done your way by other people. Or as one entrepreneur succinctly put it, 'making other people happy to make you rich'.

Many owner-managers are unable to delegate, either because they draw comfort from sticking to routine tasks such as sending out invoices – rather than tackling new and unfamiliar ones such as keeping up on developments in the industry – or because they just don't know how to delegate. Either way, neither the business nor those in it can grow until delegation becomes the normal way to operate.

Delegating brings benefits to everyone involved in the process. Benefits for the boss include:

- **More time to achieve more today and to plan for the future:** In this way you can free up time to tackle high-value-added tasks such as recruitment and selection, or motivation.
- **Backup for emergencies and day-to-day tasks:** By delegating, you have a reserve of skilled people who can keep the business running profitably if you're not there. This can also give customers and financial backers the comfort of knowing that they aren't dealing with a one-person operation that would fall apart without you.

Benefits for employees include:

- **The opportunity to develop new skills:** Failing to delegate deprives employees of the opportunity to learn new skills and to grow themselves, and drives good employees, just the ones a growing organisation desperately needs, away in search of greater challenges. Employees who have assumed the responsibility for new tasks train their staff in the same way, so the organisation can grow and have in-depth management.
- **Greater involvement:** Research consistently shows that employees rank job satisfaction to be of equal or greater value than pay. Delegation encourages people to take ownership of their

decisions and increases their enthusiasm and initiative for their work, so they get more satisfaction from their work.

Benefits for the business are:

- **Efficiency improves** by allowing those closest to the problems and issues being faced to take the decisions in a timely manner.
- **Flexibility of operations increases** because several people are able to perform key tasks. In this way you can rotate and expand or contract teams and tasks to meet changing circumstances. Delegation also results in more people being prepared for promotion.

Delegation is a management process that you shouldn’t confuse with ‘dumping’, in which unpopular, difficult or tedious tasks are unceremoniously shoved onto the shoulders of the first person who comes to hand. To make delegation work successfully, adopt the following five-point plan:

1. **Decide what and what not to delegate.**

   The general questions for deciding what should be delegated are:

   - Can anyone else do or be trained to do the work to a satisfactory standard?
   - Is all the information necessary to carry out the task available to the person(s) to whom you’re planning to delegate the task?
   - Is the task largely operational rather than strategic?
   - Would delegating the task save you a reasonable amount of time?
   - Would some initial teething problems while the new person settles into the task cause undue problems? Delegation itself is a form of risk taking, so if you can’t deal with a few mistakes then delegation proves difficult.
   - Can someone other than you properly exercise direct control over the task?

   REMEMBER You can usually readily delegate any routine jobs, information gathering or assignments involving extensive detail or calculations. Tasks that are less easy to delegate include all confidential work, discipline, staff evaluation, and complex or sensitive issues.
2. **Decide to whom to delegate.**

   The factors to consider here are:

   - Who has the necessary skills?
   - Who could or should be groomed for future promotion?
   - Who’s most likely to respond well to the challenge?
   - Who’s most likely to be or continue to be a loyal employee?
   - Whose workload allows him to take on the task(s)?
3. **Communicate your decision.**

Approaches to consider here are:

- Discuss the task you propose to delegate one to one with the individual concerned.
- Confirm that he feels up to the task or agree on any necessary training, backup or extra resources.
- Set out clearly in writing the task broken down into its main components, including the measurable outcomes, the timescales and any other important factors.
- Allow time for the implications to sink in and then discuss with the person concerned how he proposes going about the task.
- Let others in the business know of your decision.

4. **Manage and evaluate.**

   TIP From the beginning, clearly establish set times to meet the person delegated to and review his performance. Make the intervals between these reviews short at first, lengthening the period when the person's performance is satisfactory. The secret of successful delegation is to follow up.

5. **Reward results.**

   REMEMBER Things that get measured get done and those that are rewarded get done over again. The reward need not be financial. Recognition or praise for a job well done is often more valuable to an ambitious person than money.

## *Evolving leadership styles for growth*

All businesses require leadership, but they don't require the same type or amount of leadership all the time. As with children, businesses don't grow seamlessly from being babies to adulthood. They pass through phases – infancy, adolescence, teenage years and so on. Businesses also move through phases if they're to grow successfully. Each of these phases is punctuated by a *crisis* , used in this sense to signify a dangerous opportunity.

Researchers have identified several distinctive phases in a firm's growth pattern, which provide an insight into the changes in organisational structure, strategy and behaviour that you need to move successfully on to the next phase of growth. The inability to recognise the phases of growth and to manage the transition through them is probably the single most important reason for most owner-managed firms failing to achieve their true potential, let alone their founder's dreams.

