

ENTREPRENEURSHIP AND BUSINESS DEVELOPMENT

QCF Level 5 Unit

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Introduction to the Study Manual

Welcome to the study manual for Entrepreneurship and Business Development.

The manual has been specially written to assist you in your studies for this QCF Level 5 Unit and is designed to meet the learning outcomes listed in the unit specification. As such, it provides thorough coverage of each subject area and guides you through the various topics you will need to study and understand. However, it is not intended to “stand alone” as the only source of information in studying the unit, and we have set out below some guidance on additional resources which you should use for help in preparing for the examination.

The syllabus from the unit specification is set out on the following pages. This has been approved at Level 5 within the UK's Qualifications and Credit Framework. You should read this syllabus carefully so that you are aware of the key elements of the unit – the learning outcomes and assessment criteria. The indicative content provides more detail to define the scope of the unit.

Following the unit specification is a breakdown of how the manual covers each of the learning outcomes and assessment criteria.

The main study material then follows in the form of a number of chapters as shown in the contents. Each of these chapters is concerned with one topic area and takes you through all of the key elements of that area, step by step. You should work carefully through each chapter in turn, tackling any questions or activities as they occur, and ensuring that you fully understand everything that has been covered, before moving on to the next chapter. You will also find it very helpful to use the additional resources (see below) to develop your understanding of each topic area when you have completed the chapter.

Additional resources

- ABE website – www.abeuk.com. You should ensure that you refer to the Members Area of the website from time to time for advice and guidance on studying and on preparing for the examination. We shall be publishing articles which provide general guidance to all students and, where appropriate, also give specific information about particular units, including recommended reading and updates to the chapters themselves.
- Additional reading – it is important you do not rely solely on this manual to gain the information needed for the examination in this unit. You should, therefore, study some other books to help develop your understanding of the topics under consideration. The main books recommended to support this manual are listed on the ABE website and details of other additional reading may also be published there from time to time.
- Newspapers – you should get into the habit of reading the business section of a good quality newspaper on a regular basis to ensure that you keep up to date with any developments which may be relevant to the subjects in this unit. Most of the main

international daily newspapers and weekly or monthly business journals can also be accessed via the internet.

- Your college tutor – if you are studying through a college, you should use your tutors to help with any areas of the syllabus with which you are having difficulty. That is what they are there for! Do not be afraid to approach your tutor for this unit to seek clarification on any issue, as they want you to succeed in your studies.
- Your own personal experience – the ABE examinations are not just about learning lots of facts, concepts and ideas from the study manual and other books. They are also about how these are applied in the real world, and you should always think how the topics under consideration relate to your own work and to the situation in your workplace and others with which you are familiar. Using your own experiences in this way should help to develop your understanding, by appreciating the practical application and significance of what you read, and make your studies relevant to your personal development at work.

And finally ...

We hope you enjoy your studies and find them useful, not just for preparing for the examination, but also in understanding the modern world of business and enterprise, and in developing in your own job. We wish you every success in your studies for the examination for this unit.

The Association of Business Executives

July 2012

Unit Specification

The following syllabus – learning objectives, assessment criteria and indicative content – for this Level 5 unit has been approved by the Qualifications and Credit Framework.

Unit Title: Entrepreneurship and Business Development

Guided Learning Hours: 160

Level: Level 5

Number of Credits: 1

Learning Outcome 1

The learner will: Understand the concept of entrepreneurship and its close relationship with enterprise and owner-management.

Assessment Criteria

Indicative Content

The learner can:

1.1 Define and explain the terms: entrepreneurship, enterprise and owner-management.

1.1.1 What is entrepreneurship? Define and explain the meaning of entrepreneurship.

1.1.2 Identify the differences between entrepreneurs and owner-managers – growth objectives, strategic perspective and innovation.

1.1.3 Explain the tasks and roles of entrepreneurs.

1.2 Identify and discuss common and essential attributes of entrepreneurs and the various motives for creating a new business venture.

1.2.1 The characteristics of successful entrepreneurs – are entrepreneurs born or made?

- Trait theory: the big five personality dimensions – the need for achievement; the need for autonomy; the locus of control; a risk-taking propensity; and self-efficacy.
- Behaviour theory: entrepreneurship can be learned.
- Sociological factors: an entrepreneurial environment.

1.2.2 The “model” entrepreneur.

- Personal attributes: innovative, determined, external focus, team leader.

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- Technical skills: product/service knowledge, market/industry understanding.
 - Management competencies: marketing, finance, HRM.
 - Entrepreneurial management behaviour: opportunity identification, resource leveraging, networking, decision-making.

1.2.3 Entrepreneurial motives.

- Push (necessity-based) motives vs pull (opportunity-based motives).
 - Personal/lifestyle motives.
 - Desire for growth.
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Learning Outcome 2

The learner will: Understand the nature of business development in the context of existing organisations and of new business start-ups.

Assessment Criteria

Indicative Content

The learner can:

2.1 Identify the varied forms of business development.

2.1.1 Business development involves evaluating a business and then realising its full potential using marketing, information management and customer service.

2.2 Identify business development strategies available to existing businesses.

2.2.1 The business development strategy is used to underpin the main business plan and it sets out a standard approach for developing new opportunities, either from within existing customer accounts or by proactively targeting brand new potential accounts and then working to close them.

The strategy should ask the following questions.

- **Who** does the firm target?
 - **What** does the firm want to sell?
 - **Where** are the customers?
 - **When** will they be approached?
 - **Which** are the appropriate target personnel?
 - **Why** would they want to meet with the firm?
 - **How** will they be reached?
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2.3 Identify approaches to the development of new businesses and start-ups.

2.3.1 Business development techniques include:

- intelligence gathering on customers and competitors
- generating leads for possible sales
- drafting and enforcing sales policies and processes
- follow-up sales activity

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- formal proposal and presentation management and writing
 - pitches and presentations
 - business model design
 - account planning and performance monitoring
 - proposition development and campaign development.
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2.4 Describe the challenges faced by small businesses in the development of their organisations.

2.4.1 Problems accessing complementary resources such as:

- finance
- marketing and distribution networks
- competitive suppliers and manufacturing capability
- complementary technologies
- services
- intellectual property rights.

2.4.2 SMEs may have to consider outsourcing, strategic alliances and licensing to overcome these resource shortages.

2.5 Explain the range of services to assist in the start-up and development of a new business which are available through the public, private and voluntary sectors and also the peer support available.

2.5.1 Entrepreneurial networks – direct and indirect.

- Family and friends.
- Chambers of commerce: www.britishchambers.org.uk
- Federation of Small Businesses: www.fsb.org.uk
- Online networks.
- Professional networking organisations (BNI Europe): www.bni-europe.com

2.5.2 Government organisations such as Business Link/Local Enterprise Partnerships (LEPs). Services include developing an awareness of:

- Companies Act
- Finance Acts
- health and safety
- trading regulations
- data protection
- employment rights
- insurance.

2.5.3 Appropriate information services.

2.5.4 The legal requirements specific to each business.

2.5.5 The skills, knowledge and attributes needed in a successful small business.

2.5.6 The legal framework within which recruitment, selection and employment take place.

2.5.7 Key employment legislation and the personal responsibility of an employer.

2.5.8 Employees' rights, including terms and conditions of employment.

2.5.9 Health and safety at work responsibilities.

Learning Outcome 3

The learner will: Understand the concepts of innovation and creativity and the roles that both play in entrepreneurship and business development.

Assessment Criteria Indicative Content

The learner can:

3.1 Define and explain the terms: innovation and creativity.	3.1.1 Creativity – new ideas and new sources of knowledge. 3.1.2 Innovation – the commercialisation (monetisation) of new ideas in the form of new products/services, processes and/or new business/marketing models.
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3.2 Identify and discuss examples of innovation.	3.2.1 Joseph Schumpeter's five types of innovation. <ol style="list-style-type: none"> 1) New products or services. 2) New methods of production (process). 3) Developing new markets. 4) Identifying new sources of supply. 5) New forms of organisation.
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	3.2.2 Approaches to innovation. <ul style="list-style-type: none"> • Radical innovation. • Incremental innovation. • Technology push or market pull.
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3.3 Explain the processes of opportunity scouting and idea generation.	3.3.1 Peter Drucker's seven key sources of ideas. <ol style="list-style-type: none"> 1) Unexpected happenings. 2) Incongruous happenings. 3) A need for process improvements. 4) Changes in industry or market structure. 5) Demographics. 6) Changes in perception, mood and meaning. 7) New knowledge.
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	3.3.2 Scanning the external environment for "windows" of opportunity – the macro (STEEP) and micro competitive environments.
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	3.3.3 Open-source innovation – user (customer) generated ideas (unmet needs).
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3.3.4 Internal processes: brainstorming, quality circles, focus groups, project teams, suggestion boxes, etc.

3.4 Appraise selected examples of creativity in the marketplace, evaluating its role in successful entrepreneurship.

3.4.1 Discuss the role of creativity and innovation in achieving competitive advantage.

3.4.2 Explore the Four Ps of innovation space.

- 1) Position (marketing and business model innovation).
 - 2) Paradigm (mental model) – changing perceptions.
 - 3) Process innovation.
 - 4) Product/service innovation.
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3.5 Discuss the role of creativity and innovation in the development of existing businesses.

3.5.1 The small business life cycle stages: concept/test, develop or abort, growth or decline, maturity, re-growth or decline.

3.5.2 The stages of the innovation life cycle model: fluid, transitional and specific.

Learning Outcome 4

The learner will: Understand the importance of research and information in a successful business.

Assessment Criteria	Indicative Content
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The learner can:

4.1 Identify the critical nature of information in business success.

4.1.1 Knowledge of, and the ability to predict, market growth.

4.1.2 The provision of management information to make informed decisions.

4.1.3 The production of competitor intelligence.

4.1.4 Understanding of the regulatory environment.

4.1.5 Source information to test new product.

4.2 Discuss the role of SWOT analysis in the context of developing business plans.

4.2.1 SWOT and its role as an analytical tool that enables the organisation to evaluate the strengths and weaknesses of its internal resources and capabilities in relation to competitor firms and the external opportunities and threats this represents. This will determine the level of strategic fit or drift.

4.3 Explain how PESTLE analysis enables understanding of key issues and pressures in the internal and external business environment.	4.3.1 Scanning the external environment for “windows” of opportunity (trends and changes). 4.3.2 Positioning the business to respond to political, economic, social, technological, legal and environmental change.
4.4 Identify and describe common market research (MR) techniques used by businesses including the use of primary and secondary data, analysis of competitor and customer data, and the use of support from external MR consultancies.	4.4.1 Define and give examples of quantitative research. 4.4.2 Define and give examples of qualitative research. 4.4.3 Explain the key advantages and disadvantages of primary and secondary research. 4.4.4 Identify sources for primary and secondary data. <ul style="list-style-type: none"> • Secondary sources: internal records, personal contact networks, trade associations, chambers of commerce, competitors. • Primary sources: surveys and questionnaires, face-to-face interviews, telephone surveys, mail questionnaires, omnibus surveys, focus groups, observation and geo-demographic databases.
4.5 Critically appraise the usefulness and validity of published research in addressing business questions.	4.5.1 Published research can help to reduce bias. 4.5.2 Published research is cheaper and quicker than primary research. 4.5.3 Published research tends to be historic in nature and, therefore, often out of date. 4.5.4 Not all published research is accurate or suitable for benchmarking purposes. 4.5.5 Useful published resources include Mintel, Key Note and the National Census data.
4.6 Discuss the reliability of research including the issues of sufficiency of sample size and sample and interview bias.	4.6.1 Sampling techniques. <ul style="list-style-type: none"> • Sampling frame. • Random sample. • Probability sample. • Quota sample. • Stratified sample.

4.6.2 The advantages and disadvantages of each sampling technique. Interview techniques and sources of bias: sampling bias, interviewer bias.

4.7 Identify the research challenges faced by small businesses.

4.7.1 Insufficient resources – executive time and manpower.

4.7.2 Lack of knowledge and skills.

4.7.3 Prohibitive cost of accessing published research sources.

Learning Outcome 5

The learner will: Understand regulatory frameworks affecting the entrepreneur and small business owner.

Assessment Criteria Indicative Content

The learner can:

5.1 Explain the relevant regulations for the entrepreneur under the Data Protection Act (UK) – or similar elsewhere.

5.1.1 The eight principles of data protection.

- 1) Personal data shall be processed fairly and lawfully and, in particular, shall not be processed unless:
 - (a) at least one of the conditions in Schedule 2 of the Data Protection Act is met; and
 - (b) in the case of sensitive personal data, at least one of the conditions in Schedule 3 is also met.
 - 2) Personal data shall be obtained only for one or more specified and lawful purposes, and shall not be further processed in any manner incompatible with that purpose or those purposes.
 - 3) Personal data shall be adequate, relevant and not excessive in relation to the purpose or purposes for which they are processed.
 - 4) Personal data shall be accurate and, where necessary, kept up to date.
 - 5) Personal data processed for any purpose or purposes shall not be kept for longer than is necessary for that purpose or those purposes.
 - 6) Personal data shall be processed in accordance with the rights of data subjects under this Act.
 - 7) Appropriate technical and organisational measures shall be taken against unauthorised or unlawful processing of personal data and against accidental loss or destruction of, or damage to, personal data.
 - 8) Personal data shall not be transferred to a country or territory outside the European Economic Area unless that country or territory ensures an adequate level of protection for the rights and freedoms of data subjects in relation to the processing of personal data. Data Protection Act – Law: www.ico.gov.uk
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5.2 Identify relevant aspects of accountancy regulations and their impact upon start-up procedures.	<p>5.2.1 Explain the process of registering a company in the UK.</p> <p>5.2.2 Explain Companies House requirements.</p> <p>5.2.3 Overview of sole trader, partnership and limited company.</p> <p>5.2.4 Overview of legislation relevant to company directors.</p> <p>5.2.5 Discuss the legal and constitutional position of directors.</p> <p>5.2.6 Explain agency powers of directors and employees in making contracts.</p> <p>5.2.7 Discuss fiduciary duties and the avoidance of conflicts of interest.</p> <p>5.2.8 Develop an awareness of the Companies Act and Finance Acts.</p>
5.3 Describe the requirements necessary to conform to the relevant Advertising Standards code of conduct.	<p>5.3.1 The Advertising Codes contain wide-ranging rules designed to ensure that advertising does not mislead, harm or offend. Adverts must also be socially responsible and prepared in line with the principles of fair competition. These broad principles apply regardless of the product being advertised.</p> <p>5.3.2 In addition, the Codes contain specific rules for certain products and marketing techniques. These include rules for alcoholic drinks, health and beauty claims, children, medicines, financial products, environmental claims, gambling, direct marketing and prize promotions. These rules add an extra layer of consumer protection on top of consumer protection law and aim to ensure that UK advertising is responsible.</p> <p>5.3.3 The Advertising Standards Authority (ASA) administers the rules in the spirit as well as the letter, making it almost impossible for advertisers to find loopholes or “get off on a technicality”. This common sense approach takes into account the nature of the product being advertised, the media used, and the audience being targeted.</p> <p>5.3.4 The Advertising Codes consist of two types, which are “non-broadcast” and “broadcast”. ASA – Code of Conduct: www.asa.org.uk</p>
5.4 Explain the implications of the Market Research	<p>5.4.1 The principles of the MRS Code.</p> <ul style="list-style-type: none"> • Researchers shall ensure that participation in their activities is based on voluntary informed consent.

Society (MRS) Code of Conduct.

- Researchers shall be straightforward and honest in all their professional and business relationships.
- Researchers shall be transparent as to the subject and purpose of data collection.
- Researchers shall respect the confidentiality of information collected in their professional activities.
- Researchers shall respect the rights and well-being of all individuals.
- Researchers shall ensure that respondents are not harmed or adversely affected by their professional activities.
- Researchers shall balance the needs of individuals, clients and their professional activities.
- Researchers shall exercise independent professional judgement in the design, conduct and reporting of their professional activities.
- Researchers shall ensure that their professional activities are conducted by persons with appropriate training, qualifications and experience.
- Researchers shall protect the reputation and integrity of the profession.

5.4.2 See Market Research Society – Code of Conduct:
www.mrs.org.uk

5.5 Discuss legal risk in new business start-ups.

5.5.1 Unlimited liability firms.

- Sole trader.
- Partnership.

5.5.2 Limited liability firms.

- Private limited liability (Ltd).
- Public limited liability (PLC).
- Limited liability partnership (LLP).

Learning Outcome 6

The learner will: Understand issues and decisions involved in financing and resourcing a business start-up and essential aspects of financial management.

Assessment Criteria	Indicative Content
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The learner can:

6.1 Explain how a business can effectively assess its start-up financing requirements, including how it might assess its

6.1.1 Start-up budget.

- Sales forecast.
- Fixed costs.
- Variable costs.

resource and premises needs.

6.2 Describe the sources of finance available to new businesses, and those in early development, and identify and describe potential solutions.

6.2.1 Personal finance.

- The entrepreneur's own capital.
- Retained profit.
- Informal investors (3Fs: family, fools and friends).
- Internal capital networks (Asian companies investing in one another).

6.2.2 Commercial finance.

- Overdrafts, loans and credit cards.
- Leasing and hire purchase.
- Factoring and invoice discounting.
- Supplier funding.
- Export Credits Guarantee Department (ECGD) funding for exports.

6.2.3 Public finance, government grants, i.e. Small Firms Loan Guarantee Scheme.

6.3 Discuss common financial difficulties experienced by new businesses and those in early development and identify and describe potential solutions, explaining the pros and cons of different types of finance available.

6.3.1 The two key problems facing start-up businesses are lack of funding and cash flow problems.

6.3.2 The solutions include:

- personal finance (and friends) – cheap, accessible but involves personal relationships and repayment
 - bank overdraft – quick and relatively cheap. Interest only on balance but repayable on demand
 - term loans – longer term, fixed rate of interest allowable, cannot be withdrawn but secured on assets, can be expensive and repayment of capital required
 - Small Firms Loan Guarantee Scheme – useful when no adequate security but once only arrangement fees
 - hire purchase and leasing – tax treatment and interest allowable, the asset is the only security but you cannot sell the asset
 - suppliers – delayed payment is cheap but may damage supplier relations
 - factoring, invoice discounting, stock finance – assign current assets as security for a loan but may create an impression of financial distress.
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6.4 Describe the key indicators of the financial health of a

6.4.1 The three financial statements.

- Cash flow statement.
 - Income and expenses statement (profit and loss
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business and how these can be effectively monitored and acted upon.	<p>account).</p> <ul style="list-style-type: none"> • Statement of financial position (balance sheet). <p>6.4.2 Ratio analysis.</p> <p>6.4.3 Risk and sensitivity analysis.</p>
6.5 Describe key elements of financial management and control in a small business.	<p>6.5.1 Managing the working capital cycle.</p> <ul style="list-style-type: none"> • Inventory turnover. • Credit control. • Cash flow management.
6.6 Describe pricing strategies available to the small business.	<p>6.6.1 Cost-based pricing: cost plus and mark-up pricing.</p> <p>6.6.2 Customer-based pricing: demand pricing.</p> <p>6.6.3 Competitor-based pricing: meet the competition; undercut the competition.</p>

Learning Outcome 7

The learner will: Understand the enterprise culture and the characteristics of different entrepreneurs.

Assessment Criteria	Indicative Content
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The learner can:

7.1 Define the enterprise culture in business and the pros and cons of developing such a culture.	<p>7.1.1 Being enterprising involves being prepared to take risks and to “think out of the box” in developing solutions to problems. The term “culture” refers to the typical way of behaving within an organisation or in society as a whole.</p> <p>7.1.2 An organisation with an enterprise culture is one where people are imaginative and creative, rather than being reluctant to take risks. Most successful UK businesses typify the enterprise culture. This applies to a range of small and large enterprises. In big companies, there is sometimes a danger that the organisation develops a structure that discourages enterprise. However, one way of getting round this has been to organise people into teams where they are encouraged to make decisions for themselves, providing they keep in line with the overall objectives and targets of the organisation as a whole.</p>
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7.1.3 Society as a whole can develop an enterprise culture. This involves moving away from a “dependency culture” where people continually expect others (often the Government) to sort out problems for them. An enterprise culture is made up of enterprising people who are prepared to challenge existing ways of doing things, and to come up with new ideas and solutions to the benefit of society as a whole.

7.1.4 A key problem of encouraging an enterprise culture is that an organisation may not have the same level of control over its employees and their actions, which can lead to poor decisions and performance and sometimes company failure due to the absence of key checks and balances.

7.2 Identify key attributes, decisions, business achievements, public personas and approaches to enterprise culture that have defined prominent entrepreneurs, and their effects upon the business, using examples.

7.2.1 People are encouraged to have ideas. Good ideas can come from anyone in the organisation. Set up systems so that people can easily put forward ideas. If there are suggestions that are taken up, ensure the person who originated the idea is recognised in some way. Don't restrict this to having ideas for goods or services; encourage people to think about their work environment, customer service, team building and other areas of the business, so that they get into the habit of making suggestions and seeing them implemented.

Build on this by setting up regular ideas meetings or creative forums that bring people together from different parts of the organisation for brainstorming sessions.

7.2.2 People work in teams. By working together, groups of people have more to offer than lone individuals. They will have complementary skills that may need to be developed through training and practice.

7.2.3 People are given authority and freedom to try things.

In order to get people to come up with ideas and new ways of working that can save money or bring in new streams of income, you need to give them a degree of freedom to experiment. This means empowering staff with the authority to do so. This

demonstrates the trust management has in them and also allows them the space and time to try ideas out properly.

7.2.4 Success is celebrated. Regularly celebrate the organisation's achievements so that people feel they are part of a dynamic business and then they will want to contribute to it. Making a point of thanking them, they will feel recognised and they will be encouraged to continue to do so.

7.2.5 Communication is open and regular. People naturally want to talk about what they are doing and what they think is going on. So, it is important that information flows around the business – and not just from the top down. People should feel they can ask questions, explain what is and isn't working for them and have a clear understanding of the direction in which the business is going. Communication takes many forms – including memos, newsletters, emails, face-to-face meetings and telephone conversations.

7.2.6 Planning is at the heart of the organisation. Planning is the process of explaining what the organisation wants to achieve and how it is going to get there. This needs to be applied to every aspect of the work. By being clear about what everyone wants to achieve, everyone can work towards the same end. This will give the organisation focus and energy. It also helps to identify some of the potential barriers and problems.

7.2.7 Everyone has belief in the organisation. When competing with other organisations, including other businesses, the differentiation of the enterprise is that it has a social purpose, something that people can get behind and really believe in. This can generate a genuine feeling that your organisation is better and more worthwhile than the rest.