Typically, a business starts out taking on any customers it can get, operating informally with little management and few controls. The founder – who usually provides all the ideas, brings all the drive, makes all the decisions and signs the cheques – becomes overloaded with administrative detail and operational problems. Unless the founder can change the organisational structure, any further growth leaves the business more vulnerable. The crises of leadership, autonomy and control loom large.

Over time, the successful owner-manager tackles these crises and finds a clear focus, builds a first-class team, delegates key tasks, appraises performance, institutes control and reporting systems, and ensures that progress towards objectives is monitored and rewarded. The firm itself consistently delivers good results. There's no set time that each of these phases should last. A firm may take anything from three to ten years to reach the third phase of growth.

REMEMBER Each phase of growth calls for a different approach to leading the business. At times strong leadership is required; at others, a more consultative approach is appropriate. Some phases call for more systems and procedures, some for more co-operation between staff. Unfortunately, as the business gets bigger most founders try to run their business in much the same way as they did when it was small. They end up with a big small company, rather than the small big company that they require if they're to achieve successful growth. They believe that taking on another sales person, a few hundred square metres of space or another bank loan can solve the problems of growth. This approach is rather like suggesting that the transition from infancy to adulthood can be accomplished by nothing more significant than providing larger clothes.

## Managing change

The late professor Peter Drucker claimed that the first task of a leader is to define the company's mission. In a world in which product and service life cycles are shrinking, new technologies have ever shorter shelf lives and customers demand ever higher levels of both quality and innovation. Entrepreneurial leadership means inspiring change.

### Being flexible enough to change

In adapting the business to an increasingly volatile and competitive environment, the boss must become the change master in the firm. Small firms are usually better at handling change than big firms. A speedboat can always alter course faster than a supertanker. However, small firms often have to adapt to much more change than big established firms. Big firms usually define the standards in an industry, and the small firms have to scramble to keep up.

The turbulence created by changes in the economy can also create a wash that can sink small firms unless they can adapt and change quickly. Those small firms most able to adapt and change, and of course those who are most prepared, are most likely to survive and prosper during turbulent times.

But recognising the need for change falls a long way short of being able to implement it successfully. Few people like change, and even fewer can adapt to new circumstances quickly and without missing a heartbeat.

By definition, a small business seeking growth must be able to manage a fast rate of change. Entrepreneurs must see change as the norm and not as a temporary and unexpected disruption that goes away when conditions improve.

### *Planning for change*

Change management is a business process, like any other business process. Following a tried and proven procedure can improve your chances of getting it right more often. These four steps show how you can break down change management into its elements:

1. **Tell staff why change is necessary (or better still, help them to find out for themselves).**

   REMEMBER The benefits of change aren't always obvious. So spell them out in much the same way as you explain the benefits of your product or service to a prospective customer.

   Explaining the background to the changes you want to make helps people see the changes as an opportunity to be competitive rather than a threat to existing work practices.

   Better than just explaining is to encourage staff to look outside the business for themselves, identify potential problems and suggest their own solutions. Not only may they have great ideas for change – perhaps better than yours – but they may be more willing to take responsibility for making the changes succeed.

2. **Make the change manageable.**

   Even when people are dissatisfied with the present position and know exactly what needs to be done to improve things, the change may still not happen. The change may be just too big for anyone to handle. But if you break the change down into manageable bits, you can make it happen.

3. **Take a shared approach.**

   Involve people early on. Asking them to join you in managing change only at the implementation stage is too late to get their full co-operation. Give your key participants some say in shaping the change right from the start. This means that nobody feels that you're imposing the change and more brains are brought to bear on the problem.

   Individual resistance to change is a normal reaction. By understanding why people are resisting, you can help them to overcome their doubts and embrace the change. Try to anticipate the impact of the change on the people involved:

   - Get an overview of the forces at work, both in favour of and against the change.
   - Make a list of those most affected by the change. Put each person into one of four categories – no commitment; will let it happen if others want it; will help it happen; will make it happen.

TIP Examine how each person is likely to be affected by the change. Look at career prospects, working hours and conditions, team membership and so forth.

- Anticipate retraining. Often a fear of failing is the principal reason for people not trying something new.

Open, face-to-face communication is the backbone of successful change. It gets across the ‘why’ of change and allows people to face up to problems openly. It also builds confidence and clears up misunderstandings.

WARNING Open communication is vital, but announcing intended changes before you have some committed participants alongside you is a risky strategy.

4. **Reinforce individual and team identity.**

   People are more willing to accept change and to move from the known to the unknown if they have confidence in themselves and their boss. Confidence is most likely to exist where people have a high degree of self-esteem. Building up self-esteem involves laying stress on the positive rather than the negative aspects of each person’s contribution. Exhortations such as ‘you guys have had it too easy for too long’ are unlikely to do much for people when you’re faced with major competitive pressure.