7.3 Describe the concept of intrapreneurship (or corporate entrepreneurship) and its effect upon the business.

7.3.1 Intrapreneurship is the practice of entrepreneurship in an established firm. Intrapreneurship applies the start-up style of management (characterised by flexibility, innovation, and risk-taking) to a secure and stable firm. The objective is to fast-track product development (by circumventing the bureaucracy) to take advantage of a new opportunity or to assess the feasibility of a new process or design.

7.4 Explain the factors which militate against an enterprise culture.	7.4.1 Micro-management and a blame culture.
	7.4.2 Aversion to risk and fear of change.
	7.4.3 External locus of control.
	7.4.4 Bureaucratic and hierarchical structures.
	7.4.5 Rigid functional boundaries.
	7.4.6 Strong division of labour.
	7.4.7 Formal procedures and policies.

7.5 Describe the processes involved in the development of competitive advantage.	7.5.1 Innovation process model.
	7.5.2 Incremental or radical innovation.
	7.5.3 Porter's Generic Strategies.
	7.5.4 Bowman's Strategy Clock.
	7.5.5 Push vs pull approach.
	7.5.6 Intellectual property protection versus speed to market.

7.6 Explain the role of information and communications technology (ICT) in supporting entrepreneurship and business development.	7.6.1 Maximising the use of the internet for marketing, purchasing, accounting/finance and operations purposes.
	7.6.2 Cloud computing.
	7.6.3 Website, PayPal, social networking, search engine optimisation (SEO).
	7.6.4 Software programmes – Sage, Enterprise Resource Planning (ERP) and Customer Relationship Management (CRM).

Assessment:

- Assessment method: written examination (unless otherwise stated).
- Written examinations are of three hours' duration.
- All learning outcomes will be assessed.

Recommended Reading:

Please refer to the Qualifications section of the ABE website (www.abeuk.com) for lists of recommended reading books.

Coverage of the Syllabus by the Manual

<i>Learning Outcomes</i>	<i>Assessment Criteria</i>	<i>Manual Chapters</i>
1. Understand the concept of entrepreneurship and its close relationship with enterprise and owner-management	1.1 Define and explain the terms: entrepreneurship, enterprise and owner-management 1.2 Identify and discuss common and essential attributes of entrepreneurs and the various motives for creating a new business venture	1 1
2. Understand the nature of business development in the context of existing organisations and of new business start-ups	2.1 Identify the varied forms of business development 2.2 Identify business development strategies available to existing businesses 2.3 Identify approaches to the development of new businesses and start-ups 2.4 Describe the challenges faced by small businesses in the development of their organisations 2.5 Explain the range of services to assist in the start-up and development of a new business which are available through the public, private and voluntary sectors and also the peer support available	3, 4, 5, 11 3, 4, 5, 11 3, 4, 5 1, 3, 4, 5, 7, 8, 9, 11 5, 7, 9
3. Understand the concepts of innovation and creativity and the roles that both play in entrepreneurship and business development	3.1 Define and explain the terms: innovation and creativity 3.2 Identify and discuss examples of innovation 3.3 Explain the processes of opportunity scouting and idea generation 3.4 Appraise selected examples of creativity in the marketplace, evaluating its role in successful entrepreneurship 3.5 Discuss the role of creativity and innovation in the development of existing businesses	2 2 2 2, 4, 5 1, 2 11
4. Understand the importance of research and information in a successful business	4.1 Identify the critical nature of information in business success 4.2 Discuss the role of SWOT analysis in the context of developing business plans 4.3 Explain how PESTLE analysis enables understanding of key issues and pressures in the internal and external business environment	3, 4, 5, 6, 9, 10, 11, 12 3, 5, 10, 11 10, 11

	<p>4.4 Identify and describe common market research (MR) techniques used by businesses including the use of primary and secondary data, analysis of competitor and customer data, and the use of support from external MR consultancies</p> <p>4.5 Critically appraise the usefulness and validity of published research in addressing business questions</p> <p>4.6 Discuss the reliability of research including the issues of sufficiency of sample size and sample and interview bias</p> <p>4.7 Identify the research challenges faced by small businesses</p>	<p>3, 4, 5</p> <p>4, 5</p> <p>4</p> <p>3, 4, 5</p>
5. Understand regulatory frameworks affecting the entrepreneur and small business owner	<p>5.1 Explain the relevant regulations for the entrepreneur under the Data Protection Act (UK) – or similar elsewhere</p> <p>5.2 Identify relevant aspects of accountancy regulations and their impact upon start-up procedures</p> <p>5.3 Describe the requirements necessary to conform to the relevant Advertising Standards code of conduct</p> <p>5.4 Explain the implications of the Market Research Society (MRS) Code of Conduct.</p> <p>5.5 Discuss legal risk in new business start-ups</p>	<p>9</p> <p>9</p> <p>9</p> <p>4, 9</p> <p>4, 9</p>
6. Understand issues and decisions involved in financing and resourcing a business start-up and essential aspects of financial management	<p>6.1 Explain how a business can effectively assess its start-up financing requirements, including how it might assess its resource and premises needs.</p> <p>6.2 Describe the sources of finance available to new businesses, and those in early development, and identify and describe potential solutions</p> <p>6.3 Discuss common financial difficulties experienced by new businesses and those in early development and identify and describe potential solutions, explaining the pros and cons of different types of finance available</p> <p>6.4 Describe the key indicators of the financial health of a business and how these can be effectively monitored and acted upon</p> <p>6.5 Describe key elements of financial management and control in a small</p>	<p>3, 4, 6,8</p> <p>2, 3, 6, 8, 11</p> <p>3, 6, 8</p> <p>8, 9, 11</p> <p>8</p>

	business 6.6 Describe pricing strategies available to the small business	3, 4, 8
7. Understand the enterprise culture and the characteristics of different entrepreneurs	7.1 Define the enterprise culture in business and the pros and cons of developing such a culture 7.2 Identify key attributes, decisions, business achievements, public personas and approaches to enterprise culture that have defined prominent entrepreneurs, and their effects upon the business, using examples 7.3 Describe the concept of intrapreneurship (or corporate entrepreneurship) and its effect upon the business 7.4 Explain the factors which militate against an enterprise culture 7.5 Describe the processes involved in the development of competitive advantage 7.6 Explain the role of information and communications technology (ICT) in supporting entrepreneurship and business development	1, 2 1 1 2, 4 2, 4, 5, 9, 11 5, 9

Chapter 1

Enterprise, Entrepreneurship and Small Business

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INTRODUCTION

“Entrepreneurship” is a word that has different meanings and connotations for different people and, interestingly, the group of people who probably care least about the meaning and understanding of the word are the real-life entrepreneurs themselves. They tend to be more concerned with actually doing what entrepreneurs do rather than with talking about it. However, the reason that theorists, politicians and economists labour over the definition is to try to understand the characteristics, motivations and thought processes that make these entrepreneurs so very important to economic growth and employment generation.

In addition to defining this term, this chapter will also enable the reader to understand what we mean by entrepreneurs, what differentiates them from other types of business people, and their motivations for what they do.

A. DEFINITIONS

Enterprise, Entrepreneurs and Entrepreneurship

There is much confusion around the use of these three terms, both in common language and in the technical understanding of the words which depends on whether you are using them in an economic context or in academic discussion. The economic approach is that “enterprise” is what entrepreneurs do by creating new businesses, jobs and wealth, all of which contribute to the economy. The academic approach is more precise and takes the view that not all firms are enterprising; those that are involve the use of imagination and creativity, generating new ideas, dealing flexibly with changing situations, taking responsibility and making decisions.

Enterprise is the term we generally apply to a small or medium-sized business. An enterprise can be a start-up, an early stage business or a fully developed business. It can be a lifestyle business, perhaps trading locally with no long-term plans for substantial growth, or it can be a business with high-growth potential that may one day evolve into a multi-national corporation. It can also be a social enterprise or not-for-profit business. Although the word can be used in the context of major companies or international organisations, this rarely happens as it tends to reflect a level of adventurous, opportunistic and risk-taking attitudes less typical of large organisations. However, the promotion and development of enterprise cultures in larger organisations is becoming much more common.

In common language, **entrepreneurs** are people who start enterprises or businesses (those who start social enterprises are known as **social entrepreneurs**). The more precise academic explanation differentiates between the “true” entrepreneurs who establish enterprises or develop new innovations with high-growth potential, and the **owner-managers** who operate more conventional businesses in localised areas, in low-growth markets, or as lifestyle businesses where stability and sustainability are the main objectives rather than growth. Entrepreneurs can often be differentiated from other business people by specific attitudes or characteristics (see Section D of this chapter).

There are also **serial entrepreneurs**, a particular sub-group of entrepreneurs who find a challenge in the process of creating and growing a new business and then selling it for a profit (or delegating its management to others). They then move on to create another new venture, often in a totally unrelated market.

The other type of entrepreneur is the one who demonstrates the entrepreneurial characteristics of innovation and creativity, dealing with challenges, spotting opportunities, and breaking down barriers to change in larger public and private sector organisations. We describe these as **intrapreneurs**. They thrive in more dynamic organisations and often act as the champions of developing enterprising cultures.

The term entrepreneur typifies an individual attitude of opportunity-spotting, and the creation and exploitation of business opportunities to create wealth – often with the implicit use of innovation, imagination and risk-taking. The entrepreneur creates and operates the enterprise, and in doing so displays the characteristic of **entrepreneurship**. However, too often the term has been used in the restricted context of new business start-up, particularly by academics and educationalists. As mentioned earlier, the people who tend to care least about academic definitions are the entrepreneurs themselves, who are just interested in getting on with the job. Entrepreneurship is also referred to as the process of growing and sustaining the business after the start-up stage, implying a broader definition. Furthermore, the definition attributed to Harvard Business School is that: “Entrepreneurship is the pursuit of opportunity beyond the resources you currently control”. This opens up scope for the word to be applied equally to non-profit social enterprises, and to intrapreneurship within large commercial and public sector organisations to reflect entrepreneurial behaviour amongst staff.

High-growth and Lifestyle Businesses

Businesses with potential for high-growth are very much in a minority, probably accounting for just 3-5% of all business start-ups, and they are frequently (but by no means always) based around technological or other innovations. The UK Government defines high-growth as growth in turnover of at least 20% per annum over three years, but that in itself is quite modest. It has been recognised for some years that the top 3% of growth companies will be the ones that create 95% of new employment opportunities in the economy. Between 2003 and 2011, the South-East England Development Agency (one of the UK's former Regional Development Agencies) developed a network of 16 Enterprise Hubs across 22 locations to support early stage businesses with high-growth potential. These were defined in terms of both growth in turnover (25-50% per annum) and scalability – being capable of trading nationally within one to two years of start-up and internationally within two to four years. Some (but not all) high-growth businesses operate on growth markets; other develop new and innovative products and services for conventional markets where their products create a niche or competitive advantage.

In contrast, lifestyle businesses typically operate on a more local level, or within one country, although as shown in the definition of small and medium-sized enterprises in the next section of this chapter, some 23% of small businesses do export. Some of them start out as having growth potential but never fulfil it (although they still make very good profitable businesses). The reasons for that may be the strength of competition or a lack of investment funding. Quite frequently, though, it is a positive decision on the part of the owners not to grow beyond a certain size, perhaps because they have achieved a

comfortable, profitable and stress-free lifestyle and would rather retain this than attempt to achieve further growth.

Entrepreneurs operating high-growth businesses will usually be more strategically focused than owner-managers, and will have defined growth objectives. They are also likely to have shorter-term exit strategies (e.g. trade sales or stock market flotation). Owner-managers of lifestyle businesses, on the other hand, may have deliberately chosen a low-growth strategy, and may have a longer-term exit strategy. This strategy is more likely to be based on the sale of the business when they reach retirement age, or perhaps passing the business on to a younger member of the family. It is also claimed that entrepreneurs are change agents with strong unique selling points (USPs) whereas owner-managers do not innovate; however, there are many innovative owner-managers around but their innovations may be targeting smaller niche markets, or may be based around service improvement to customers rather than the invention of new high-tech products.

One other key difference between lifestyle and high-growth businesses is in the financing of the business. Lifestyle firms will usually raise their investment funding from a combination of friends, family, local banks and possibly small business angel investments. In contrast, the high-growth firms may require a series of funding stages: perhaps research and development grants and proof of concept funding to take them up to the patent protection stage for a new product; followed by pre-market funds to launch the product and subsequent seed funding to grow the market; followed by major venture capital investment to break into large international markets.

Small and Medium-sized Enterprises

Before the 1970s, the small business sector did not really register on the political and economic radar and its significance in creating economic wealth and employment was overshadowed by traditional heavy manufacturing industry. With the demise of manufacturing and growth of the service sector in the 1970s and 1980s, awareness of the significance of small and medium-sized enterprises (SMEs) began to grow rapidly.

The original attempts to define and understand the term SME were quite haphazard. A report commissioned by the UK Government in 1971 (the Bolton Committee Report) attempted to define the sizes of small firms across a number of key industries. For example, a "small" manufacturing firm had fewer than 200 members of staff whereas small mines and quarries had only 25 or fewer. In the motor trade, a small firm had a turnover of under £100,000 but in the wholesale trade the turnover was £200,000. Small transport firms had fewer than five vehicles, and catering businesses were small so long as they were not multiple outlets or managed by a brewery. With such vague definitions, it was not surprising that the UK Government had no clear or positive policies to support small firms, although the New Enterprise Programme of the 1970s was the first, albeit unsatisfactory, attempt to support small firms by encouraging them to undertake training and development to improve their staff and management skills.

With the demise of the larger manufacturing organisations by the 1990s, SMEs came to be regarded as the main alternative source of employment, particularly when larger organisations began to shed staff, and the skilled workers looked to use their redundancy packages to create opportunities in self-employment. As a result, the small firms sector grew in importance to politicians as a potential solution which could help to reduce the politically sensitive high and rising levels of unemployment. By 1998, it was estimated that there were 3.75 million small firms providing 7.7 million jobs, and that of all UK firms, 84%

had fewer than ten members of staff, and 89% had fewer than five; by 1998, 96% of all UK firms employed fewer than 20 members of staff, growing to an officially recognised figure of 4.3 million in 2004.

One problem that persisted was the lack of clarity about the exact definition of an SME. The UK government Department of Trade and Industry definition was that it had fewer than 250 employees or an annual turnover below £5million. This had the negative effect of prompting the assumption that the needs of a new small firm with just five to ten staff are similar to, or just a scaled down version of, those of a firm employing 200 staff that may have been established for 20 or 30 years. With the current high value of new technology, and the emergence of more high-growth innovative new firms, very small firms with just a handful of staff can be involved in high-value contracts exceeding £5-10million, whilst other much “larger” businesses, employing substantial numbers of unskilled staff on low-paid, labour-intensive work, can have a turnover well below that figure.

In that context, annual sales turnover has become largely irrelevant in the definition of SMEs. It makes much more sense to sub-divide the SME sector, for example into micro-firms, with fewer than ten full-time equivalent (FTE) staff; small firms, with 11 to 50 FTE staff; and medium-sized firms with 51 to 100 FTE staff. In effect, most firms with 100 to 250 staff are relatively large and well-established these days, and certainly tend to employ the necessary specialist management skills that are usually found in larger companies.

The distribution of the different sized SMEs is also an issue. In rural areas, there are few businesses in the 100 to 250 employee bracket, and frequently over 98% are micro-firms which provide the bulk of potential local employment.

Another issue is how best to identify and focus limited amounts of government resources on those SMEs that could create the largest number of new jobs – the 5% of start-ups with innovative high-growth potential that will generate 95% of new jobs and capital wealth. On this basis, the current government definitions certainly need to be refined to focus business support funding into the parts of the small firms sector which are likely to produce the most long-term growth and potential employment.

In 2003, in what many critics would regard as a rare example of common sense, the European Union (EU) came up with a framework definition of SMEs that would achieve general acceptance and credibility. A micro-firm is defined as having ten or fewer staff, a turnover of no more than 2 million Euros, and an annual balance sheet total of no more than 2 million Euros. A small firm has a maximum of 50 staff, 10 million Euros of turnover, and 10 million Euros on its balance sheet. A medium-sized firm will have no more than 250 staff, a turnover of no more than 50 million Euros, and a balance sheet not exceeding 43 million Euros. Whilst these definitions have been accepted across Europe, two issues arise. First, with quite widely varying inflation rates amongst the EU member states, and even between members of the Eurozone, it will be interesting to see how the thresholds are adjusted as time goes on. Second and more important, the new definitions still do not overcome the fact that a medium-sized firm with 51 staff and 10 million Euros in turnover will be substantially different in terms of management skills and structure, access to resources, market influence etc, than a firm with 249 staff and a turnover of 50 million Euros. Those differences are exacerbated with the insistence of bankers, government agencies, politicians, academics and policy-makers of:

- lumping the three very different groups together and treating them as a homogeneous group called SMEs

- failing to distinguish between those lifestyle-based, non-growth micro-firms and those with the high-growth potential to create new jobs and wealth.

The UK Government's Department for Business, Innovation and Skills publishes an annual statistical survey of small and medium-sized businesses every year. The 2010 survey (available from www.bis.gov.uk by searching on "BIS Small Business Survey 2010") reveals some interesting data, as shown in Table 1.1.

Table 1.1: 2010 Survey of UK Small and Medium-sized Businesses

Legal Trading Status	All SME Employers	Micro-firms 1-9 Staff)	Small Firms (10-49 Staff)	Medium-sized Firms (50-249 Staff)
	2010 % (2007 %)	%	%	%
Private Limited Companies	59 (51)	56	73	72
Sole Traders	19 (29)	22	5	1
Partnerships	10 (16)	11	8	5
Private Companies Limited by Guarantee	3 (2)	2	5	6
Charities/Not-for-profit Companies	1 (0)	1	2	3
Public Limited Companies	2 (1)	2	3	4
Limited Liability Partnerships	2 (1)	1	2	5
Other – e.g. Trusts, Community Interest Companies	1 (≤0.5)	–	–	2
Mean Average Turnover	£1.156m	£0.606m	£1.424m	£7.5m

- Private limited companies are most likely to be found in manufacturing (73%), construction (76%) and business services sectors (69%).
- London SMEs include 65% of private limited companies, compared with 45% in Scotland, 51% in Wales, and 40% in Northern Ireland.
- 83% of UK SME employers are registered for Value Added Tax (VAT) (down from 85% in 2007).
- 62% of SME employers are family-owned businesses (69% in 2007).
- 14% of SME employers are female-led (no change since 2007), although the figure was 32% in the service sector.
- 17% of SMEs employed more staff than 12 months ago, 21% employed fewer, and 61% employed the same number. (This only adds up to 99%, presumably due to rounding.)
- 28% of all SME employers reported a greater turnover than one month ago, 34% reported no change, and 33% reported lower turnover.
- 71% of SMEs reported a profit or surplus in 2010, including 71% of micro-firms, 72% of small firms, and 81% of medium-sized firms.
- 24% of SMEs reported losses in 2010, including 24% of micro-firms, 23% of small firms, and 16% of medium-sized firms.
- 52% of all firms reported their intention to develop new products or services over the next two to three years.
- 75% of all firms reported their intention to increase turnover by entering new markets in the next two to three years.
- Innovation – 47% of all firms had introduced new or improved products or services during the preceding 12 months.
- 23% of all firms sold goods or services, or licensed products outside of the UK in the previous 12 months – broken down into 21% of micro-firms, 29% of small firms, and 40% of medium-sized firms.

One of the biggest differences between the various sizes of SME lies in their attitudes to training. Traditionally, the uptake of business and management training by small and micro-firms has been low, with staff from those companies often paying their own fees, unlike larger organisations which are more likely to have staff training budgets. The majority of management training provision by academic institutions has been focused on the corporate needs of larger businesses and organisations, which shows a failure to understand that a) small firms are not simply scaled-down versions of large firms, and b) that small firms (and in particular owner-managers of lifestyle businesses) need a breadth of practical business skills rather than a depth of knowledge of more specialist skills. The exception to the uptake of training in small firms is the relatively small proportion of high-growth start-ups and early stage businesses. The owners of these businesses are frequently well-educated individuals with a professional or technology-based background, who have come to understand that staff development is a key part of the process of achieving the high levels of business growth that they seek.

B. THE “MADE OR BORN” ARGUMENT

We will briefly examine the question: “are entrepreneurs made or born?” – our entrepreneurial equivalent of the “nature versus nurture” argument from educational psychology.

Entrepreneurs Are Born

The “entrepreneurs are born” side of the argument is based on instinctive creative, innovative and opportunity-spotting behaviour; the range of personality and character traits that go alongside it such as self-reliance, the need for esteem and self-actualisation (as per Maslow’s Hierarchy of Needs); and the hunter-gatherer instinct to provide for the family by creating wealth, etc.

- Entrepreneurship skills are inherently different from other business and management skills.
 - They are instinctive and inherent in certain people but absent in others (is there genetic proof of this?)
 - They cannot be learned or acquired but they can be developed and enhanced.
 - The extent to which they are present in a person may be influenced by their upbringing – e.g. a reaction to childhood poverty or deprivation, or a childhood spent in a competitive business environment (does this imply inherited skills?)
- Enterprise skills reflect the human hunter-gatherer and tribal instincts.
 - The need to compete and demonstrate superiority (leader of the pack).
 - The need to provide for the family (income from profit/accumulation of wealth).
 - The need to be seen as a superior being and/or a good provider (trappings of wealth/materialism/money as a measure of success).
- Entrepreneurs have a high need for achievement, and enterprise skills contribute towards our inherent needs for esteem, recognition and self-satisfaction (as per Maslow’s Hierarchy of Needs).

- Entrepreneurship activities satisfy the human desire for continuous renewable challenge and achievement. Serial entrepreneurship is the business equivalent of progressively scaling higher mountains, starting with Snowdon, and progressing to the Eiger, Annapurna, and ultimately Everest.
- Enterprise management skills hinge on personality, i.e. the possession of certain personal qualities; training can sharpen those skills, but it cannot create them if they are absent in the first place. (This is really an antiquated view based on conventional ideas of the type of leadership required for managing large hierarchical organisations.)
- The ability to spot new opportunities and the desire to act upon them is an intangible characteristic common to entrepreneurs. (Is it unique to them, though? Could the same not be said of opportunistic politicians or creative artists?)

Whilst entrepreneurial skills **can** be learned, educators cannot create successful entrepreneurs by training alone. Training can, in fact, be a bad thing for people lacking the essential entrepreneurial personality traits to succeed – e.g. tenacity, opportunity-spotting, risk-taking – as it arguably sets them up to fail.

Entrepreneurs Are Made

The “entrepreneurs are made” argument is based on the development of entrepreneurial attitudes by exposure to business and enterprising environments during the developmental years or subsequent working life; the transferability of entrepreneurial skills such as networking and creative thinking by learning and by practice; and the provision of additional business skills by training and empirical experience.