   You need to emphasise the importance to the change project of each person, both as an individual and, where appropriate, as a team member. A positive, confident climate for change needs lots of reinforcement, such as the following ideas:

   - Reward achievement of new goals and achieving them quickly.
   - Highlight success stories and create as many winners as possible.
   - Hold social events to celebrate milestones.
   - Pay personal attention to those most affected by the change.

REMEMBER Change takes longer than you think. Most major changes make things worse before they make them better. More often than not, the immediate impact of change is a decrease in productivity, as people struggle to cope with new ways of working while they move up their own learning curve.

The doubters can gloat and even the change champions may waver. But the greatest danger now is pulling the plug on the plan and either adopting a new plan or reverting to the status quo.

To prevent this ‘disappointment’, you have to set realistic goals for the change period and anticipate and plan how to handle the time lag between change and results.

## Measuring Morale

How your employees feel about their jobs, their co-workers, the company, and you and other bosses has a direct effect on how well or poorly they do their jobs. You need to stay on top of morale issues to keep your business running smoothly.

The most reliable way to measure morale at work is to carry out an attitude survey. In a big company, one-to-one interviews and focus groups may accompany such surveys. But in a small firm that’s not really an option.

In much the same way as you may survey customers to find out how happy they are with your products and services, survey your employees to find out what they feel about their employment conditions. Attitude surveys provide an objective measure to counterbalance the more descriptive view that you can obtain from discussions and gossip. They also provide a useful way to see whether morale is getting better or worse over time.

You may decide to introduce attitude surveys because of a particular event, such as a number of key staff leaving at the same time or some other obvious problem. Change can upset morale and that can have a knock-on effect on business performance. But after you’ve started, keeping the practice up makes sense. At the very least surveying your employees demonstrates your concern, and at the best it gives you valuable pointers to raising morale, output and profits.

REMEMBER A word of warning: your attitude surveys are inevitably going to reveal two basic facts. The first is that everyone believes that they’re underpaid. The second is that everyone believes that communication is awful. Both these feelings are fairly normal and you can at least draw comfort from that.

Most people believe that they’re underpaid both by market standards and in relation to the effort they put in. They also believe that the gap between levels in the company is too great. This belief that they’re poorly rewarded exists irrespective of how much people are actually paid, or indeed how hard they work. If you ask them why they don’t leave, they tell you about loyalty to a small firm or perhaps, more flatteringly, loyalty to you.

Nearly all employees also believe that their boss knows a secret that directly affects them and that the boss isn’t willing to divulge. This may be about restructuring, moving, merging or outsourcing. This phenomenon happens at all levels. The shop floor believes that supervisors have secrets; supervisors believe that managers withhold crucial information on plans that involve them; and the remaining managers know that the directors are planning their future in secret. So they become convinced that a communication problem exists in the organisation because no one tells them what is *really* going on.

You have to take all the information from your employees into consideration when sizing up the situation, and not just the results of one attitude survey.

TIP HR-Survey ( www.hr-survey.com ) and CustomInsight ( www.custominsight.com ) provide fast, simple and easy-to-use software to carry out and analyse Human Resources surveys. They both have a range of sample surveys that you can see and try before you buy, which may just be enough to stimulate your thinking.

## INTRODUCING ATTITUDE SURVEYS

John Huggett, a young and abrasive entrepreneur, moved south from Yorkshire and bought up a small but seriously troubled engineering factory. The company employed 22 people and had shrunk over the years from more than 50. The business had suffered losses for over a year. But John succeeded brilliantly in solving the problems that had built up over the years.

In the process, by his own admission, he came close to committing murder – telephone directories and occasionally the telephone itself flew through the air. Those in the organisation perceived John – not unnaturally given his style and the rescue job he was attempting – as a fire-eating monster. No one saw the human behind the gruff exterior.

At that time this didn't matter. However, as the factory moved into a period of growth and expansion, John recognised that he and the management team needed to make a conscious effort to change towards a more consensual style of management. People didn't feel empowered and they weren't about to stick their necks out when the blood still ran from the walls. John stood up in front of the workforce and said, 'We're going to have a different management style, and we're going to change.' He introduced an attitude survey to take the temperature of the water and committed himself, in advance of the survey, to live by its results.

He and the management team have done just that, introducing exceptionally effective team briefings, management walkabouts and other consultative mechanisms. The workforce took time to be convinced, but they came greatly to respect John's integrity and open style.

# About the Authors

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Thousands of students have passed through Colin's start-up and business growth programmes, going on to run successful and thriving enterprises, and raising millions in new capital. He is on the board of several small businesses; is a University Academic Governor; and has served on the boards of public companies, venture capital funds, and on Government Task Forces.

**Paul Barrow** trained and qualified as a Chartered Accountant with Deloitte & Touche before obtaining his MBA at Bradford University. As a senior consultant with Ernst & Young, he was responsible for managing and delivering quality consulting assignments. During the mid-1980s, he was Investment Review Director for a UK venture capital business.

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