- Entrepreneurship is a transferable management/business skill, just like leadership, delegation, business planning and financial management, which can be learnt or enhanced by learning and training. It is further enhanced when the learning is supported by practical experience.
- Conditioning/formulation of pro-enterprise attitudes is brought about by exposure to appropriate family and external influences. If a child grows up in an entrepreneurial family, is exposed to discussions about business, and has contact with the business itself, then a career in enterprise will be regarded as perfectly normal.
- Constant changes in technology and the marketplace demand constant up-skilling as old (instinctive) skills become less relevant or obsolete (is that true?)
- Many people become entrepreneurs because they do not fit in with conventional social/employment opportunities, e.g. Richard Branson and Bill Gates.
 - They are highly individualistic personalities, often non-conformists or social misfits, who seek self-employment as an alternative to working for an employer.
 - The opportunities available to them have been restricted, e.g. because of race, colour or creed.
 - Engagement in a family business forms an integral part of their cultural background.
 - They are self-motivated individuals with high aspirations and the self-confidence to achieve.
- Azjen’s (1991) theory of planned behaviour (Kirby 2003, pp117-118), a person will start a business if he/she has:
 - enough information to form an opinion
 - an opinion favourable to starting the business
 - the intention to start a business
 - sufficient support/encouragement.

People are more likely to start a business if they believe they have the knowledge/ability to do it. Perceived behavioural control is the strongest predictor. A person's "intention to perform the behaviour" increases as their control over the behaviour increases (Kirby 2003).

- Family background and environmental influences are key to creating entrepreneurial attitudes. Research shows that a majority of entrepreneurs come from families with parental involvement in business ownership or self-employment (Bolton and Thompson 2004).

The Compromise View

The compromise view reflects the fact that neither of the two opposing arguments just outlined can be strictly proved or disproved, and that in reality entrepreneurs exhibit characteristics of both.

- Entrepreneurs are both born and made. Arguably 75% of personality traits are due to genetic influences, and 25% due to family background and environmental influences (although others put the split at 40 genetic/60 environmental) (Bolton and Thompson 2004, p15).
- Very few entrepreneurs are "born" – perhaps just the high-flyers/opportunity-spotters/serial entrepreneurs for whom it is a lifestyle. Most acquire their traits via experience, childhood development, and external influences. The majority are really just small/self-employed businessmen/women (Burns and Dewhurst 1996).
- A true and typical profile of entrepreneurs would be invaluable for banks/venture capitalists to enable them to spot potential winners and losers (Carter and Jones-Evans 2000). However, this is totally impossible due to the inherent inconsistency of the entrepreneurial character.
- A more appropriate way of understanding entrepreneurs is by defining them in terms of:
 - craftsmen entrepreneurs – they often seek a steady income rather than continuous growth, usually via self-employment or a micro-firm based on technical or trade skills; and
 - opportunistic entrepreneurs – they often have higher education and/or good leadership skills, and are more ambitious, growth orientated, and willing to take risks.

The Entrepreneur's View

From a pragmatic viewpoint, whilst the "made or born" argument may be of some academic interest, it is surely the very last thing on the mind of the practical entrepreneur; he or she just wants to get on with running and developing the business, as it is the process of being entrepreneurial that makes things happen, not talking about the theory behind it.

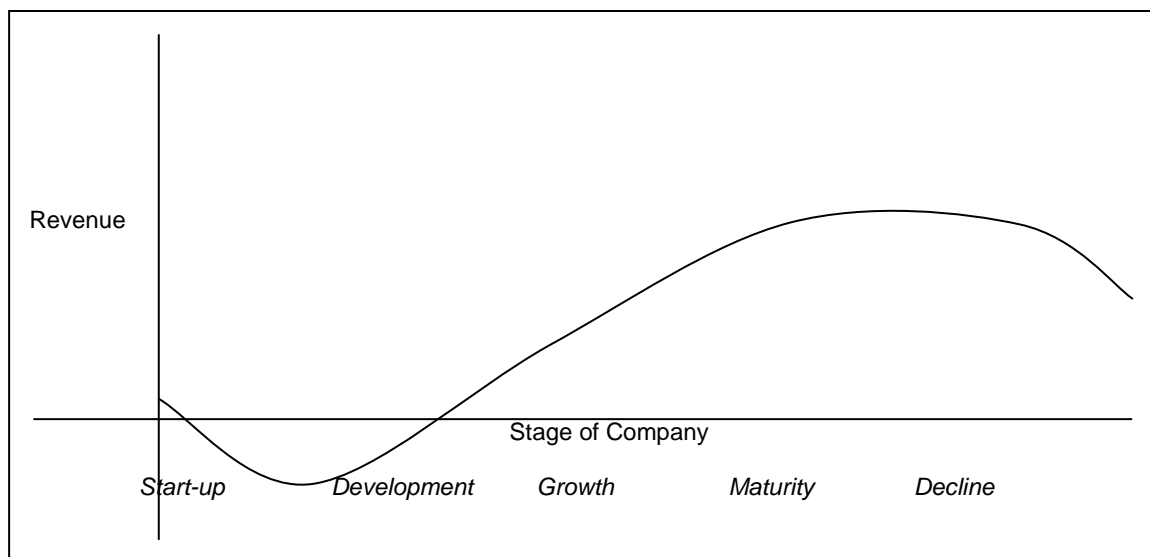
In fact, most entrepreneurs would probably argue that engaging in academic arguments of this type is totally contrary to the dynamic process of innovation and entrepreneurship.

C. BUSINESS LIFE CYCLES – THEORIST AND PRACTITIONER VIEWS

Business Life Cycles – Theorist View

A number of academic theorists have described or explained what is called the business life cycle during the past 40 years, and most of them follow a similar pattern. This pattern is best described as the “hockey stick curve”, where at start-up stage there is negative revenue but as the company grows, it reaches its break-even level of trading; revenue continues to grow until it peaks, and eventually starts to decline. The same model (see Figure 1.1) is often used to illustrate product life cycles.

Figure 1.1: Business Life Cycle Model



Depending on which theory is being considered the shape of the curve or the titles of each stage may change. For example, Gibbs and Davies (1990) talked of: *Initiation – Development – Growth – Maturity – Decline*; and Churchill and Lewis (1983) of a similar model: *Existence – Survival – Success – Take-off – Resource Maturity*.

Burns and Dewhurst (1996) took the view that as two-thirds of firms failed within the first ten years of existence, a more realistic model was: *Start-up – Incubation – Growth – Maturity – Decline/Failure*. Greiner (1972) used a similar pattern but described how the progression between one stage and the next had to be triggered by a crisis facing the business, rather than by positive choice on the part of the entrepreneur.

An Alternative Practitioner View

Butler (2006) took a radically different view, explaining that the traditional views of business life cycles were inherently weak and inadequate in explaining how businesses really develop. This applied in particular to the more innovative businesses with high-

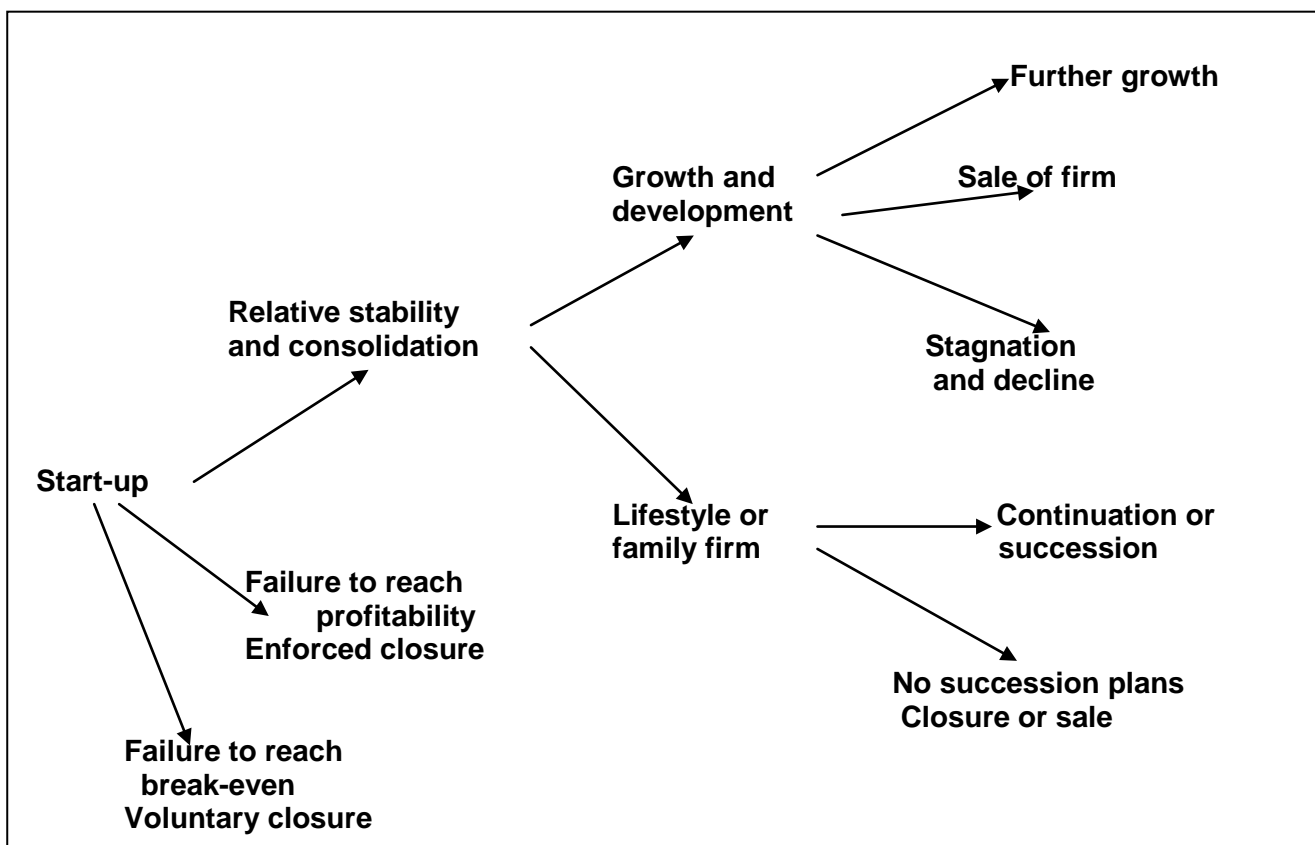
growth potential that might evolve into a different form of existence (or trading status) relatively early in their development by virtue of trade sales, mergers with larger companies, stock market flotation to raise investment capital.

He highlighted some significant problems inherent in the conventional business life-cycle model which is based on a number of unjustified assumptions.

- Entrepreneurs all want continuous growth – some will just want to operate lifestyle businesses.
- Firms will continue to grow until they reach a stage of maturity – some firms will cease to operate before they reach that stage for a number of reasons including early failure, trade sale to another company, merger or stock market flotation.
- At some stage, firms will inevitably stagnate and decline – serial entrepreneurs, for example, identify exit strategies that involve the sale of the firm or its intellectual property well before the firm reaches maturity or even the peak of its growth.
- There is no allowance for them to jump a stage, to regress, or to exhibit characteristics of more than one stage at any time – in a recession, struggling firms may downsize before resuming growth at a later date, or high-growth firms may jump a stage in development.
- The maturity stage is **not** inevitable for all firms – highly innovative firms may continue to grow beyond that.
- Most important of all, conventional theories ignore the objectives and motivations of the entrepreneurs themselves, which will be constantly changing, particularly in the early stages of the business!

Figure 1.2 offers a more realistic view of the business development process.

Figure 1.2: Business Development Process (Butler 2006)



Butler identifies three key phases in the early development of a business during which the motives and personal objectives of the entrepreneur/owner are critical to the decisions being made and to the future development of the business (see Table 1.2).

- Start-up: business formation and early trading when the focus is on survival and growing revenue before the initial investment funding runs out.
- Relative stability (and consolidation): after a break-even level of trading has been achieved, when the focus switches from survival to increasing profitability and starting to grow.
- Growth and development: a strategic decision has been made by the entrepreneur or owners to go for positive long-term growth.

If the start-up business reaches break-even level before working capital runs out, progression to the relative stability (and consolidation) phase is almost inevitable. This is of major personal and psychological significance to owner-managers due to:

- relief at hitting break-even trading level
- having a steady, then climbing, bank balance rather than one that is constantly falling
- the return of self-confidence/suppression of doubt that the business will succeed
- a stemming of the growth in personal financial exposure.

Two main risks arise at the relative stability (and consolidation) phase.

- As performance is consolidated and profits improve, firms become complacent, or too comfortable in the way they are operating, or they just lose the impetus to grow. Whilst movement to the growth and development phase occurs naturally for some businesses, particularly those led by entrepreneurs who have a long-term strategy for the business, many small firms become caught for too long in relative stability (and consolidation) phase and fail to move on. In some cases, they simply decide to stay as lifestyle businesses, and not to opt for further growth.
- Owners become bogged down in operational issues and lose sight of longer-term objectives. Moving on to the growth and development phase requires a major change from operational and tactical thinking to strategic thinking.

Impact of Entrepreneurial Motivations on Early Stage Businesses

The ability to make this culture shift to strategic thinking is part of what distinguishes entrepreneurs from owner-managers. For the business owners, it may mean moving out of the “comfort zone”, changing managerial processes that have evolved with the business, perhaps delegating certain managerial functions to free up time for a strategic role, or letting go of tight direct control. There is also the potential issue of the owners re-exposing themselves to personal financial risk and uncertainty if additional finance has to be raised to fund the growth of the business.

Table 1.2 explains in more detail how, at each of the three stages, the motivations and personal objectives of the entrepreneur can have a major impact on the behaviour and operations of the business, and on the decision-making process. This is particularly true where the entrepreneur is the primary driving force and motivator behind the business. Further issues of entrepreneurial attitudes and characteristics are examined in Section D of this chapter.

Table 1.2: Development Stages for the Majority of Small Firms (Butler 2006)

Development Phase	Duration	Primary Business Objectives	Entrepreneur's Personal Objectives	Typical Behavioural Characteristics	Decision-making Processes
Start-up	6 months to 3 years	<ul style="list-style-type: none"> - Survival of the business - To reach break-even level before working capital runs out 	<ul style="list-style-type: none"> - To achieve profitability at the earliest opportunity to reduce personal financial exposure - Sense of achievement/personal satisfaction 	<ul style="list-style-type: none"> - Accept all available business - Focus on gaining extra marginal contribution to costs rather than overall profitability - Tendency towards headless-chicken syndrome: much activity and effort generating relatively low profit margins 	<ul style="list-style-type: none"> - Primarily operational - Tendency for tactical decisions to be subsumed by chance of marginal contribution - Focus on short-term returns with little strategic thinking
Relative Stability	1 to 2 Years	<ul style="list-style-type: none"> - Consolidation - Review and revise the operational processes of the business 	<ul style="list-style-type: none"> - To increase profit to ensure the long-term survival and stability of the business (and to reduce personal financial risk in the process) - Move towards achieving return on capital investment, and repay personal effort. 	<ul style="list-style-type: none"> - Consolidation of activities, more focus on profitability/profit margins - More selective attitude to customers, e.g. rejection of slow payers and low-profit business - More attention to customer needs, quality and long-term relationships - Tendency to stagnation and complacency in some firms if this phase lasts too long 	<ul style="list-style-type: none"> - Switch from operational to tactical thinking - Initially not much strategic thinking, but this increases towards the end of the phase as a basic pre-requisite of the next phase
Growth and Development	Ongoing in future years	<ul style="list-style-type: none"> - Planned expansion to increase market share, turnover and profit - Capital growth 	<ul style="list-style-type: none"> - Expand market share and sales turnover to generate and increase personal wealth - Continue the reduction of personal financial risk (less urgent now) - Expand personal power and influence 	<ul style="list-style-type: none"> - Confidence and stability achieved in the second phase provide the basis for a more adventurous attitude towards the marketplace - Future growth financed from profits, and external funding now more readily available - Importation or development of more specialist management skills, and increased delegation of responsibility 	<ul style="list-style-type: none"> - Primarily strategic and tactical - Operational decisions tend to be increasingly delegated as business grows

D. ENTREPRENEURIAL ATTITUDES AND CHARACTERISTICS

Entrepreneurial Motivation

In the previous section, we examined some of the motivations that influence the decision-making processes and growth strategies in early stage businesses. The motivations of entrepreneurs form an integral part of their attitudes and characteristics. Furthermore, much of the analysis and discussion of entrepreneurial motives fails to distinguish between those “true” entrepreneurs that are focused on growth, and the owner-managers that may have less ambitious objectives. For example, the motives associated with highly entrepreneurial people include:

- profit/wealth creation for the owner(s) via growth in capital value
- personal achievement and satisfaction (e.g. serial entrepreneurs), self-belief/proof of ability/independent spirit /self-fulfilment/achievement and, to some extent, the fear of failure
- expansion of the business to create a better prospect for sale
- power/empire-building/competitive instinct/enjoyment of entrepreneurial activity (e.g. Richard Branson, Bill Gates, Robert Maxwell)
- opportunity and vision.

The motivations displayed by more modest entrepreneurs and/or owner managers could include:

- profit/wealth creation for the owner(s) via dividends from profits
- strengthening market position/reducing susceptibility to takeover
- reducing personal financial exposure
- improving profitability by economies of scale/cost savings/better purchasing power
- creating a steady personal income/comfortable lifestyle
- maintaining the business at its current size to protect investment (protectionist)
- growing and controlling the business to protect income and investment (business oriented)
- growing the business to protect investment and pass it on to the next generation (dynast)
- keeping the business at its current size to pass it on to next generation (family succession).

These two lists of motivating factors also reflect what are described as the “pull and push” motives. Pull motives for starting a new enterprise are essentially opportunity based, where, for example, an entrepreneur spots an opportunity in a market to introduce a new product or innovation, or sees a way of making a profit by solving a customer’s problem. Push motives are more necessity based, where, for example, a skilled person is made redundant and needs to create an alternative source of employment and income by using their skills, market knowledge and contacts to start a new business.

Chell, Haworth and Brearley (1991) described four types of entrepreneur – one “true” and three “pseudo”.

- Entrepreneurs: pursue growth and change.
- Quasi-entrepreneurs: innovators but perhaps lacking the drive for growth.

- Administrators: business operators, e.g. second generation owner-managers, with a focus on profit margins and stability.
- Caretakers: similar to craftsmen – e.g. self-employed tradesmen with little strategic thinking or desire for growth.

Chell's typology highlights two important distinctions between:

- entrepreneurs aiming for growth and profit and those aiming for steady income/stability
- first and second generation owner-managers, i.e. the start-up entrepreneur and the manager of a small business.

These differences are down to motivation, though, rather than personality or characteristics.

Behavioural Characteristics

As mentioned previously, the Harvard Business School definition states that:

"Entrepreneurship is the pursuit of opportunity **beyond** the resources you currently control [emphasis added]".

It is not just:

- about profit/growth opportunities
- about new ventures/products/marketing options
- about large projects/achievements
- in small businesses/the private sector.

It is:

- an attitude of mind that encompasses innovation and the use of imagination to achieve results
- a driving force in generating and managing change
- equally relevant to the public and non-profit sectors.

In short, entrepreneurship is a complex and multi-faceted process and, by implication, the entrepreneurs themselves are a complex mixture of attitudes, personality characteristics and motivations. There have been a great number of attempts to define these attitudes and personality traits more precisely, and although there are areas of common ground, no single definition has yet been achieved. This is probably because it is so difficult to gain consensus on the precise definition of an entrepreneur, and on which of the entrepreneurial characteristics are most important.

There are certainly a number of attitudes and behavioural characteristics that are generally accepted as being of primary significance to entrepreneurs, including the following.

Abilities.

- To spot opportunities.
- To take calculated risks.
- To formulate business strategies.
- To create and exploit networks.

Individual characteristics.

- Determination/perseverance/tenacity.
- A strong need to achieve.
- Clear focus on goals/objectives.
- Imagination/creativity.
- Independence/self-reliance.
- Show initiative / take responsibility
- (The appearance of) honesty/integrity.

However, it can also be argued that simply possessing these behavioural characteristics and abilities does not in itself make an entrepreneur, as it is the ability to apply them to create profitable and growth-focused businesses that makes an entrepreneur worthy of the label. Along with those abilities and characteristics go the attitudes that are also commonly shared by entrepreneurs and that help them to utilise their abilities. These include the belief that:

- Enterprise behaviour is positive/good /not to be ashamed of.
- Opportunities should not be ignored.
- Taking calculated risks is an acceptable business activity.
- The creation of wealth/profit is a commendable pursuit.
- Change should be viewed proactively, and engaged/managed.
- People should make use of innovation/creativity/imagination to solve problems.

Bolton and Thompson (2004) have integrated the various abilities, characteristics and attitudes just described to produce a list of ten key attributes of entrepreneurs. They:

- are individuals who make a significant difference or impact
- are creative and innovative
- spot and exploit new opportunities
- obtain the resources required to exploit opportunities
- are good networkers – building and utilising networks of contacts
- are determined in the face of adversity – resilient and tenacious
- manage risk – evaluating risks and addressing them rather than avoiding them
- have control of the business
- put the customer first – listening to customers and understanding their needs
- create capital – capital wealth and value in the business.

Using this list, “entrepreneurship” is explained as a balance between:

- talent – abilities, e.g. creativity, opportunity-spotting, networking
- temperament – needs, e.g. urgency, responsibility, performance orientation, opportunity-taking; and drives, e.g. dedication, ego, activation
- techniques – skills sets, e.g. individual skills and experience; and personal techniques to develop talents and to manage temperament.

Trait Theory

For psychologists, trait theory, as a study of human dispositions, provides a very good means of explaining personality and its effects on behaviour. This is because traits in the form of habitual patterns of behaviour, thought or emotion, can be measured (e.g. by personality tests), they can be validated by research over a period of time, and they aid the

understanding of human behaviour. So for example, the five key human personality traits are described as:

- openness to experience and intellect – the primary cognitive trait
- conscientiousness – the adoption and use of principled behaviour
- the level of extroversion (or introversion) a person possesses
- agreeability – the extent of a person's trusting, friendly and cooperative nature
- neuroticism – the extent to which individuals become emotional or upset.

Along with these five go a larger number of less significant traits. Trait theory has also been applied in specific business contexts, for example in explaining the leadership abilities of management by achievement, leadership motivation, honesty and integrity, self-confidence, cognitive ability, knowledge of business, emotional stability, creativity and flexibility – overall, quite a substantial and complex list.

The weaknesses of trait theory are that it generates long and complex lists, and that the selection of key traits and their relative importance can be quite subjective and open to disagreement.

Chell, Haworth and Brearley (1991) identified three key traits that apply to entrepreneurs.

- The need for personal achievement.
- Their locus of control – the extent to which they believe they can personally influence and control the business environment in which they operate.
- Their propensity to take balanced risks.

Chell further explained the entrepreneurial character in terms of technical skills (knowledge of the products or services and the markets in which the entrepreneur operates), management skills and knowledge (planning, marketing, finance, human resources), personal skills or attributes (tenacity, determination, focus, leadership ability) and entrepreneurial behaviour (ability to spot opportunities, procure resources, develop networks and make decisions).

However, a few years later (Chell 2008) she had modified her views, suggesting that trait theory in itself was insufficient to explain the entrepreneurial character as human personality is not stable across all situations, and is affected by reasoning, awareness, perception and judgement. She also argued that trait theory and the cognitive approach to understanding entrepreneurs undervalued the importance of human and social capital – the importance of whom and what you know, and the use of business networking and social networks, especially in accessing the market and financial resources and experience of others.

E. KNOWLEDGE AND SKILLS REQUIREMENTS OF ENTREPRENEURS

Entrepreneurial Skills

In summarising the key entrepreneurial characteristics identified in Section D, we can identify a number of common features shared by entrepreneurs and accepted by theorists as making significant contributions to entrepreneurial success.

- The ability to spot and act on opportunities.

- The propensity for strategic thinking and long-term planning.
- Being innovative and creative.
- Being resourceful – the ability to access or lever resources to benefit the enterprise.
- Being resilient and tenacious/determined to succeed.
- The ability to influence others and make an impact on their operating environment.
- A strong need for achievement.

In addition, entrepreneurs also demonstrate a number of skills or personal strengths, which arguably could be learned by anyone.

- Financial knowledge and understanding.
- Sales and marketing expertise.
- Networking skills.
- An understanding of customers and a focus on their needs.
- The ability to manage under pressure/plan and prioritise work.

Owner-manager Skills

Owner-managers have a different longer-term skills requirement to entrepreneurs: to become efficient managers and administrators rather than chasing the resources that will facilitate rapid growth. In the early stages of the business, they need a good breadth, as opposed to depth, of skills (as covered later in this section); however, once the business reaches profitability, the focus needs to switch to maximising the operational efficiency to sustain profits. This will require the delegation of some of the lower-level operational planning and decision-making.

Some of the management skills are the same as those needed by entrepreneurs, such as sales and marketing and financial skills, but the actual activities will differ. For example, whilst the entrepreneur will need the financial skills and knowledge to source and negotiate investment funding, the owner-manager will be more involved with forecasting and managing budgets and negotiating with the bank manager for loans for capital equipment or overdrafts for seasonal revenue fluctuations. Similarly, whilst entrepreneurs may focus on accessing new international markets, owner-managers may be more concerned with improving customer service to ensure customer retention.

Changing Nature of Roles and Skills Requirements as Businesses Grow

At the start-up stage, the entrepreneur or owner-manager is likely to be working to a very limited budget and will probably only be planning to employ staff when:

- they are absolutely necessary
- the business can realistically afford them.

This means that the business will probably start off with a very small workforce (if any), some of whom may be part time or family volunteers. From the skills perspective, this means that the entrepreneur/owner-manager will need to possess a broad range of generic business skills until such times as more specialist staff become affordable. Effectively, the owner may be the managing director, sales person, operations or production manager, accountant, and delivery driver all at the same time. This is fine for a short period of time but rapidly becomes unsustainable as the business grows.

As a rule of thumb, the smaller the business, the wider the range of skills that the entrepreneur/owner-manager will need to operate it, particularly in the early stages of its development. In order to succeed, it is important to draw up a skills profile for the business, identifying the diverse range of expertise required. This might include the following.

- Technical knowledge or expertise of the goods or services which the business plans to provide, and how the customers will make use of them: from the customer's perspective, the supplier is the specialist who is expected to answer all the awkward questions.
- Marketing skills: to facilitate market research, to develop a marketing plan to promote and distribute the goods or services. Many owner-managers set up in business in a sector with which they are already familiar, and so have some basic knowledge of their market; however, there is still a need to maintain objectivity, particularly when estimating market share and sales volumes.
- Sales skills: these are often assumed to be the same as marketing skills, but there is a distinct difference. The firm may have an excellent product, and a market ready to take it, but skill is still needed to persuade customers or distributors that it (rather than a competitor's) is the right product to use or retail. In the early stages of development, the business may not be able to afford to pay a full-time sales person and the owner(s) may have to do the job themselves.
- Organisational skills: the ability to plan and organise time and the business operations to ensure that things like staff, resources, materials and finished goods are in the right place at the right time. Careful planning and attention to detail allow for the most productive use of time and resources, and avoid costly waste.
- Decision-making: the ability to analyse problems, identify and evaluate options, and make objective and rational decisions, including how they will be implemented effectively.
- Financial skills: keeping day to day accounts is not necessarily the best use of the owner's time, as a part-time book-keeper or accountant would probably be much more cost-effective. However, it is still important for the owner to be able to understand the accounting procedures. In particular, it is essential to have a basic understanding of budgetary planning and control, in order to keep the business on track, and to spot any potential problems. There may also be a need for the owner to be involved in credit control and debt collection.
- Customer service skills: this is not just a case of keeping customers satisfied by providing good standards of service. For early stage firms, one of the biggest headaches in dealing with customers is debt collection, and persuading customers to pay their bills on time without offending them or losing their business.
- Management of information and computer literacy: this covers the use of word processing, databases, desktop publishing, accounting software, e-commerce, online marketing, and electronic communication, as well as the importance of compliance with data protection and other regulations.

As the business grows and employing staff becomes more affordable (the relative stability/consolidation phase which usually follows the achievement of break-even levels of trading when profits start to grow), the entrepreneur/owner-manager is able to start delegating some of the routine administration work, such as book-keeping, order-processing and sales calls. At this point, the owner starts to move away from the operational decisions and day to day running of the business; instead he or she becomes more focused on tactical decision-making to generate new customers and make the business more profitable and efficient. The required skills set starts to narrow slightly as routine tasks are delegated, but that process in itself requires staff management skills –

the ability to supervise, delegate work, train and motivate staff to get the best out of them. The importance of this is often underestimated, and for new owner-managers who have never previously been involved with managing staff, one of the hardest aspects is delegation: trusting the staff to get on with their own jobs without constant close scrutiny, so that the owner can get on with the job of running the business.

As explained in Section C, progression beyond the relative stability (and consolidation) phase to achieve growth and development requires personal motivation from the entrepreneur/owner-manager, but it cannot be achieved without the development of higher-level management skills in the form of strategic planning. It is usually at this stage in the development of the business, typically where it is employing 20 or more staff, that the owners will start to employ specialist functional managers such as accountants, sales or operations managers, and a human resources specialist. At this point, the owner is able to delegate much more of the tactical decision-making which allows him or her to focus on strategic growth.

Management Teams in High-growth Businesses

There are several fundamental differences between high-growth/high-tech start-ups and conventional start-ups or lifestyle businesses. These necessitate a significantly different approach to skills requirements.

- High-tech business ideas involving very specialist or sophisticated technologies are often developed from university or private sector research institutions by highly qualified specialist technologists. By virtue of their background, they are unlikely to have gained much, if any, practical business experience. They make ideal chief technical officers, but to enable the business idea to have any chance of fruition they need to be led by a much more entrepreneurial person acting as chief executive. The latter can negotiate and raise the various stages of funding and make the market connections to take the innovation to market. This can sometimes be problematic when the expert technologist is reluctant to hand over control of their project to another person.
- Technology-based innovations, particularly in the biomedical sector where substantial trials and testing are involved, will require staged development funding spread over several years, and negotiated with different providers at each stage. These funds include research and development grants, proof of concept funds, pre-market product development finance, market launch funding, subsequent seed or accelerator funds for growth, and longer-term potential large-scale investment for expansion. This may require the use of a specialist financial director.
- High-growth potential innovations which have a specialist market focus or target substantial export markets will need entrepreneurial expertise, plus possible international marketing or product licensing expertise, and almost certainly significant investment funds to break into those markets.
- Potential investors or lenders will expect to be presented with a sound technology and business idea, evidence of protected intellectual property, solid marketing and financial plans, and a strong balanced management team.

For the high-growth or high-tech business proposal, this means that at a very early stage when the business idea is being developed, a key part of that development will be the identification of a strong, experienced, and highly skilled management team. This typically comprises a chief executive officer (CEO)/entrepreneur to lead the team, a chief technology officer to lead the research and technical product development, a financial

director to resource and manage the staged investment funding, and a sales and marketing director to lead the product to market. Most important of all, this team must be able to work effectively together.

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Chapter 2

Innovation and Enterprise Cultures

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INTRODUCTION

The purpose of this chapter is to examine why innovation is so important to business survival, development and growth and, therefore, to the national economy as a whole. The chapter will also review some of the current thinking on how innovation can be used in business, and how both businesses and other organisations can encourage and create a culture of innovation and creativity. However, it is important at this point to clarify the difference between innovation and creativity.

Innovation is essentially a process of the commercialisation of new ideas in some form, whether that be bringing new inventions or products to market, offering new services to customers, or introducing improvements or cost savings in the way goods and services are provided. The UK Government's definition of innovation is "the successful exploitation of new ideas", and within that process of exploitation there are two challenges.

- The challenge in innovation is to transform creative ideas into tangible products or processes that will improve customer services, cut costs, and/or generate new earnings.
- The challenge for managers is to use strategic innovation to create business growth and increase capital value.

Although this definition refers mainly to measuring the success of innovation in financial terms – generating revenue, cutting costs, and creating capital value – it must be remembered that innovation is not confined to commercial business: it can equally be used in the public sector or in charities and not-for-profit organisations to improve services to customers or clients. Here, the outcome may also be measured in terms of social benefit.

Creativity is closely related to innovation but is more about the process of generating new knowledge, ideas, concepts or technologies that may or may not subsequently form the basis for new innovations.

A. UNDERSTANDING INNOVATION – THEORIES AND EXPLANATIONS

A Few Thoughts and Quotations

- "Madness is when you expect different results by doing the same things ... innovation is about being different and better" – Bishop and Jones (2003).
- "There is only one admirable form of the imagination: the imagination that is so intense that it creates a new reality that makes things happen" – Sean O'Faolain (Irish author).
- "Which is worse, having an idea and not doing anything with it, or not having any ideas at all?" – source unknown.
- If: "Luck is what happens when opportunity and preparation collide" (Seneca), then:
- "Innovation is what happens when opportunity and imagination collide!" (Butler 2006).

We see from these that innovation is a dynamic process that generates change by utilising new ideas generated by human imagination, to create or address new market opportunities. Interestingly, history has demonstrated that the process of innovation often moves fastest in times of conflict – consider World War II which resulted in a host of new technologies including radar, sonar, the use of jet engines in aircraft, V2 rockets and, of course, the atomic bomb. This process is probably best exemplified in a further quotation from the classic film *The Third Man*, when Orson Welles as Harry Lime is standing at the top of the Ferris wheel in Vienna: “In Italy for thirty years under the Borgias they had warfare, terror, murder and bloodshed – but they produced Michelangelo, Leonardo da Vinci and the Renaissance. In Switzerland they had brotherly love, 500 years of democracy and peace, and what did they produce? ... The cuckoo clock.”

Definitions and Explanations of Innovation

As explained earlier, innovation is a process of using ideas to generate something new or unique which has some measurable value. This process can take a number of forms.

- Challenging existing thinking, methods of practice, and accepted norms to change attitudes or the way things are done.
- Using creativity and imagination to generate alternative and profitable solutions to problems.
- Anticipating future customer needs, often before the customer does. Henry Ford who introduced the first mass-produced cars is reputed to have once said: “If I had asked the customers what they wanted, they would have said a faster horse”.
- Applying new technology to businesses processes and markets to create new or additional value.
- Stimulating change by applying imagination to opportunities – the process of envisioning what products or services will be needed before that need is recognised by the customers.
- Connectivity – harnessing resources, networks, people, opportunities and ideas to stretch beyond existing boundaries, and to make the innovations happen.

There is more to innovation than developing new products and services – it can also include:

- innovative ways of delivering existing services, e.g. the introduction of online shopping and home delivery by supermarkets
- new ways of informing consumers about products and services or promoting them to the consumers, such as the use of multi-media advertising – TV, radio, newspapers, text, email, and social networking
- new ways of organising resources to produce or deliver products and services, such as outsourcing human resources support functions, or contracting out distribution services to reduce overheads
- new approaches to the management of relationships with customers and suppliers via supply chain management, e.g. sharing online data about stock levels to facilitate just-in-time delivery and minimise the costs of holding and storing stock.

Challenges of Innovation to Smaller Firms

The majority of companies are not particularly innovative. It is reckoned that in the USA, 87% of new jobs in the small firms sector come from just 5% of firms. Kirby (2003) describes three types of company.

- Elephants – large, slow-growth enterprises, unresponsive to economic change.
- Mice – small (especially family) no-growth firms.
- Gazelles – new rapid-growth ventures based on innovation – these are the 5% that create new employment opportunities.

There is an extra category which is often used in the business support sector – that of “three-legged gazelles” which are the companies which originally showed high-growth potential but never realised it. Venture capitalists sometimes refer to these firms as “the living dead” as they never achieve much but still continue to operate.

Small firms often lack the resources to drive innovation but do have the drive and flexibility to facilitate change that is often missing in larger firms. They have highly committed leaders with a future-focus, and they regard innovation as integral to business evolution. They have more customer and market awareness, along with the ability and flexibility to configure customer relationships which is often lacking in larger organisations. This means that although large corporations may have the resources to dedicate time to searching for and spotting new market opportunities, the more flexible and market-aware smaller companies are more inclined to exploit those opportunities when they arise.

However, smaller firms are disadvantaged in other ways, as they often lack capital to finance new developments and banks are not necessarily prepared to lend the seed capital to fund innovation. Funding innovation can be difficult as projects are often too small to be of interest to venture capitalists or investment institutions, but commercial lenders and private investors cannot easily handle the risk assessment process to evaluate the investment potential of high-tech innovation. Also, small firms often lack the capital to protect and subsequently defend the intellectual property rights (IPR) of their innovative ideas. Therefore, they have to adopt a first-to-market strategy to get their innovations branded and recognised as market leaders before competitors emerge.

Theoretical Models of Innovation

Drucker (2006) described Seven Sources – events or occurrences that provoke or generate ideas that potentially lead to new innovations.

- Unexpected happenings – chance events that can lead to the development of new ideas or potential opportunities.
- Incongruous happenings – similar to unexpected happenings but, for example, the event triggers an unrelated idea.
- A need for process improvements – demand-led ideas resulting from a problem or need.
- Changes in industry or market structure – possibly resulting from changing customer demand, but equally likely to be generated by the need to make cost savings, improve profitability, or to keep pace with competitor activity.
- Demographics – changes in demand resulting from social change, especially in specific demographic or age groups.

- Changes in perception, mood and meaning – e.g. the emergence of environmental awareness and the need for energy conservation.
- New knowledge – the development of new technologies offering new opportunities.

To these we can also add:

- customer-led identification of needs or opportunities – sometimes described as open-source innovation
- ideas led by continuous improvement, resulting in incremental innovation
- technology-push innovations where changes in technological capability create new products or services which customers did not realise they needed until they were available. Examples are Henry Ford's early motor vehicles and modern search engines
- market-pull innovations such as mobile phones where the market and marketing process create the need for the products or services.

Idea generation is an activity that more and more companies engage in, via methods such as brainstorming sessions, quality circles, focus groups, project teams, suggestion boxes, and of course planned and systematic market research. At a higher level, companies employ dedicated staff to search for new opportunities, for example by the systematic scanning of newly published patents. The scanning for opportunities can take place in what is described as the macro-environment by looking at events, trends and changes in the six areas defined by the PESTLE strategic analysis tool – political, economic, social, technological, legal, and environmental – also referred to as STEEP in Porter's Five Forces (1998) which leaves out technology; or at the micro-level within the market areas in which the company already operates or intends to operate.

Schumpeter (1934) was one of the first modern economists to acknowledge the economic value of innovation. He described five types of innovation.

- New products or services which did not previously exist, such as iPads, smart phones, music downloads.
- New methods of production or delivery of services, which are essentially processes through which products and services are delivered, such as cloud computing, electronic banking, online purchasing.
- The development of new markets, such as the computer games market, iPhone applications.
- Identifying new sources of supply – outsourcing, licensing and franchising.
- New forms of organisation or means of operating, such as virtual companies.

Jones (2002) describes what he calls the Ten Innovation Myths.

1. Innovation does not impact on the bottom line – in the case of breakthrough innovations, it actually has major potential to generate or improve profitability.
2. Innovation only applies to products, not services – as shown in the examples discussed earlier, it can apply to both.
3. Innovation is only relevant to a few industries – it can be applied in some form in just about any industrial or business sector as well as in not-for-profit and private sector organisations.
4. Innovation requires high investment in new technologies – at lower levels, in the form of modification to processes, the costs may be negligible; complex and innovative process modifications that cost more are usually justified by achieving cost savings.

5. Innovation only occurs in research and development (R & D) and marketing – it can occur in any business function, although breakthrough innovations may be more frequently seen as arising from R & D.
6. Innovation is a talent that a few people are born with and cannot be learnt – a growing number of companies encourage innovation in all employees via an enterprising and innovative culture.
7. Only small firms can innovate – any organisation can innovate although, as described earlier, smaller firms tend to have the flexibility that enables them to respond to innovation opportunities.
8. Innovation disrupts the organisation – the change resulting from innovation is potentially disruptive, but not if it is properly managed.
9. Innovation cannot be managed – the process of managing the development of new innovations from R & D, proof of concept, patenting and market launch is highly structured and supported. The impact of innovations on markets may be harder to manage if the sources of supply cannot match demand. This is particularly true of, for example, innovations in medicine which may be highly expensive, of limited availability, and unaffordable to parts of society or developing countries.
10. Innovation cannot be measured – it can, and in a number of ways: by increased sales, profits and revenues, cost savings, better performance or efficiency in processes, reductions in faults, breakdowns or problems, improved customer satisfaction, safety or social improvements, for example.

Rogers (1962) explored the processes of adoption of new innovations, describing what he called the S-curve. This graphically illustrated the rate at which new innovations and technologies spread through cultures, describing five intrinsic characteristics of innovations that influence a person's decision to adopt or reject it. These are its:

- relative advantage over previous related (or an earlier generation of) innovations
- level of compatibility with an individual's life
- relative complexity or simplicity – if it is too complex, the individual will not adopt it
- trialability – its potential to be experimented with by the user whilst it is being adopted (if it is too hard, it will be rejected)
- observability – the extent to which it is visible to others: the more visible it is to the user's peers and networks, the more likely it is to create positive reactions.

Rogers goes further by identifying five categories of adopters.

- Innovators – the first adopters, young and socially active, willing to take risks, financially well off and likely to be interacting with innovators.
- Early adopters – the next group of adopters, younger, educated, socially active and likely to be opinionative, but slightly less inclined to risks than the innovators.
- Early majority – a larger proportion of the adopter population that follow on after the first two groups; their social status is above average but they are not opinion-leaders.
- Late majority – more sceptical and slow to adopt, with lower social and financial status; they follow the bulk of society.
- Laggards – the very late adopters, older, with little opinion-leadership, lower social status and a limited range of social contacts.

Rogers' theory was that with successive groups of consumers adopting the new technology, its market share will eventually reach saturation level, and demand for the innovation will start to decline.

Tidd, Bessant and Pavitt (2008) took this idea further to explore how the diffusion of innovation could be forecast, by considering:

- how the characteristics of a new innovation may influence its adoption
- how the commercialisation process and diffusion affect adoption
- what techniques are available for forecasting future adoption of innovation.

Francis and Bessant (2005) identify the 4Ps of innovation space (the Innovation Diamond), which explore where there is opportunity for an organisation to innovate on four possible dimensions including:

1. position (marketing and business model innovation) – where an established product or service is offered in a new context, raising issues of adoption behaviour
2. paradigm (mental model) – changing the perceptions of customers
3. process innovation – how the process can be delivered in a new manner
4. product or service innovation – what new/innovative product or service is offered to the customer.

The extent of each of the four dimensions is measured on a scale from incremental (e.g. service improvement) to radical (e.g. innovation breakthrough). This approach can be used to analyse the potential for an innovation in the marketplace, with a view to using innovations to create “market space”. Each of the four dimensions has its own type of market space that is distinct from the other three. The purpose of this analysis is to aid in the development of innovation strategy, to decide in which direction (towards which space) the strategy should move.

The Tidd, Bessant and Pavitt (2008) model of innovation was to develop a more integrated approach that reflects the way in which the subject has moved on in a more technology-focused world. There are four components in the innovation process that need to be integrated and managed.

- Strategy – the process of identifying innovation potential.
- Supportive organisational systems to develop the processes.
- Effective implementation mechanisms and structures to enable the innovations to happen.
- Effective external linkages – the development of strategic networks.

B. THE INNOVATION SPECTRUM AND IMPORTANCE OF BREAKTHROUGH INNOVATIONS

The term innovation is open to a broad range of interpretations. In its simplest form, often used by public sector bodies under the guise of “sharing best practice”, this could be a case of directly copying someone else’s idea or good practice, or perhaps copying and modifying it to suit the needs of the organisation. However, in the strict sense this is not innovation at all as nothing new or significantly different has been created.

As we move along the continuum (see Figure 2.1), the depth of innovation becomes more significant. Beyond **copying and modifying**, we see innovation in the form of **expanding** on what already exists, although, again, this is arguably not innovation in its true sense. The next stage of producing something **novel** is really the point where the process begins to generate something different, and this leads on to the next stage: the creation of something **new** – perhaps a solution to a specific problem. Finally we reach the stage of **breakthrough innovation** – the type of innovation that will make a major impact on

markets, in the delivery of products and services, or as a solution to a problem. Examples are things like the light bulb, radio, TV, personal computers or, in the medical context, X-rays, penicillin, heart-transplant techniques or even Viagra, any one of which have constituted major technological breakthroughs and have created opportunities to open up massive new markets and/or value to users.

Innovation is not about doing the same things differently, e.g. producing old products in new colours, re-inventing old ideas, or sticking to conventional norms or boundaries that restrict change. Whilst the use of innovation for the continuous improvement of business processes and practices does help to maintain competitiveness in the marketplace, too much focus on incremental product improvement/marginal efficiency improvements can inhibit major development. To gain real competitive advantage sometimes requires a major breakthrough or step-change – to create a disproportionate increase in the customers' perception of value, as illustrated in Figure 2.2.

The value of innovation to businesses lies in the competitive advantage that it can create. Continuous improvement by itself is insufficient to keep companies ahead of their competitors, whereas innovation creates new market opportunities that enable companies to grow faster and generate increased profits. Also, as the pace of change in the 21st century accelerates, firms that fail to change will fail to keep up with the competition, making engagement with innovation and change a necessity for survival.

Figure 2.1: The Innovation Continuum

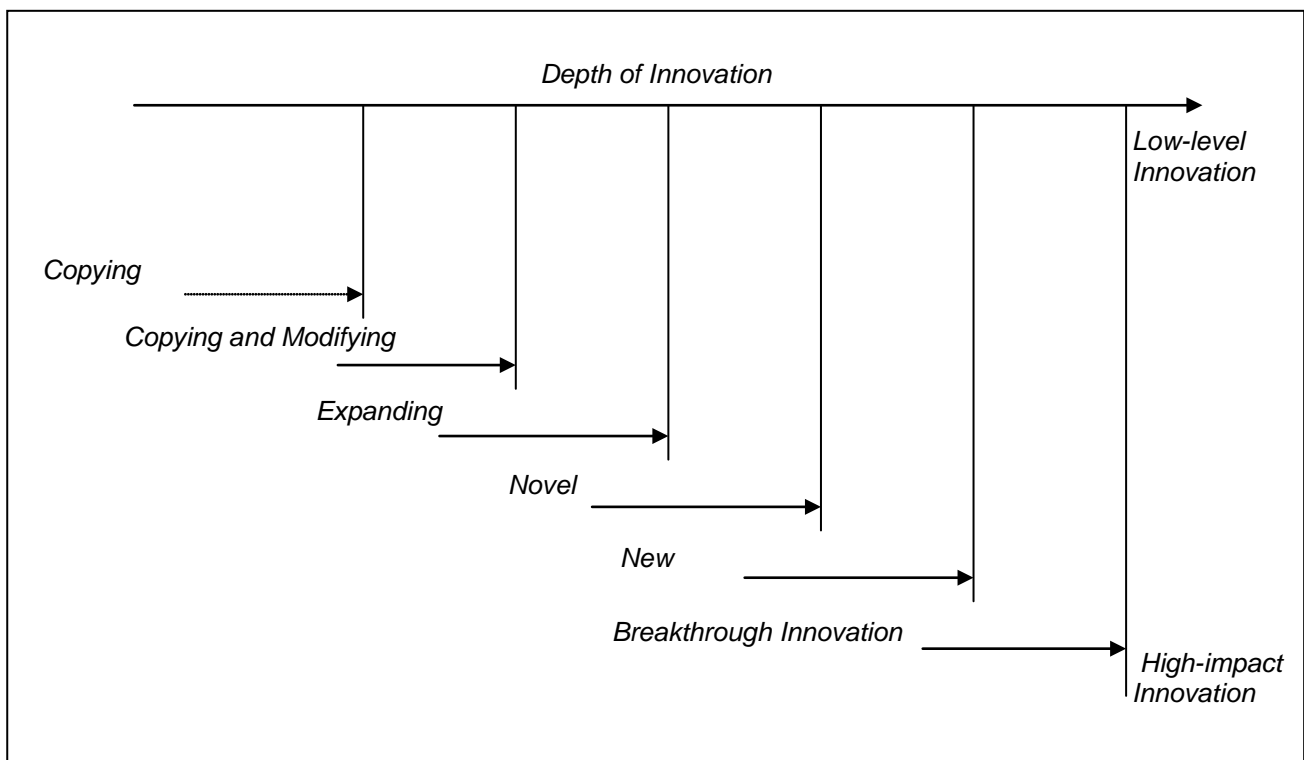
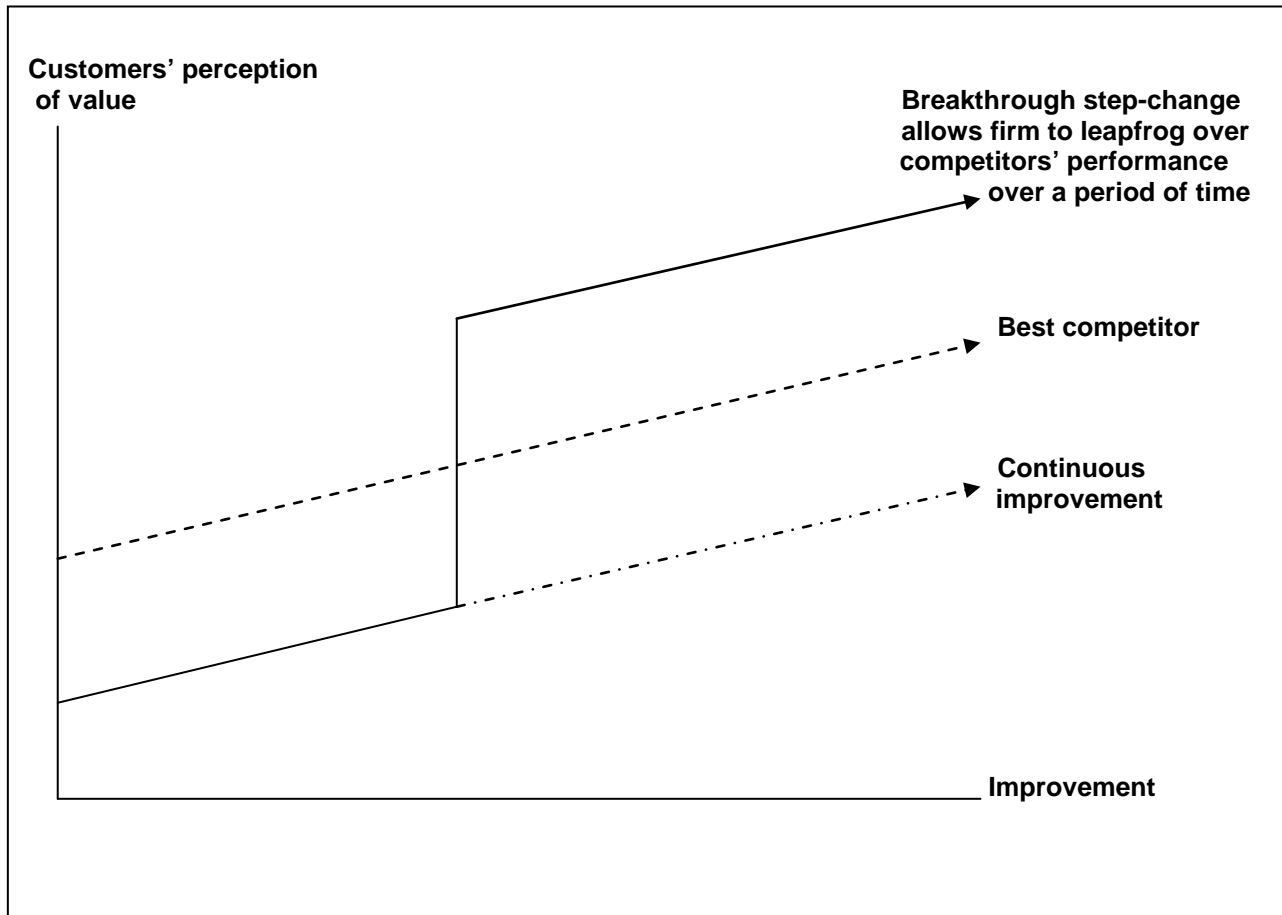


Figure 2.2: Innovation Breakthrough

C. ISSUES WITH DEVELOPING TECHNOLOGICAL INNOVATIONS

Barriers to Technological Innovation

We have already discussed some of the barriers to implementing technological innovations.

- The need for highly skilled and experienced management teams.
- The lack of capital to finance new developments, especially those involving complex technologies or extensive lead times before any product is ready for market.
- The need to access different forms of funding from potentially different sources during the development stages of the innovation – e.g. R & D grants from research councils, follow-on funds for proof of concept, to prototype and demonstrate the viability of the innovation for potential commercial production, the need for funds to protect intellectual property, the pre-market development of commercial designs and production processes, and then the production and launch of the products in the marketplace.
- With innovations with high-growth potential, there is a further need for funding to accelerate and achieve this growth potential.
- If a market opportunity has been identified, the publication of a patent for an innovation can alert potential rivals to the opportunity. If they have greater

resources, they may be able to get an alternative product to market faster than the original innovation. This makes a strong argument for ignoring patents and going for the straight-to-market option mentioned previously.

- Small or independent private investors, such as business angels, find it very difficult and often costly to evaluate the risk of investing in new innovations against the potential returns on investment. Even larger and more sophisticated venture capital companies have the same problem and expect to write off up to 20% of their investments.

To this list, we can add some additional factors.

- Early stage companies, in particular, face the problem of accessing substantial funding without having to give up too much equity in the business. The earlier that external investors are involved in the development funding, the larger the equity stake (shareholding) they will expect, in order to reflect the degree of risk they are taking. In some cases, this can mean that by the time a new innovation gets to market, it may be 80-90% owned by external investors. Business advisers will always recommend borrowing from banks or other sources (e.g. personal loans, bootstrapping or the 3 Fs) to fund early stage development, before approaching external investors. That way, the owners can build value in the innovation which will then mean they have to give away less equity for subsequent funding. Unfortunately, the lending banks often take the opposite view, asking to see private investment (e.g. business angel funding) before they will risk any lending.
- In the two to five years it may take to get a finished product innovation ready for market launch, the product development is effectively “work in progress” which, apart from any patents that may have been registered, offers no tangible value on the company balance sheet against which lenders or investors can assess the risk they may be taking.
- There is also the risk, at any time, that someone else may have been working to solve the same problem that the new innovation addresses, and may come up with a similar innovation more quickly, or a better innovation that takes over the market. This is what happened in the 1980s when the Betamax video tape format was taken out of the market by its VHS rival – a better product that arrived soon afterwards.

Picking Winners

The challenge to lenders and investors when facing proposals for new innovations is to be able to pick the winners. For the business owners themselves, the success of the innovation is essential for the survival and growth of the business. For bankers who want to ensure that their money will be repaid in full with interest, they must pick winners to minimise the risk of the borrower failing and defaulting on the loan. For investors, the objective is to pick winners that will enable them to achieve their targets for returns on investment. They are looking for growth in capital value rather than interest or dividends, and will usually expect that growth in value to be a minimum of 25% per annum over the investment period. The underlying problem is that whilst everyone loves a winner – not everyone can spot it!

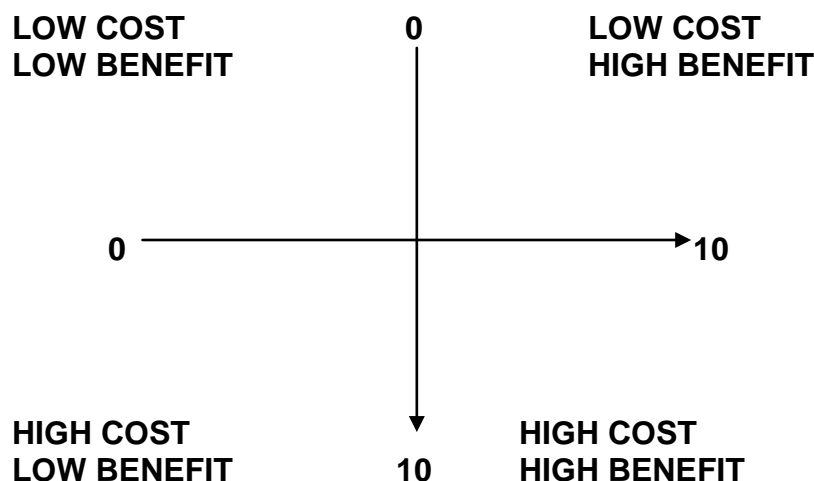
There are a range of sophisticated models used by the analysts in institution investment and venture capital organisations and they still sometimes get it wrong. There are some simpler, but still very effective, evaluation tools available for smaller investors. Bishop and Jones (2003) use a form of cost–benefit analysis that evaluates costs in terms of the capital and investment resources required; the timescale for implementation; the people

needed to make it happen; and the skills requirements; and benefits in terms of likely impact on profits and revenues; strategic fit with objectives; the likelihood of success; and the uniqueness or competitive stance. These factors are scored for each potential investment proposal and plotted on a graph, as shown in Figure 2.3.

Once the relative positions have been plotted on the graph, their potential to receive investment funding can be evaluated, broadly speaking, as follows.

- If they fall into the high cost/low benefit part of the graph, they represent bad investment potential.
- Low cost/low benefit ideas are fine for companies looking to achieve continuous improvement, but will never allow the leapfrogging of competition that breakthrough innovations can achieve; so again, they do not have ideal investment potential.
- High cost/high benefit proposals could be the breakthrough opportunity, but they could equally be high risks and end up as “three-legged gazelles”.
- Low cost/high benefits proposals are the ones that everyone is looking for as they offer the real breakthrough innovation potential.

Figure 2.3: Cost–benefit Analysis Graph



D. EXAMPLES AND CASE STUDIES

The following four case study examples are high-tech start-up businesses with the potential for high growth that were based at the University of Kent's Business Incubator and supported by the Canterbury Enterprise Hub between 2004 and 2009.

Synapse Microcurrent

This was a medical device innovation: a wound dressing that incorporated a small power cell, some electronic circuitry and a micro-chip that sent minute electronic pulses around the dressing, effectively tripling the rate at which wounds healed. The originator (a biotechnology specialist) recognised the huge potential for international sales in the medical field, both for treating severe physical injuries and for treating post-surgical

infections such as MRSA much more quickly and thus avoiding infected patients blocking beds whilst recovering. It also had huge potential in countries like the USA where medical insurance companies are always looking to reduce costs. He realised that to achieve this potential he would need the help of an entrepreneur: the right person was identified and, from there on, the business started to move forward.

The product was initially tested on racehorses. They have significant problems with the healing of leg wounds, and it is also quicker and easier to get medical device products approved for animals than humans. It also generated an initial revenue stream whilst the human testing was carried out. The product was then tested on humans including the British Lions Rugby Team and Chelsea football team. Once approved, it was launched on the general market and announced via a sponsorship deal with the Samoan rugby team at the Rugby World Cup. The company is still going strong.

Oil Drum Ltd

This company started out processing used cooking oil and converting it to bio-diesel. It then moved into the production of a product that uses electrolysis to generate un-pressurised hydrogen for direct injection into truck engines, resulting in fuel savings that were claimed to be between 10 and 22 %. The product was patented in 2008 and loan funding was raised to launch it for sale in the UK and to license it overseas for production and distribution. The company grew rapidly but became involved in a legal action against one of its distributors that had infringed the licence agreement and patent. Oil Drum Ltd won its case in the High Court in London, but the costs of that case were so high that the company ran into cash flow and financial difficulties and closed due to insolvency in 2010. This illustrates the problems facing small firms of having sufficient resources to defend their intellectual property when in dispute with larger organisations.

Purelabs Ltd

The owner of Purelabs Ltd runs a small independent magazine publishing business. Like all other magazine publishers, he faced the problem of planning the magazine layouts for each issue: the flatplan – an activity traditionally carried out using copious sheets of paper. He decided on the need to find a technology solution to this problem, and with a small loan from the University of Kent's Great Ideas in Science and Technology Fund, he produced the Intelligent Flatplan which is a web-based software application that can be accessed on a pay-as-you-use basis by magazine publishers.

He opted for a first-to-market strategy with an almost complete product that was launched at the biggest annual publishing exhibition in London. Within 18 months, the product had become the worldwide market leader in flatplan software, and it has been growing steadily ever since. The interesting feature about the web-based system is that it was designed to require very little maintenance or management: the entrepreneur-originator has deliberately engineered his own redundancy from the business, which has enabled him to move on to a new innovation that he expects to revolutionise the way magazine advertising is sold.

Geneform Ltd

For a long time, Geneform Ltd had been a small specialist biotech research business. However, the owner was a highly skilled scientist, and his status in the industry had enabled him to access substantial private investment funding to move the company forward and to take on another scientist. The technology was focused on the splitting of DNA strands to enable the analysis of individual DNA molecules for diagnostic purposes – at a better cost and level of accuracy than similar techniques. This was ideal for the rapid diagnosis of infectious diseases such as tuberculosis, chlamydia, gonorrhoea, MRSA, streptococcus and clostridium.

The R & D process took four years, and proof of concept testing and patenting took another two. By 2010, his technology had attracted the attention of a number of potential suitors and investors; in 2011, he sold the business to a Scandinavian diagnostics company. Although the company had never actually generated any revenue, the value of the sale was “substantial”; the final sale figure, and the earlier staged investment he achieved, had partly been due to his deliberate process of progressively building value in the business via patents, research publications and external grants.

E. ENCOURAGING AND DEVELOPING INNOVATIVE AND ENTERPRISING CULTURES

Innovation Cultures

For innovation to thrive, a business needs a very positive culture amongst its staff. They need to be willing to try new methods and practices, open to change and new ideas, and comfortable with suggesting new ideas to their managers. They also need a strong customer focus and to be flexible in handling priorities to meet deadlines, especially where those deadlines involve customers and supply chains.

Developing positive and enterprising cultures in large and small organisations can be a complex process – a bit like a jigsaw puzzle – as all the pieces need to be put in place side by side before the picture (the value or benefits of the process) can finally be seen.

Depending on the nature and size of the business, that process may involve the following.

- Encouraging creativity in staff, and encouraging suggestions for new ideas and innovation from staff at all levels.
- Changing established attitudes within the organisation, e.g. old fashioned master–servant relationships that used to be seen between management and workers, and building trust between staff at different levels of seniority. People’s attitudes take time to develop, often evolving over a period of time; once established, they can be slow to change.
- Breaking down old habits and resistance to change. This can be difficult, especially where staff do not feel motivated to put themselves out for the business. This attitude can be very negative and harmful to business growth, and is sometimes illustrated by comments such as “that’s not my job”, or “I’m paid to work, not think”, which is the antithesis of an entrepreneurial or innovative culture.

- Establishing new norms of behaviour. This includes both the formal norms imposed by company rules, and the informal norms developed via tacit consent by the staff over a period of time, e.g. the behaviour in the workplace that co-workers will or will not accept from their colleagues.
- Motivating or incentivising the staff to maintain their newly developed creativity.

In small firms, the culture of the business and the attitudes of staff frequently reflect the personality and management style of the owner-manager, whether good or bad.

Therefore, the staff in a business with an enterprising and customer-focused owner will typically pick up that attitude and reflect it to the customers, whereas staff working for an autocratic or perhaps arrogant owner may tend to behave in the same way towards the customers.

Enhancing Creativity and Innovation

Some staff are naturally creative, whilst others, perhaps the majority, have no interest in this. That may be very much determined by the environment in which the business operates: for example, in some sectors such as design, advertising and the media, employees, by virtue of their job roles, tend to be naturally creative. In contrast, assembly workers using standard operating procedures to produce identical products may not be.

Employers can enhance creativity and innovation in a number of ways.

- Positively expect staff to be creative – make it the norm – and inform staff of those expectations. Introduce it gradually as something that is mutually beneficial and get staff to buy in to the idea to break down resistance to change.
- Build innovation into targets and objectives as part of the annual staff appraisal process. Initially this may just involve asking a member of staff to identify two or three improvements to his or her job over the next year. After that, once staff appreciate the concept of being involved in the innovation process, their targets can become more ambitious. Ideally, by the third appraisal cycle, they will start to choose and take responsibility for those targets themselves. That is where the innovation culture really starts to move the business forward.
- Encourage and support staff with skills development, perhaps creative thinking training, or other activities outside of the workplace that will challenge them to solve problems or use their imagination. That development can take much simpler forms as part of everyday activities by involving staff in brainstorming sessions to help solve problems or quality circles to identify and investigate improvements in the business. Managers do not have a monopoly on good ideas, so the key to making these two activities work effectively is to create a situation in which everyone feels that their ideas and suggestions are equally valued and listened to. This can give a major boost to the development of an innovation culture.
- Expect and tolerate failure – innovation is risky and will inevitably involve a proportion of failures, so staff must be pre-warned that this is a normal part of the innovation process. Managers need to understand that it is essential to avoid a blame culture that might dissuade staff from trying out other innovations; they need to encourage experimentation and accept failure without blame as a normal part of the innovation process.
- Be prepared to invest time to investigate innovation opportunities. Some companies specifically allocate time out of normal working duties on a regular basis (e.g. one day per month) and often in an environment outside of the office, during which staff

are expected to focus on developing new ideas or opportunities, or to work on new projects.

- Encourage staff to challenge convention and look for causes and explanations. Encourage all levels of staff to ask questions: what? where? when? how? why? – and often more importantly, why not?
- Encourage staff to build relationships with customers and listen to them to identify any potential problems they might have. One person's problem is another person's opportunity; if a business can solve a customer's problem, it both enhances the relationship with the customer and potentially adds to revenue and profit.
- Be prepared to challenge current thinking and/or working practice – query the reasoning behind it, and query whether or not alternatives have been considered. "We've always done it that way" is not a good reason to refuse change, and there is nothing like an inflexible standard operating procedure to stifle the consideration of innovation or improvement. Don't ask "what is the risk of doing it?", but rather "what advantage could be lost by not doing it?"
- Finally, reward innovation – whether that is by celebration of achievement, public acknowledgement or praise for success, promotion, or financial incentive or reward. Staff suggestion boxes, which were themselves an innovation 50 years ago, don't just relate to improving working conditions. There are many companies that use them exclusively to promote suggestions for improvement and innovation, and some pay staff a fixed sum, or even a percentage of the costs saved or extra profit that is generated by implementing the improvement, over the following one or two years.

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Chapter 3

Business Planning and Start-up

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INTRODUCTION

The question that is often asked by people who are starting a business is: “Why do I need to bother with a business plan?” Apart from the obvious response – “If you don’t have one, nobody will lend you money” – there are a number of very strong reasons and justifications for developing proper business plans, including:

- to focus the mind on the purpose of the business and what the business will offer
- to clarify for the business proposers just what they want and expect from the business
- to research and identify the target markets and customers
- to identify the resources (staff, skills, physical, and financial) that will be needed
- to quantify financially the costs and funding of those resources
- to plan the implementation of the business and the budget implications of this
- above all, to test the viability of the business, in terms of markets, break-even levels, investment costs and returns, to ensure that it can survive and grow.

It must also be remembered that business plans are not just used by start-ups. They are a valuable management tool for planning and monitoring the successful operation of the business. They can also be used for long-term planning to investigate strategic development options – growth, diversification, acquisition and exit strategies or sale of the business. They can be used to raise external funding or investment to finance those strategies, or to develop new products or innovations, and of course they can measure the profitability and success of the business to determine what dividends the owners can take to repay their investment and effort.

A. BARRIERS TO STARTING AND GROWING A NEW BUSINESS

Barriers to Starting a New Business

The typical barriers to entry for start-up businesses fall into five main categories.

- The high cost of capital investment for some sectors, industries or technologies.
- Accessing finance for start-up.
- The strength and attitudes of competitors within the market.
- The staff skills/expertise and networks and contacts required.
- Compliance with regulatory requirements.

High investment costs.

- The cost of capital equipment and machinery for manufacturing. This can be one of the biggest barriers to start-ups, particularly where it is necessary to purchase specialist or high-cost equipment for production purposes, or to develop prototypes and subsequent mouldings for components or products to be produced by third parties.
- R & D/proof of concept for technology-based products. A major issue for technology-based companies is where the purchase of expensive analytical or processing equipment is required in order to develop new products. Most biotech

companies, for example, will require specialist laboratories with positive air pressure and filtering, a range of high-precision instruments, microscopes, centrifuges etc. They may also need to buy in specialist proteins or chemicals for their analysis. All of this mounts up to substantial costs that will have to be incurred long before any revenue is achieved.

- Staff time/costs for pre-start-up stage. The longer the pre-revenue development stages of a business, the more funding is needed to pay for the staff involved in that development, particularly where highly specialist technical staff have to be employed. One remedy is to offer those staff “sweat-equity”, whereby they may work for nothing initially, or accept a lower than normal level of pay in return for some equity in the business. Typically, this will be non-voting shares that will not affect the voting-share equity that is available to attract investor funding.
- Cost of sales and marketing to achieve market penetration. The issue of barriers to market entry will be examined in Chapter 4, but essentially where those barriers are high, the pre-revenue financial costs of penetrating the target market can also be high and must be considered when estimating the start-up capital requirements.

Finance.

- Access to funds for investment. As explained in Section B of this chapter, in the past few years it has become progressively harder for start-up businesses to acquire the funds they need; they have become more reliant on friends and family and boot-strapping to move the business forward to a point where a sufficient customer base is established to enable them to access business angel or bank funding.
- Borrowing capacity/availability of security. Typically lending banks do not expect to lend any more than the sum of investment made by the entrepreneur(s) or other investors. However, the capacity to borrow more than that may be available where the entrepreneurs (or his or her family) are able to offer security, usually in the form of a charge on private property or a guarantee by a person who owns property or some other form of equity.
- Perceived risk to lenders/investors. Lenders are typically more risk averse than investors, as an investor will balance the risk against the potential return on investment, whereas a lender's return is the interest paid on the borrowing which would normally be lower. Lenders are more concerned with the perceived risk of not getting their loan repaid, whilst the investors accept that risk against the prospect of high capital growth.
- High cost of borrowing. Large established companies can usually arrange medium- to long-term loans at 3-4% above base rate. Pre-2008, small firms could arrange such loans for 5-7% over base rate, but post-2008 that interest rate has increased to 7-10% and short-term overdraft borrowing can be significantly higher – 12-15% or more.

Competition.

This area will be examined in detail in Chapter 4, but the main barriers to market entry are:

- numbers of direct competitors in the market, or competitors with substitute products
- size and resources of competitors compared with the proposed business
- competitors' strength within the market and control of in terms of influence and market share
- competitors' attitude to new entrants (aggressive/neutral/dismissive)
- customer brand loyalty and willingness to consider new or alternative products.

Staff skills/expertise/networks.

- The extent of the entrepreneur's own business skills, experience of launching new enterprises, and ability to manage staff and other resources.
- The problems of sourcing staff with specialist technological expertise and/or market knowledge.
- The problems of attracting staff to work in a small business environment. This used to be more significant when larger companies were regarded as more stable sources of employment, but when national levels of unemployment are high, small firms become equally attractive as potential employers.
- The ability of the entrepreneur to use existing contacts and networks and to establish and develop new networks that can assist or support the establishment and development of the business.

Legal and regulatory compliance.

- Sector-specific regulations. Most sectors of business have some form of specialist regulatory compliance – e.g. food hygiene and storage in the catering industry, regulations for financial advisers in the investment sector, and pesticide regulations in agriculture. On the whole, these regulations are well known within each of the sectors; new entrants to those sectors are well aware of them and their associated costs which, if known, can be factored in along with other start-up costs. However, there are some sectors in which the regulatory compliance can have much more substantial financial implications – banks, for example, have to hold a proportion of their assets in liquid form (not that many entrepreneurs will be considering starting a new bank!); and travel agents and tour operators have to lodge substantial financial bonds with ABTA and similar bodies in case customers are stranded abroad when an operator becomes insolvent.
- Generic compliance, such as health and safety and employment law. These are universal regulations affecting all businesses, irrespective of sector. They do not usually form a barrier to start-up but they do present a substantial burden of red tape that can be disproportionately heavy on small firms because of their size and lack of resources.

Barriers to Growing an Early Stage or Small Business

Issues for the entrepreneur (or, more typically, the non-entrepreneurial owner-manager). These include some of the factors that were discussed in Sections A and C of Chapter 1.

- Too much operational focus and a lack of strategic thinking or planning.
- No desire for growth:
 - perhaps due to a deliberate choice of lifestyle business, or
 - because the entrepreneur/owner-manager is satisfied with the current size and profits of the firm.
- No desire for further risk or personal financial exposure once the firm is stabilised and profitable.
- Lack of necessary strategic/managerial/sales and marketing skills.
- Wariness of employing other managers because of the:
 - fear of loss of direct control/own investment in the hands of others, or
 - dislike of delegation or inability to delegate.
- The implicit role change from entrepreneur to manager as a business grows.

Market and customer issues.

- The market has limited or no potential for growth – which suggests the growth strategy of the business needs to be refocused on options for diversification or new product development.
- The cost of further market penetration is prohibitive – where the cost or effort involved in gaining additional market share is disproportionate to the profit or benefits it will generate.
- An unstable or depressed market environment – where the return on investment cannot easily be verified or may be too risky.
- A lack of knowledge/experience of alternative markets – further in-depth market research and analysis are required to evaluate options.
- The implications for quality of service to current/loyal customers – rapid growth may stretch the business resources and become disruptive to product or service delivery, causing a negative impact on customers.

Financial barriers.

- The problems of accessing finance for growth, such as:
 - no reserves from previous profits
 - limited borrowing capacity, e.g. up to existing limits, highly geared
 - no security is available for (further) borrowing.
- The high cost of borrowing large sums and servicing interest payments.
- The risks of borrowing, for example to finance growth for a single large customer. This has proved to be a common problem for small firms supplying large corporations, particularly supermarkets, where the buyers have no loyalty to the small suppliers beyond the duration of their current contract.
- The risk of over-trading – the growth may be highly profitable but the rapid rate of growth outstrips available working capital and causes cash flow problems, and potential insolvency.

Resource implications.

- Growth may necessitate bigger and more expensive premises, with the associated capital investment requirements.
- Extra staff may be needed, along with the associated overheads, admin and payroll costs; in some cases, there may be aggravation and disputes too, where owners and managers do not have experience of managing large numbers of staff.
- There may be a need for major capital investment in production plant and equipment to match the increased demand resulting from growth.

Organisational issues.

- The additional administration burden from red tape and legal compliance.
- The need to start to employ functional managers or specialists – human resources, accounting, sales and marketing, production distribution/service delivery.
- Possible changes to the structure and culture of the firm:
 - from small and friendly to larger and more impersonal, and/or
 - with less influence from the entrepreneur's own character/attitudes.

B. THE IMPORTANCE OF PROPER BUSINESS PLANNING

Why Are Business Plans so Important?

There are many reasons to justify the preparation of business plans, not just for business start-up enterprises, but as an ongoing process for established businesses. The important thing to remember is that just producing a good business plan alone will not result in a sound, profitable or prosperous business. The business plan is just that – a plan. Like any other plan, the only way to see if it really works is to monitor its progress at regular intervals, enabling the business to respond to any potential problems which may arise, and changing or modifying the business strategy as necessary.

Plans are important, first of all, because the process of producing a business plan is a very efficient way to focus the ideas of potential entrepreneurs, in terms of defining their objectives and assessing their own abilities to organise and run the business. It also acts as a means of testing the viability of the business proposal before actually committing its proposers to any substantial expenditure or investment. Typically, this type of plan should be prepared before the start-up or acquisition of the business, and certainly before any substantial financial commitments or investments are made.

Second, the planning process establishes parameters and specific targets which provide a yardstick against which the progress and profitability of the business can be measured. In other words, this is the process of converting the proposers' objectives into quantifiable financial forecasts and targets against which progress and achievement can be measured. Again, this planning activity is a pre-requisite to starting or acquiring a business; beyond that, though, it is also an essential part of the ongoing process of running a business, and should be continued long after the initial start-up period.

Third, there are relatively few aspiring entrepreneurs who have the resources to be totally self-financing, so most are faced at some time with the need to raise external finance, if not at the start-up stage, then later when they wish to expand and grow the established business. For these persons, possession of a good business plan is crucial to their future. Their first appointment with the potential investor, financier or bank manager to discuss the proposal can be likened to an audition for a role in a play or film: if they blow their lines, they blow their chances – or at least, reduce their prospects of getting the part they really want! It is, therefore, vital to prepare the plan thoroughly, and to present it in a professional and competent manner. However, it is also important to remember that the business plan is essentially a sales document that will be used to convince the potential lenders or investors to engage with the business. As such, in order to persuade the lenders or investors to engage with the idea, it must be presented in a positive, honest and enthusiastic manner to project the viability of the proposal and the competence of the proposers to convert the idea into a profitable business.

The Business Plan as a Means of Focusing Ideas

The production of a comprehensive business plan is really centred on a process of questions and answers; and the deeper you move into the plan, the more questions arise

which must be answered. Most people who consider buying or setting up a business, or becoming self-employed, have a fairly general idea of what they would like to achieve from it in terms of their personal ambitions, wealth and lifestyle. However, the question: “What are your specific objectives?” needs to be asked, to prompt them to define the precise parameters within which their proposed business will operate. Typically, this question is only asked for the first time when they start to fill in the bank’s business plan form. The primary objectives (often called the mission statement) of the business need to state clearly and specifically the purpose for which the business exists, and the market in which it will operate, as in these examples.

- I intend to operate a high-quality and profitable mobile catering service, specialising in wedding receptions and private parties, in the Kent and Sussex areas.
- We will be providing a service which designs, constructs and maintains heated swimming pools for large private homes in London and south-east England.

Invariably, statements such as these will immediately raise the question: “How will this be achieved?” This requires the potential entrepreneur to examine and explain the financial, operational, marketing and control aspects of the proposition, which forms the core of the business plan.

The next aspect to be considered is the viability of the proposition, prompting yet another question: “It sounds like a good idea, but what makes you think it will work?” Unfortunately, hunches, gut-feelings, innate beliefs, and intuition cannot guarantee the viability of a business venture, so the answer to the question requires some tangible ideas: “I am offering a service for which there is a growing awareness and demand and, at the current time, the nearest alternative supplier is located 100 miles away”. Viability may involve a range of considerations including market research and segmentation, feasibility studies, assessment of potential sales turnover and profit margins, break-even analysis, availability of regular supplies, availability of competent staff, and adequate working capital. Again, the budding entrepreneur is required to focus in much more detail on the practicalities of the proposition, including his or her own personal skills.

The business idea itself may be perfectly viable for any competent or experienced business person, but the other area to be considered is whether or not the budding entrepreneur actually has the necessary skills and competencies to pull it off. Do they possess the necessary technical knowledge of the product or service? Do they have knowledge of the market? Have they had any sales experience? Can they manage people and delegate work? Do they have the necessary financial skills for book-keeping, credit control and managing budgets? Next, if any of these skills are lacking, can they be acquired or will it be necessary to buy them in and, if so is this affordable? Whereas large established companies can afford to buy in or develop specialist skills, in start-up or early stage companies the money is not there, so the owner or manager needs a breadth of general business skills, as well as a depth of knowledge of the product or service. The available breadth of expertise and personal abilities are areas which lending banks consider and explore as part of their evaluation of proposals.

Measuring Progress and Achievement

As explained earlier in this chapter, it is imperative that every new business has clearly defined objectives and parameters within which it will operate. However, these only have purpose and value if they can be used as a basis for measuring the performance of the business on an ongoing basis.

To achieve this, the objectives have to be broken down and expressed as a series of specific measurable targets for each key performance area of the business. For example, in the financial context, this might include:

- annual budgetary plans, forecasting income and expenditure on a month by month basis, against which actual income and expenditure can be monitored
- forecasts of gross profit margins and net profit margins, derived from the budgetary plans, which can be monitored to pick up any problems due to rising costs, falling sales or seasonal fluctuations in sales
- the effects of specific sales or promotional activities on sales revenues or profit margins
- cash flow forecasts, and the effects of giving or taking credit
- the need for additional working capital to sustain business, e.g. by means of short-term overdrafts or longer-term loans to facilitate expansion of the business
- the affordability of capital investment: Do we replace or repair? Do we produce components ourselves, or buy them in? Do we use loans or hire purchase to buy equipment, or do we lease?

In the sales and marketing context, examples might include:

- forecasts of market share that will be achieved by each range of products or services
- sales forecasts and projected revenues for each individual product or service
- expected profit margins or contributions to overheads achieved by those revenues
- costs of sales activities
- costs of special promotions and expectations of increased sales and revenues generated by them
- costs of customer service and retention.

The planning and monitoring of progress and achievement are an integral part of the ongoing management of business operations. The initial business idea formulates the initial policies which determine the financial and marketing plans and targets. The achievement (or otherwise) of those targets, or the modifications to the plans in response to external influences and change, will influence the resources available for the future; and this, in turn, will impact on future business planning. This is the constant cycle of plan, implement, monitor and revise. Ideally, of course, any revisions should take the form of proactive plans which are made in anticipation of future events, rather than a series of reactions in response to past events or circumstances.

Raising Finance for Start-up or Expansion

Very few start-up businesses (apart, that is, from some self-employed trades, or ex-lottery winners) are in the position of not requiring funding to start trading, and virtually all of those that have ambitions of growth for the future will need some form of finance to expand and grow. In the UK, even those not requiring start-up funding are usually asked by their bank to provide a basic business plan in order to qualify for an initial period (usually the first year of trading) of free bank charges on their business accounts.

The various options for raising business finance are discussed in Chapter 8, but for the majority of small firms the starting point is their local bank manager. Inevitably, the first question asked of a budding entrepreneur is: "Can I see your business plan?" – a question which is usually closely followed by: "What forms of security or collateral can you offer?"

Obtaining start-up funding from banks has never been easy but since the credit crunch started in 2008 many start-ups are finding it almost impossible, as the banks become increasingly risk averse. This is particularly true of banks that had to be nationalised in 2008-09 because of their profligate lending in the previous few years, when it was less difficult for anyone who had a reasonable amount of security to borrow money to start a new business.

Today, the clearing banks take a much more responsible attitude to potential business customers, seeing themselves as stakeholders in the businesses. This is reflected in the questions they ask, and the risk analysis process they use to review the viability of new business proposals.

The ability to prepare a comprehensive and coherent business plan is essential for anyone starting in business, particularly if externally sourced finance is required. The UK Government's VAT registration statistics suggest that only half of new businesses survive more than five years, so a strong business plan will not only make raising funds less difficult, it should also make it more likely that it will succeed. Preparing a plan is not difficult, given the many standard formats which are available these days. However, the plan should not just be about satisfying the bank manager's information requirements; it should also provide the entrepreneur with the knowledge and information needed to ensure the business can survive the difficult early stages to become profitable and grow.

How Often Should the Business Plan Be Updated?

Most business plans are updated on an annual basis. For most small firms, it is unrealistic to prepare very detailed budgets and cash flow forecasts for more than a year ahead, but preparing them for less than a full year will not generate useful information. It is important to remember that the business plan is a live document, for use as part of an ongoing process – it is not just something prepared for the bank manager at the start of the year, and then put in the filing cabinet and forgotten until next year. Most firms revise their plans quarterly or at the half-year stage if there look like being any major changes that might affect their original forecasts. For example, a fall in product demand will reduce revenue, so costs may also need to be trimmed back to maintain profitability; or if sales rise, the budgets will need to be adjusted to reflect not just the increased revenue, but also any associated increase in costs of production or distribution.

Plans need to be monitored frequently if they are to be of any real use. Budget outcomes (actual figures) should be compared with forecast figures at least once each month, and then within two weeks of the end of the month. This will enable prompt identification of any major discrepancies or problems which lie on the horizon. When discrepancies occur they must be questioned: Why has this happened? Is it a one-off occurrence, or the start of a longer-term trend and potential problem? What has to be done to resolve the situation? Unfortunately too many people faced with apparent problems are more concerned with apportioning blame than with identifying the cause of the problems and working to find a solution. The subject of financial monitoring and control will be examined in more detail in Chapter 8.

One other aspect to be considered here is the fundamentally different approach to planning by small firms and their larger counterparts. Welch (1995) states that "the big-company model of managing and career development does not apply to small businesses". Larger organisations normally have the resources, stability and security to

facilitate long-term strategic planning, typically three to five years ahead, and the immediate year ahead is seen as the short term. For the entrepreneurs or owner-managers of small firms, the immediate problem is often simply one of survival – where is the next order coming from? – particularly in the early stages of the business, when planning just one year ahead counts as long term. In the early stages, most small firms focus on short-term plans and goals with survival as the first priority. Consequently, they look to the equally short-term policies that will enable them to meet those short-term goals. As discussed in Section C of Chapter 1, only when they have achieved some measure of stability and security can they start to look at longer-term planning and investment.

How Much Detail Should the Business Plan Contain?

The answer to this question will very much depend on the type of business for which the plan is being prepared. For example, a self-employed window cleaner with no overheads or equipment apart from a car, ladders, bucket, chamois and scraper will have quite simple requirements – in fact the biggest problem will probably be in planning where to get the clean water from on each part of the daily round. In comparison, someone setting up a wholesale or manufacturing business, or as a hotelier, import/export agent, or specialist holiday tour operator – where longer-term capital funding is required or where specific and possibly complex legislation applies – may have quite a detailed business plan.

Some self-employed people who have no need of external funding simply do not bother to prepare business plans. Others who work on a part-time basis, with perhaps another regular day job or a working domestic partner, may have a very simple plan, as they may not be dependent on that particular business activity as their sole source of income. Hence the size and content of any business plan will depend on the type of business it relates to, the borrowing requirements, and the personal circumstances and resources of the entrepreneur or owner-manager.

C. EXPECTATIONS OF LENDERS AND INVESTORS

Expectations

When experienced lenders or investors take a first look at a new business plan proposal, they rarely read it through from front to back. Typically, they will skim over the introduction to get an idea of what the proposal is about and then jump straight to the finance section to look at the profit and revenue forecasts for the first two years. If they are comfortable with them, they will move on to examine the marketing section to assess how realistic the marketing proposals are. Only if they are satisfied with this will they read the proposal in detail, and even then there are usually a host of questions that need to be answered before they reach the stage where they are ready to make a decision about whether or not to lend or invest.

Essentially, when reviewing a proposal, investors and lenders are looking for answers to a number of specific questions.

- How financially viable does the business proposal look and, in consequence, what is the likelihood of a loan being repaid, or making a good return on capital investment (via interest/dividends/capital growth)?

- How reasonable are the sales and profit forecasts and projections – do the figures look realistic?
- Do the proposals demonstrate a good degree of understanding and analysis of markets and customers?
- How detailed and realistic is the marketing plan?
- How strong are the skills, experience and competences of proposers? Does the business have a strong management team?
- How realistic is the timescale for implementation? If it is protracted, is there a risk of the business failing to get started?
- Do the proposers understand their break-even position – in terms of units sold, or sales revenue, or time taken to reach break-even? Is there enough working capital available to enable the business to reach break-even before it runs out of money?
- Has a detailed risk analysis been carried out, and have contingency plans been identified to address or mitigate risks?
- What opportunities have been identified for investors to exit at the end of the investment period (exit strategies)?

Due Diligence

This is the process used to evaluate business proposals for lending or investment. In its simplest form, for a start-up business it may comprise a detailed risk analysis of the proposed borrowing against the business plan, coupled with checks on the financial position of the proposers. This involves things like taking up bank references and personal references, and carrying out credit checks, insolvency list searches, and property searches where property is offered as security.

Where substantial borrowing or investment is required, e.g. for staged funding of high-growth companies, the due diligence process will be much more complex. It might include searches and reports from the Registrar of Companies, references from suppliers, dialogue with customers, patent searches and checks on licences or other intellectual property, market analysis reports, reviews of published articles relating to company research projects, and detailed scrutiny of technical processes by independent experts. All of these items can take up great deal of time, effort and expense which is why a lot of venture capital investors will not even consider investments under several million pounds.

D. BUSINESS PLAN FORMAT AND STRUCTURE

The following generic business plan format is a 2011 update of a model developed by Butler (2006) that has been designed to cover the content required to meet three specific objectives.

1. It has been synthesised from a number of business plan formats used by major UK clearing banks (HSBC/Barclays/Lloyds TSB/RBS etc) and modified to provide the content and coverage required by most lenders and investors to enable them to make a balanced decision about providing funding for the business proposal.
2. It follows the Small Firms Enterprise Development Initiative (SFEDI) National Occupational Standards for Business Enterprise which define best practice for the process. SFEDI (www.sfedi.co.uk) is the Sector Skills Body for Enterprise in the UK.

3. Most importantly, the plan's content and structure should require the potential entrepreneur to understand and address a range of key questions and issues that are essential to survival during the start-up and early stages of a new business.

Generic Business Plan Format

- 1 THE BUSINESS IDEA (*introduction/executive summary*)
 - 1.1 Brief outline of type of business proposed and trading status
 - 1.2 Range of services to be offered (primary and secondary)
 - 1.3 Personal parameters of owners, e.g. full-time/part-time operation, hobby business, lifestyle factors, constraints, etc
 - 1.4 Geographical location/home of business
 - 1.5 Brief summary of anticipated customers/target market and their distribution
 - 1.6 Statement of viability – why I/we will succeed
- 2 THE BUSINESS PROPOSER(S)
 - 2.1 Brief background/personal history/summary CV of key team members
 - 2.2 Personal influences, ambitions and long-term objectives
 - 2.3 Why I/we want to go in to business
 - 2.4 Personal skills, expertise and experience relevant to business
 - 2.5 SWOT analysis, and identification of personal development needs
- 3 RESOURCES REQUIRED
 - 3.1 Costed start-up inventory of equipment and materials
 - 3.2 List of any equipment/materials already available
 - 3.3 Details of IPR owned/applied for
 - 3.4 Premises requirements and any modifications required
 - 3.5 Transport requirements/availability
 - 3.6 Staff and skills requirements in early stages (if needed).
 - 3.7 Relevant health and safety factors/implications
- 4 FINANCE
 - 4.1 Spreadsheet showing first year budgetary plan and cash flow forecast
 - 4.2 Explanation of basis for planned budget
 - 4.3 Personal survival budget – to determine owners' salaries/drawings
 - 4.4 Break-even analysis – in terms of timescale/revenue/units sold
 - 4.5 Profit forecasts for years one and two
 - 4.6 Value of current resources/capital available/investment to date
 - 4.7 Further finance required (and phasing if appropriate)
 - 4.8 Potential sources of finance – loan capital/equity options
 - 4.9 Preferred sources of finance and reasons for choice
 - 4.10 Financial monitoring procedures within the business
- 5 MARKETING
 - 5.1 Detailed description of target market and operating area
 - 5.2 What is special/unique about my/our services, or how do they differ from those offered by competitors?

-
- 5.3 Market research carried out and/or planned for the future
 - 5.4 Description of relevant seasonal factors and other influences
 - 5.5 Analysis of competitors' services, activities, prices etc
 - 5.6 Marketing plan
 - 5.7 Schedule of fees and charges for products or services
 - 5.8 Statement of quality standards and customer service policies, and how these will be monitored to maintain and improve services
 - 5.9 Monitoring of sales, and changes in marketing trends

 - 6 IMPLEMENTATION AND MONITORING (*describe the following*)
 - 6.1 Chosen means of operation (limited company/sole trader/partnership/community interest companies etc), and reasons for choice
 - 6.2 Maintaining compliance with relevant legislation (including brief summary of why other key legislation may not be relevant)
 - 6.3 Timetable/phasing of start-up (including pre-start-up research and development/proof of concept activity if relevant)
 - 6.4 Identification of key/critical stages of implementation, risk analysis including key tasks, potential delays etc, and contingency plans for dealing with problems
 - 6.5 Longer-term objectives for the business once established, and exit strategy if relevant
 - 6.6 How the success of the business will be measured

 - 7 SUMMARY
 - 7.1 Re-affirm reasons for viability and expected success

 - 8 APPENDICES (*other information supporting the plan*)
 - 8.1 Letters of intent/support from potential customers/suppliers
 - 8.2 Market research data
 - 8.3 Estate agents' information on potential premises
 - 8.4 Design material/copyrights/patent information
 - 8.5 Technical product information
 - 8.6 Detailed CVs of proposers and/or associates
 - 8.7 Samples of advertising material, leaflets, business cards

E. DIFFERENTIAL NEEDS OF HIGH-TECH AND HIGH-GROWTH-POTENTIAL START-UPS

Summary of Main Factors

Aspects of this topic have already been covered in part in Chapters 1 (Sections A and E) and 2 (Section C), but here is a summary.

- High-tech and high-growth-potential start-ups will usually require a more sophisticated management team that can demonstrate a high-level of expertise in sourcing finance and investments, managing substantial budgets, and with national or international marketing or licensing experience, strong management and leadership skills, and specialist technical knowledge coupled with R & D experience.
- Such companies will often take a number of years to reach the revenue-generation stage, and en route to that will require successive stages of funding from different

sources raised from potentially different sources – R & D grants, proof of concept funds, pre-market product development finance, market launch funding, subsequent seed or accelerator funds for growth, and longer-term potential large-scale investment for expansion.

- The typical capital investment costs of starting up will be higher for technology-based innovations, and may have to be obtained from a range of different sources over a period of several years.
- The working capital requirements of funding rapid growth will be much higher for high-growth-potential businesses.
- There may be a need for costly protection of IPR, and where the innovation is generated from an academic research source, those rights (or a proportion of the equity of the business) may have to be shared.

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Chapter 4

Developing the Business Idea

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INTRODUCTION

When developing an idea for a potential new product or service, the idea needs to be developed to a certain point before it is possible to identify which, if any, customers might want to use it; then, exactly what customers will want or expect from the new product or service to make them want to pay for it needs to be defined; this, in turn, feeds back into the development of the idea. This is what the first stage of market research is all about – to find out if there really is a market out there for the proposed new product or service.

When the existence of that market is confirmed, the subsequent stages of market research will be concerned with determining:

- the size of the market
- the competitive or substitute products that are available in the market
- who the competitors are
- which barriers might inhibit or block entry into the market.

Once these barriers are understood, the business can start to develop a strategy for addressing them. Part of that strategy will be to define and promote the new product or service in terms of its unique features that differentiate it from the competition, and the unique benefits it can bring to customers as a solution to their particular problems.

This, in a very simple form, is the process of creating competitive advantage.

A. IDENTIFYING CUSTOMERS

Understanding Customers

Prior to commencing the detailed market research process, there are a number of basic questions the potential entrepreneur needs to ask in order to understand more about the customers who will hopefully be buying the products or services in question.

- Why should the customers want to buy the products or services? What features and benefits do they offer that cannot be obtained from other products or suppliers?
- What is the competitive stance of the business – i.e. the individual (or combined) selling points of the products or services? This might include the unique features they offer; how they meet the needs of the niche market; the competitiveness of the pricing; and the quality of the product or service.
- Where are the customers located? How will they be supplied – face to face, by mail order, using delivery services, or via a wholesale or distribution network? For some businesses, particularly those that are offering locally based services or retailing direct to the public, the geographical location will be of major importance; however, location may be relatively unimportant where mail order or internet sales using postal or contract courier services are concerned. What is of major importance is that the customers get the products or services they require, at the right price and quality and at the time they want them.
- What are the customers' buying criteria or expectations? These may be expressed in terms of service levels, product reliability, convenient access, the flexibility of service or product supply, and prompt availability.

- How much are they motivated by price and quality? For example, are they looking for the cheapest option; will they tolerate lower quality to reflect a lower price; would they prefer to pay a high price for a high-quality or luxury product; or are they just looking for value for money?
- How frequently will they buy the products or services? Will they be regular long-term customers, or occasional purchasers? Frequency of purchase also needs to be considered alongside the relative size and value of purchases. Regular long-term customers are ideal for providing a steady revenue stream, but if the value of those regular purchases is low, it may pay the business to target larger but less-frequent purchases.
- Do the customers share common features that are relevant to the market – e.g. similar age groups, or the same gender, marital status, social class or ethnicity?
- Taking the analysis of customers further, are there particular groups of customers that will buy, such as teenagers, single parents, elderly or retired people, or people with an illness or disability? Do the customers have any common lifestyle factors, hobbies or interests? Are they perhaps health food or fitness enthusiasts, do-it-yourself enthusiasts, environmentalists, young home owners, rock musicians, car owners or football fans? Are there any social or psychological factors involved, such as public image, prestige, wanting to be fashionable, following social trends, needing to identify with others, or a desire for self-improvement?

Market Segmentation

Identifying customer “segments” serves several purposes. It helps to identify which of the groups of customers has more potential than others to generate sales revenue, perhaps because some will be willing to pay more for what is being offered, or because some may have bigger needs than others. It also helps to define targets for more detailed market research, leading to marketing strategies that will enable the business to focus the sales and marketing effort at the parts of the market that offer the maximum potential.

A good example of how suppliers segment their offer to meet the different needs of customers is the structure of tariffs for mobile phone usage. Table 4.1 illustrates how the prices from one of the major European networks for the iPhone 4S (shortly after its launch) reflected the different levels of customer usage.

Table 4.1: Mobile Phone Usage-based Tariffs

Length of Contract	Phone Minutes	Free Texts	Internet Usage	Cost of Phone	Cost of Monthly Contract
24 months	600	No limit	1 GB	Free	£41.00
24 months	900	No limit	1 GB	Free	£46.00
24 months	1200	No limit	750 MB	Free	£41.00
24 months	600	No limit	1 GB	£99.97	£36.00
24 months	200	250	500 MB	£169.97	£31.00
24 months	50	50	100 MB	£309.97	£20.00
Pay as you go	n/a	300	100 MB	£489.99	£10.00 / top up

The heaviest business users pay high monthly contract costs, but the phone is provided free of charge; for medium usage, there is a lower contract charge, but a modest purchase

price for the phone; and for low usage, there is a pay as you go option, with no contract, but the phone has to be purchased up front at the full retail price.

In Section D of Chapter 2, we examined four case studies, one of which was Oil Drum Ltd, producers of a hydrogen-generating fuel-saving device for diesel engines. Rather than analysing the customers' motives for buying, frequency of purchases etc, as would be appropriate in a wholesale or retail situation, the company used a different model (see Table 4.2) of customer segmentation for the sale of patent licences for the production and sales of its products, based on a combination of geographical segmentation, and segmentation by product use.

Table 4.2: Oil Drum Ltd's Customer Segmentation Model

Application	Market Segment for Sale of Licences
Trucks and buses – fitting at time of manufacture	Individual truck and bus manufacturers, irrespective of national location, e.g. Volvo (USA), Ford, MAN (Europe)
Fleet vans/pick-up trucks – fitting at time of manufacture	Individual van manufacturers, irrespective of national location
Trucks and buses – retro-fitting	National licences for individual countries or groups of countries, e.g. UK, Western Europe, Baltic States, Eastern Europe, USA, Canada, Australia, China, Japan, Brazil, India, Nigeria
Fleet vans/pick-up trucks – retro-fitting	National licences for individual countries or groups of countries – possibly in conjunction with licences for trucks and buses
Agricultural vehicles – retro-fitting	National licences for individual countries or groups of countries – possibly in conjunction with licences for trucks and buses
Airport vehicles – retro-fitting	Corporate operators or groups of airports, with large aircraft fleets (e.g. Ferrovial, British Airways/Iberia), for retro-fitting to vehicles used air-side
Military vehicles	Licences for individual manufacturers (e.g. BAE Systems) – but permitting global sales of their products
Diesel generators	Cross-national licences for generator manufacturers, and national licences for retro-fitting
Marine engines – retro-fitting	Cross-national licences for marine engine manufacturers, and national licences for retro-fitting
Light aircraft	National licences for individual countries or groups of countries

B. RESEARCHING POTENTIAL MARKETS

Stokes (2010) describes small business marketing as something of a paradox – small firms often regard marketing as an activity for larger organisations, and yet their very flexibility and responsiveness to customer needs is the epitome of good marketing practice. Part of their attitude to marketing is due to the limited nature of their size, turnover and profit, which means that they are much less able than their larger counterparts to commit large proportions of their gross profit to marketing activities. In addition, many owner-managers lack marketing skills, apart from those they have picked

up empirically, often through making mistakes along the way or as a result of following gut instinct. Others do not go beyond basic essential sales activities or responding to customer demand; having to focus on day to day survival leaves them with little time or inclination for long-term strategic market planning. Little research has been carried out into the relative survival and growth rates of those small firms that do employ market research techniques as part of their business planning compared with those that do not; simple common sense tells us, however, that the more we know about our customers and our markets, the more chance there is of maximising opportunities and minimising risks, which has got to improve the chances of survival and growth of any business.

Market research is an ongoing process which seeks the answers to a range of questions in the ever-changing market environment.

- How large is the market for my goods or services?
- Is the market growing, is it static, or is it shrinking, and are any of these situations likely to change in the near future?
- What proportion of the market do I command right now?
- What potential proportion could I realistically achieve?
- What would I need to do to achieve that?
- Is the effort worthwhile, or should I consider an alternative?
- Are there any barriers to entering the market or to expanding within it?
- Are there any seasonal factors that influence the market?
- What resources will I need, and over what timescale?
- What problems can I anticipate?
- Who are my competitors and what are they offering?
- Are the competitors' goods or services as good as, or better than, mine?
- Will the competitors perceive me as a threat and respond aggressively?
- Do the competitors command strong loyalty from their customers?
- What are the key features my customers are looking for, and can I match them?
- What are the prevailing prices in the market, and can I meet or beat them and still make a reasonable profit?

If we summarise the main aspects covered by this range of questions, there are four main areas.

- The size and nature of the market itself.
- The proportion which we hope to gain.
- Our competitors and their offerings.
- The prospects for our own goods or services within the market.

Each of these areas will now be examined in more detail.

The Size and Nature of the Market

The first question to consider is the scale of the market. Is it an international market or part of one, such as the oil or motor vehicle industry? There may be little hope of competing directly with multi-national corporate companies such as Ford or Toyota, but there still may be an opportunity to supply them with specialist components. Is it a national industry like the market for English cheddar cheese, Belgian chocolate or German sausages? Here there may be a good chance of overcoming any barriers to entry, such as high levels of competition, by targeting a niche part of the market. Is it a local market, such as a specific trade or service provided within a small geographical area? At this level, it becomes more

important to identify and target the needs of the customer, as well as promoting the quality of the product or the service, in order to build up a solid reputation.

Research data and findings about specific markets are usually readily available at international and national levels, through trade journals and associations, economic reports and analyses, and national and regional statistics. Not only can the overall size and growth potential of the market be established, but the respective share of key players can usually be realistically estimated by someone who knows the market well. It is possible to buy reliable market research information about national and international markets from published sources, such as Frost & Sullivan. However, this can be quite expensive, and – because it is often compiled from research across a range of companies in a specific sector – it may be too generalised to be of value to a new business that is targeting a small part of that sector. At local level and in smaller, more specialised markets, it is much harder to find the necessary direct information, and even at regional level the information may be aggregated with that of other markets within economic development reports, rendering it too general to be of much use to a new small firm. The problem is compounded if the proposed business is aiming at a new or niche market for which there may be no established data. In such cases, the only solution may be to actually make direct contact with any potential competitors, in order to find out more about them. This used to be a very difficult and time-consuming process but thanks to internet search engines it is now much simpler.

The Target Market Share

If the level of supply within the particular market has not reached full capacity, then the target market share may well be determined by existing suppliers' production and supply capacity. If market demand is greater than the capacity to supply, then gaining a share of the market may not be difficult as long as the goods or services are of a comparable price and quality to those of the competition. However, if there is already a good deal of competition within it, then the target that might potentially be achieved may need to be more modest; without heavy investment, it may prove hard to break into a new market, let alone to subsequently sustain and expand market share. Almost certainly, the competitors will have something to say about a new entrant to the market and may vigorously compete to keep the newcomer out. Actually determining the target market share usually requires some specialist knowledge of the market sector to ensure that the targets are reasonable and realistic. It also implies some knowledge of the sort of sales and promotional activities that would be required in order to penetrate the market to the required extent.

The Nature of the Competition

At international and national levels, the key players within an industry or service sector are usually well known to each other and, in many areas, have regular contact with each other on matters of mutual interest (e.g. credit control or lobbying against new legislation). Where formal links do not exist at company level between rival organisations, there are still nearly always informal links at a personal level. These may be between former work colleagues who have changed companies, or people who have trained together in the past or met at trade exhibitions or conferences. It is interesting to observe executive behaviour at such events where, in spite of the most serious business rivalry, the barriers can be lowered in a social situation, over a meal, or after a few drinks.

The development of networks of contacts through formal and informal interaction between colleagues, peers and rivals is a valuable marketing tool in helping to learn about and understand the competition. A huge amount of business is transacted by this type of networking, and an equally large volume of marketing knowledge can be gleaned and shared simply by talking to other business people. Networking is probably the most valuable sales and marketing tool available to the small business owner and it is a skill that should not be neglected. It is not just a case of meeting and talking to people, but of listening to their ideas and problems, passing on contacts and information to help solve those problems, sharing opinions and, eventually, finding other contacts are talking about you and passing on your details to others. It is a long-term investment in time and effort, but can produce a good payback in generating new unsolicited business, if your reputation is sound.

Where goods and services are concerned, anyone who is not a total newcomer to the market will normally have a good idea of who the competitors are and what they have to offer. More detailed technical information or price lists can usually be obtained from rival companies via a telephone request or by posing as a potential customer. Budding entrepreneurs should not feel guilty or apprehensive about this approach as it happens all of the time, and sooner or later some other newcomer or an existing rival will do the same to them. Further information can usually be found through an internet search, or from trade or local directories such as the Yellow Pages or Thompson Local, or specialist trade associations; often the entrepreneur's bank manager or local enterprise agency may also be able to help. It pays to have a checklist of what information is required about competitors, including who they are, what goods or services they offer and whether they are direct competitors or potential substitutes for your own offering, pricing, the price-quality proposition, the availability of special discounts (e.g. for bulk orders), promotions or credit terms, and specific unique features and benefits, or the selling points they use to persuade customers to buy.

The Firm's Own Goods or Services in Comparison

Having examined the competition and their offerings, the entrepreneur now needs to turn to his or her own goods and services to determine both how they stand up against the competitors', and the nature of the demand within the market as a whole. Again, this raises a number of questions. What unique benefits can we offer our customers? Is the price right or is it too high or too low? If we pitch our prices lower than those of our competitors, will we sell more, or do the customers have some other prominent criteria for buying? Is the quality right for what the customers want, and in comparison with the competitors' offerings? Should we sell our products on the basis of quality rather than price? Does the market want a solid but cheap product, or would a more refined and expensive alternative sell better? If so, just how much more refined and expensive would that have to be? Perhaps there is even a place for both, amongst different types of customers, as was shown in the phone tariff segmentation example in Table 4.1.

Another aspect of market research is that of product testing. Products are test-marketed to establish consumer reactions and response, either physically (e.g. product sampling or tasting) or by an online or face to face research activity. Depending on the product, this may also have to involve some advertising or promotional activity just before, or at the time of, the launch of a new product. A good example of this is the consumer testing of specific goods in discrete television franchise areas before they are launched on a national basis. Other products or services may be tested by market research surveys in supermarkets,

town centres or door to door, where quality can be evaluated against price bands, using questions about how much people would be prepared to pay for the product, and their reactions to the presentation and packaging, etc.

At this point we also need to examine the relative costs and profitability. Which products or services will provide the best contribution to business overheads and profit? What proportion of less-profitable goods or services can be sold without adversely affecting the chances of survival? This is where it is important to link the marketing aspects of the business to the financial planning process, as they are essentially interdependent. For example, a higher sales volume at a slightly lower level of contribution to overheads may cause a drop in overall sales revenue and subsequent profit. The expectation from this part of the market research process is that it will help to decide the positioning of the goods or services in the marketplace, and the corresponding pricing policy for them.

C. EVALUATING MARKET RESEARCH

Sources of Market Information

Market research is looking for three main types of information.

- Information about the market itself – including size in units sold or revenue value, scope for expansion, trends such as growth or decline, national and/or international coverage, average selling prices and profit margins, and the names of the main players in the market.
- Information about competitors – their names, size, market shares, locations and areas of operation, customer loyalty, their products as direct competition or potential substitutes, price and quality strategies, USPs, sources of supply, after-sales service etc.
- Information about customers – who they are and where they are located, buying frequency or patterns of purchase, motivation to buy, average spend, demographics and other factors that offer potential for segmentation.

Most start-ups and early stage small businesses do not have the financial or staff resources to carry out extensive research into new markets above and beyond quite basic internet research which may be limited to quite general information about the markets. They also lack the resources to employ the services of specialist market research companies. So, for more specific information they have to look to published sources or other secondary data. There are some substantial market research specialists such as Mintel and Frost & Sullivan that compile annual market- or sector-focused reports based on both national and international research. They typically collect and collate data from major players in each market and generate aggregated and anonymous summaries of the markets as a whole. These market reports can be purchased by anyone wanting to research a specific market and although they are costly (often between £1,500 and £7,000 each) they are still much cheaper than commissioning primary research from a market research agency. Key Note offers some more basic data, such as market focus and business ratios, for a few hundred pounds, but it is still quite easy to run up a large bill for this information. The key to using these services is to:

- define precisely what is needed
- ensure that the data on offer is relevant to small businesses, as much of the published data is aimed at multi-national corporate companies

- ensure that it is up to date, as some of the cheaper options may be several years old.

Information about competitors can be gained from primary sources, for example by identifying the main competitors via internet searches and then researching their websites, or by investigating them more directly, perhaps by requesting or buying samples of their products or by posing as a potential customer to obtain information from them. At a local level, if the competitors are small businesses, then the simplest solution may be to use local directories such as Thompson Local, Yellow Pages or equivalents, or to look for advertisements in the local press.

More detailed information can be obtained from secondary sources such as trade or business directories (Kompass or Kellysearch), trade association yearbooks or, for local competitors, via chambers of commerce. It must be remembered though, that information obtained from secondary sources may need to be checked for validity and accuracy, as well as to ensure that it is up to date. Advertisements in trade magazines can also be very useful as they not only reveal the potential competitors, but also indicate the means of advertising that those competitors prefer to use to reach their customers. For more specific information about the companies themselves as opposed to their products, it is quite simple to obtain details by payment of a small fee to the Registrar of Companies for annual reports, to Experian or Equifax for credit checks, or to the Fame database for a broader overview of the business including annual reports and credit status.

Obtaining information about customers can be difficult if they are widely distributed, unless they can be segmented in some way according to their demographic characteristics. National Census data may be useful to help determine the relative size of regional or local populations. If the target customers have a specific common interest, such as a hobby, their potential interest in a new product or service may be determined by putting a small advert or questionnaire in magazines or on websites; but often it necessary to carry out more detailed and face to face research in order to understand how potential customers might respond to the offering; this is frequently obtained using questionnaires.

The Market Research Society Code of Conduct, which sets advisory standards of conduct for researchers, is covered in the Appendix to this chapter.

Market Research Methods and Techniques

As mentioned earlier, start-ups and small firms frequently lack the financial or staff resources to carry out proper market research, and that problem is frequently compounded by the lack of any depth of marketing knowledge or skills. In the case of start-ups, time may also be a limiting factor as the entrepreneur may be planning and researching the business whilst still working full time elsewhere. The entrepreneur also needs to achieve the right balance between quantitative and qualitative research.

The quantitative research will primarily focus on facts and figures that are quantifiable and can be used to make decisions relating to size of markets, potential sales volumes and corresponding sales revenues – hence the value of published market research that is collated from a broad range of sources and analysed and presented in a form that offers relevant in-depth information. However quantitative marketing data does not entirely consist of numerical data about sales forecasts and revenues, or numbers of potential

customers in a geographical area or market sector. It can also include numerical analysis of information collected about things like people's attitudes and preferences.

Published research is cheaper and easier to access and is usually more objective, so it reduces the potential for bias when conducting primary research. However, published research tends to be historical in nature and is, therefore, often out of date. This means it is not always accurate and can be unsuitable for benchmarking purposes because different data gathering methods may have been used.

The qualitative data is equally important to the entrepreneur but in a different way. It has the potential to capture the views, opinions, needs, preferences and motivations of the customer population. This enables the entrepreneur to develop a market strategy that will focus on meeting the needs of the customers, and use the product's features and benefits and USPs to persuade them to buy. Qualitative information is much less readily available from published sources, so it is usually sought directly or indirectly from the customers themselves, e.g. via questionnaires or interviews.

The use of questionnaires or interviews also raises issues about the reliability of research, including the issues of ensuring a sufficiently large sample size, and avoiding interview bias or subjectivity. Bias can be caused by an inappropriate choice of sampling technique and through the selection of an unrepresentative sample which may be too small in terms of the size of the overall population.

There are several sampling techniques that can be employed to achieve statistically valid and unbiased research outcomes, including random samples, sampling frames, probability samples, quota samples and stratified samples. These techniques are employed by trained and experienced market researchers and consultants, but the majority of start-ups and small firms do not have the expertise to use them themselves, the time to learn about them and incorporate them into the design of their market research, or the money to pay consultants to do the work for them. The research methodology and sample populations also have to be considered in the context of what is appropriate for the size of business and complexity of the proposed product or service. For example, the depth and accuracy of research required to justify investment in a sophisticated nanotechnology device to detect explosives at airports by analysing gases in air samples will be much more complicated than the research needed to justify opening a new high street shop selling sports goods. In reality, the research process can become quite ad hoc: determining what is, or is not, a sufficiently large sample population or sufficiently broad cross-section of interviewees may well be determined by what is deemed acceptable by the potential lenders or investors who are evaluating the research. Quite simply, if they are not satisfied that the research is adequate to justify funding, it will be rejected.

Questionnaire Design

Questionnaires can be administered in a number of ways, depending on how accessible the questionnaire targets are for the researchers. Each method has its advantages or limitations.

- Face to face, e.g. to captive groups – this is ideal if the targets have specific interests relating to the proposed product or service.
- Using street or supermarket interviews – it is relatively easy to achieve a good size of sample, but it may be biased towards particular groups. For example young researchers may target their own age groups in preference to others, or the

location may not offer a good cross-section of the population. The method may also be annoying for those who are intercepted for questioning, resulting in negative responses.

- Computer-assisted telephone interviews – these are more time consuming but can give valuable results, especially if the interview is booked in advance for a specific time.
- By telephone, from home or a call centre – this is good for contacting large numbers quickly but the response rate may be low.
- By email – this is cheap and good for covering potentially large numbers, but the response may be biased if only those who are interested in the product reply.
- Direct computer interview – this can be very productive if qualifying questions are used to pre-select interviewees and when there is some nominal reward for participating, e.g. e-rewards which use credits that can be redeemed for vouchers or air miles. The interviewees are profiled, and then invited to participate in research relevant to their profile, typically using several short qualifying questions (with a low reward) before progressing to the main structured online questioning for which they earn the full reward.
- Self-administered questionnaires – these need to be targeted at the relevant audience; if that is not a captive group, or accessible by email, then the process can result in low response rates.
- Postal questionnaires – these are used relatively rarely now as email is cheaper, faster and easier to administer. They could still be valuable, though, if the target audience are not computer users, e.g. older people.

Here are a few points and guidelines for effective questionnaire design.

- Keep the wording brief and clear to avoid ambiguity.
- Select words carefully to avoid the risk of bias or potential discrimination.
- Consider the ability or limitations of the respondents to answer the questions, e.g. use dyslexia-friendly fonts and line spacing to make the questions visually clearer.
- Consider the willingness of the respondents to answer the questions, especially if they relate to personal issues or health problems.
- Word the questions in the respondent's frame of reference or understanding – try to put yourself in his or her position.
- Explain to the respondents the purpose of the questionnaire and what you want to achieve from it.
- Begin with questions that will gain the respondent's interest.
- Ask general questions first.
- Ask questions that require effort in the middle part of the questionnaire.
- Ask any positive, controversial, sensitive or demographic questions at the end.
- Once the draft questionnaire is complete, get someone else to look through it, and ideally pilot it with a small group.
- Review it again – is it too long, is it boring, will it really provide the information you require? How would you yourself feel about being asked to complete it?

Open-ended questions are used typically in unstructured questionnaires, i.e. where blank spaces are left for respondents to fill in their replies. They would be used when:

- you are unsure of the type of answers you will receive
- you require the respondents' own thoughts
- you do not wish to anticipate what the answers might be
- there are far too many possible answers to list.

The advantage of open-ended questions is that answers are given in “real” language, using interviewees’ own thoughts rather than pre-determined responses. They can be used to interpret or provide further information on set choice questions, and they can suggest alternative responses to those previously identified by the questionnaire designer. However, the downside is that they are difficult to edit, time consuming to analyse, open to interviewer bias, and the answers received are sometimes vague, glib or irrelevant.

Set choice questions are the more commonly used alternative to open-ended questions. They are more structured and offer the respondent a choice from which to select, which will usually incorporate a neutral (“don’t know”) option. There are three basic configurations for set choice questions.

- Dichotomous – these offer two choices (plus a possible neutral option), e.g. yes/no, male/female, less than/greater than. These are easy to edit and code, they reduce the potential for interviewer bias, and do not exclude people with poorer language or communication skills. However, alternatives are polarised so measurement error can creep in; they do not reflect intensity of feeling (e.g. agree/strongly agree); and the positive or negative wording may influence choice.
- Multichotomous – these are multiple choice answers where one or more answers will be indicated. These are easy to edit and code with little chance of interviewer bias, and do not disadvantage the inarticulate; but they tend to be more time consuming, and it is often difficult to keep the list to a manageable size to avoid confusion or loss of interest.
- Scaled-response – these offer a choice of responses so that the respondent can indicate strength of feeling/interest. They will typically be an odd number (three or five) to allow a neutral option, e.g.: strongly disagree; disagree; neither; agree; strongly agree. Some questionnaire compilers add a “not applicable” option. Others choose to eliminate the neutral option to force a positive choice one way or the other, based on the belief that there should be no middle option as it is far too easy for interviewees to be non-committal. Scaled-response questions are easy to edit and code, good to measure the intensity of the response, and provide wider options for statistical analysis. However, respondents sometimes find them tedious or time consuming to complete, and the statistical analysis of them does not take account of the respondent’s own frame of reference – personal interests, beliefs, motivations etc.

D. UNDERSTANDING THE COMPETITION

Barriers to Market Entry

The barriers to market entry facing business start-ups are essentially very similar to the barriers to start-up and growth. These were covered in Chapter 3, and include the following.

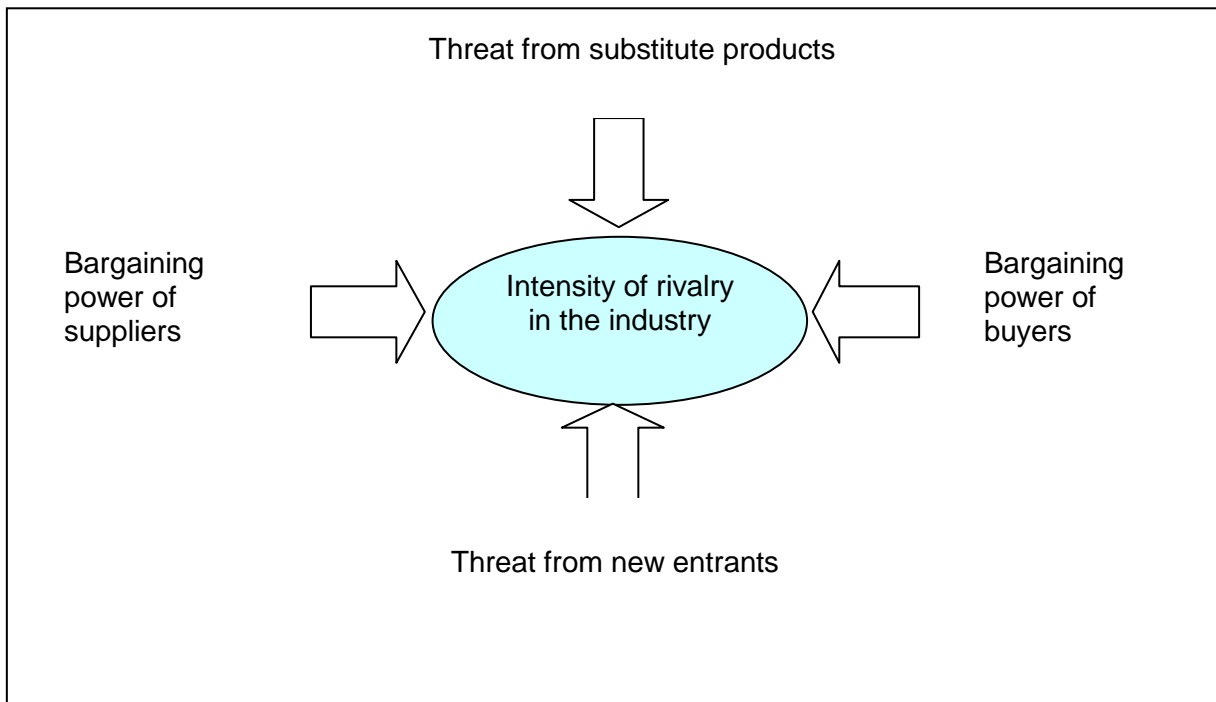
- The number of competitors with directly competing products or services which operate in the market, or the competitors which offer potential substitute products.
- The size and resources of competitors in comparison with the new entrant to the market. This includes factors such as capital value, borrowing capacity, financial reserves, and economies of scale; as well as the marketing skills and expertise available within those businesses or the external expertise they can afford to buy in.

- The competitors' strength and control within the market in terms of influence or dominance and market share – particularly in markets with few suppliers where customers may be deterred from trading with new entrants in case they put their supply line with the main supplier at risk.
- The competitors' attitude to new entrants – e.g. aggressive, neutral or dismissive. In some newly created markets, new entrants with similar or indirectly competitive products are actually welcomed as their existence can help to increase the overall demand and size of the market. However, in other markets, the dominant companies just ignore new entrants until they grow sufficiently large to present a threat to market share; or they may fiercely resist new entrants. The classic example of this is Freddie Laker's attempts to introduce low-cost airline flights in the 1980s; the established airlines worked together to undercut the prices until he was forced out of business, after which they restored their original pricing structure. Another example of this type of aggressive attitude is where large dominant companies will use their financial resources to employ lawyers to object to patent applications for new and innovative products that might threaten their market share. Although they know that the objections to the patents will be rejected, this delaying tactic can buy time to develop their own alternatives to the proposed innovations.
- Customer brand loyalty and willingness to consider new or alternative products. The longer customers have been in positive supply chain relationships in a market with large, well-established and reliable suppliers, the harder it will be for new entrants to persuade them to try buying from them instead – unless, of course, the new suppliers can offer a significant advantage in price, quality or an innovative solution to meet customer needs.
- The market knowledge that established companies hold. This covers a detailed understanding of how the market operates and the key factors that influence the market and the way customers behave, and also the marketing experience and expertise of the staff that they can afford to employ. New entrants will have a relative lack of such skills and knowledge. Smaller businesses also find it much harder to attract such expertise, even if they can afford it, as they may not be able to offer the same prospects for advancement as a large firm.

Porter's Five Forces

Porter (1998) proposed a model (Figure 4.1) that identified five forces that exist in the competitive market environment in which businesses operate. The model acts as a means of analysing and understanding the nature and extent of the competition that influences the potential of the business to operate and succeed in the market.

By ascertaining the relative power of each of these forces on itself, a business can identify how to position itself to take advantage of opportunities and to overcome threats. It is also important to remember that the forces are constantly changing, so the analyst must focus on the key forces at work at any one time. This should be a regular periodical review rather than a one-off exercise.

Figure 4.1: Porter's Five Forces (adapted from Porter 1998)**Force 1: the threat of new entrants into the industry**

What are the main barriers to market entry and how big is each one? Porter identifies:

- the capital costs of entering the market – high costs can restrict potential new entrants
- any legal or regulatory constraints that have to be overcome – the more complex they are, the more it will deter new entrants
- brand loyalty and the cost to customers of switching to new products compared with the convenience of staying with the existing supplier with whom strong relationships may already exist
- the economies of scale available to established firms in the market – this makes them more cost efficient than smaller rivals
- access to input and distribution channels – existing distribution channels are not always available to new entrants and may have to be developed from scratch, which can be both costly and time consuming.

Force 2: the threat of substitute products

How strong is the threat of substitute products?

- Can the price, quality and performance of the substitutes match the existing products in the market? Is there a sufficient price or quality difference that might make the substitute product more attractive in spite of perhaps not being quite as good? For substitutes in the same market that are very similar, the costs of switching from one to another can be low, but for indirect substitutes they might be higher.
- Would the customers be willing to switch to the new products? High levels of customer care or loyalty could deter any switch.

Force 3: the bargaining power of buyers or customers

How strong is the customers' buying power?

- If there is a large number of small customers and relatively few suppliers (with large volumes), the more power suppliers will have over the customers (e.g. Tesco, Asda, Sainsbury's). In contrast, if the number of customers is low and they spend large sums with suppliers, they will have much more power and influence over the suppliers.
- How many other businesses (competitors) supply the market? The more there are, the more bargaining power buyers have.
- How much does it cost to switch between substitutes? Low costs give more power and flexibility to buyers.

Force 4: the bargaining power of suppliers (to businesses in the industry)

How strong are the suppliers in the market?

- How unique and/or scarce is the product? Is there a plentiful supply in the market? Scarce supplies of essential products facilitate influence and control over the market. A good example of this is the way that oil prices shoot up whenever there is political unrest in the Middle East.
- Can the product be easily substituted and is the cost of switching low? If there are few alternatives and/or the cost of switching is high, supplier power remains high.
- Do the suppliers sell to other markets or are they dependent on a single market? Broader market access can strengthen the bargaining power of suppliers, especially if other markets offer equal or better profit margins.
- How many suppliers are there in the market? Is it highly competitive with lots of small suppliers, or dominated by just a few large and strong suppliers?

Force 5: the intensity of rivalry between businesses in the industry

How much rivalry is there between firms in the market?

- The other four forces feed into this rivalry.
- Is competition between rivals based on price or non-price aspects (branding, advertising, quality, service, warranty, uniqueness, availability of substitutes etc)?
- The intensity of competition will be influenced by the barriers to entry – high barriers will restrict competition from outsiders, but low barriers will make it more likely.
- Mature markets may lead to the periodic “shake-out” of weaker rivals, perhaps by merger or acquisition, or because they fail.
- Strong buyers and the availability of close substitutes will increase rivalry, especially if there is little brand loyalty with customers.

Table 4.3 summarises the five forces and their influence on profitability.

However, there are several limitations to Porter's model that need to be considered.

- Porter's theory assumes that relationships between suppliers, customers and competitors are, and will usually be, adversarial. It overlooks the positive and effective management of customer relationships as another influencing factor.
- It implies that the five forces apply equally to all competitors in an industry – but they will each vary in size, brand strength, product range and quality of products. In *Competitive Advantage* (2004), Porter also distinguishes between “good

competitors” that can be tolerated in a market as they present no threat or have a positive use by limiting the “bad competitors” that do pose a threat.

- It assumes that the market and external environments are static, but markets constantly change and external factors change them further.
- It focuses mainly on product-based markets, not the provision of services or resources.

Table 4.3: Summary – How the Five Forces Can Influence Profitability

Force	Profitability will be higher if there are:	Profitability will be lower if there are:
Force 1: Bargaining power of suppliers	Weak suppliers	Strong suppliers
Force 2: Bargaining power of buyers	Weak buyers	Strong buyers
Force 3: Threat of new entrants	High entry barriers	Low entry barriers
Force 4: Threat from substitute products	Few possible substitutes	Many possible substitutes
Force 5: Competitive rivalry	Little rivalry	Intense rivalry

E. IDENTIFYING USPS AND STRATEGIES FOR COMPETITIVE ADVANTAGE

Competitive Advantage

“Competitive advantage” is about defining what advantages one business has over another and how these can be sustained. Lasher (1999, p51) claims that “few firms have been able to achieve sustainable competitive advantage”, i.e. to stay at the head of their market for a long period of time. Certainly for new and small firms that situation is realistically unachievable, except in the very rare case where they have a totally revolutionary innovation. There may be a great deal of prestige in being the market leader, particularly in major international markets, but the average small business is not in that league, and its primary concern is that of achieving profitability rather than market share. However, the concept of competitive advantage should not be passed over without first asking a few basic questions, as it is still very relevant to achieving profitability.

- What is it about my products and services that make them stand out from the competition?
- What unique features do they have that make people want to buy them as opposed to the alternatives?
- How can I ensure that this uniqueness persists?
- If that is not possible, what else can I do to keep ahead of my rivals?
- What can I do to make my customers remember me and come back for more?

The answers to these questions will start to form the options for the strategic marketing plan.

Porter (2004) suggests that “holding a 100% market share is rarely, if ever, optimal. It is sometimes more sensible for firms to yield position and allow good competitors to occupy it than to maintain or increase share”. This pragmatic view is based on the idea that a monopoly on market share is extremely difficult to achieve, even if regulators allow it, so it is much better to share it with the safe and non-threatening competition. Porter says: “A firm’s optimal share of the industry it is targeting should be high enough not to tempt a competitor to attack it. A firm must also have sufficient market share superiority (combined with other competitive advantages not related to share) to maintain equilibrium in the industry”.

Those other competitive advantages may include:

- possessing significant economies of scale
- few industry segments
- buyers willing to purchase from a single supplier
- a steep learning curve that is proprietary to the product or service
- no distribution channels stocking multiple brands (unless they are your own)
- other significant barriers to entry
- smaller competitors who can share value activities (i.e. “good” competitors).

We can also add to this list the entrepreneurial culture that encourages constant development of new and “breakthrough” innovations to sustain competitive advantage.

Differentiation Strategies

Johnson, Scholes and Whittington (2008) offer three alternative generic strategies that can contribute to competitive advantage.

1. Cost leadership is the strategy by which businesses maintain competitive advantage in the marketplace by planning and managing the cost structure (comparative price) of their goods and services in relation to that of their competitors.
2. Differentiation strategy focuses on product choice, quality, service, and perceived value in the eyes of the customer. For small firms, this is often more feasible than the cost leadership option where, as new entrants to the market, they may not be able to achieve the same economies of scale as established competitors.
3. Focus strategy allows the organisation to target its efforts towards one or more specific niches in the market; this, in particular, is a frequently used means by which small firms can achieve market share in the face of competition from bigger rivals. The drawback, however, is that too much success by a small firm in a niche market can attract unwelcome attention from powerful and wealthier competitors.

There is an additional hybrid strategy proposed by Lasher (1999, p87): “best-cost provider”. This combines cost leadership with differentiation, e.g. providing a high-quality product at a mid-range price.

USPs, Product Features and Benefits

One of the first principles that is taught during sales training courses is: “Don’t sell products or services – sell the features and benefits they offer the customers”. This idea will be explored further in Chapter 5, but it is important to remember that the prime purposes of market research are to answer the following questions.

- What are the USPs of the product or service that will appeal to the customer? Implicit in this question is the issue of whether or not the product or service may actually have more than one USP, which may appeal to alternative customers. This comes back to the importance of the market segmentation process in analysing customer needs and motivations. It is the USPs that will distinguish the products or services from those of the competitors; the more distinctive those points of differentiation are, the less likely it becomes that the competitor can offer a direct substitute, and even more so an indirect substitute, that will be of interest to the customer. The exception to this may be where the competitor offers a price advantage for a direct substitute that is so attractive to the customer that it overrides the perceived value of the USPs.
- What are the features and benefits that the product or service can offer the customer? To get behind this question, the market research process also needs to determine exactly what the main problems or priorities facing the customers are; if a customer has a specific need or problem, the features and benefits of the product or service can be sold as a solution to that problem, which – all other factors (price, quality, product availability, after-sales support, etc) being equal – makes it all the more likely that the customer will commit to buy.

It is important to remember that strong USPs when coupled with features and benefits that provide solutions for specific customer needs or problems can create a stronger motivation to buy than a competitor’s cost leadership strategy. In the event that the rival’s low prices are still an issue, there is still the option to introduce a marginal reduction in price whilst maintaining the sales focus on the USPs, features and benefits.

In addition, strong USPs, features and benefits can also increase the customers’ perception of differentiation between the product on offer and what may in reality be similar or substitute products offered by the competitors. This effect is further reinforced when coupled with strong product branding.

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APPENDIX

The Market Research Society Code of Conduct (www.mrs.org.uk) advises researchers to follow this model of good practice.

1. Researchers shall ensure that participation in their activities is based on voluntary informed consent.
2. Researchers shall be straightforward and honest in all their professional and business relationships.
3. Researchers shall be transparent as to the subject and purpose of data collection.
4. Researchers shall respect the confidentiality of information collected in their professional activities.
5. Researchers shall respect the rights and well-being of all individuals.
6. Researchers shall ensure that respondents are not harmed or adversely affected by their professional activities.
7. Researchers shall balance the needs of individuals, clients and their professional activities.
8. Researchers shall exercise independent professional judgement in the design, conduct and reporting of their professional activities.
9. Researchers shall ensure that their professional activities are conducted by persons with appropriate training, qualifications and experience.
10. Researchers shall protect the reputation and integrity of the profession.

Chapter 5

Developing the Marketing Plan

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INTRODUCTION

The process of creating a marketing strategy has four main stages.

- Carrying out market research.
- Developing plans for market penetration.
- Planning the marketing mix that will make the strategy happen.
- Putting in place the sales activities and customer service support to ensure sales growth and customer retention.

In the Chapter 4, we explored the market research process, so this chapter will focus on the activities that follow on from the market research: developing and implementing the marketing strategy and the sales and customer service policies that need to be in place to make it work and to ensure that the business is able to achieve sustainable growth by retaining its customers so that sales effort can focus on generating new business.

A. DEVELOPING A COHERENT MARKETING PLAN

Market Penetration

Market penetration is about evaluating the market research which has been carried out and deciding on the strategy that will be used to penetrate that market, by employing any competitive advantages that the products or services offer. Here are some examples.

- Lower production, distribution or other costs – these provide the opportunity for lower prices, which can be used to break into the market and establish a customer base. The downside to this approach is that once a company gains a reputation for offering low prices, it can be hard to raise those prices back to the market norm without losing some customers. Ideally, therefore, the pricing strategy needs to be supported with some other benefit to the customer.
- Higher quality – this becomes the selling feature; if coupled with a price that is in line with competitors' prices, it could create customer perception of the product as excellent value for money.
- Niche markets – this is where within a larger market there is a gap for a specialised sub-market that is not currently being addressed. Niche market opportunities can be extremely profitable, especially in the short term, but unless the niche is very small and can be addressed by a single supplier, or protected by patents, competitors will eventually be attracted to it. The companies that are most successful at exploiting niche markets move quickly to maximise market share but at the same time start looking for ways to keep their advantage, e.g. through product innovation, or by looking for other niche opportunities.
- New markets – where there is currently no direct competition and where until competitors can catch up, the new products can command a premium price similar to the niche market situation. Markets for new or innovative products are ideal for first-to-market strategies whereby the entrepreneur may positively choose not to go through the time-consuming and expensive process of protecting intellectual property, but will just get the product out to the customers and establish it as market-leading brand before the competition can realise what is happening. True, the competitors will invariably follow with their own similar new products, but unless

they come up with a breakthrough innovation themselves, they will always be following the market leader.

- Unique features – these might differentiate your products from the competition for a period of time, especially if the intellectual property for the unique features can be protected to prevent the competition from copying your products or introducing similar features into their own products. Unlike the first-to-market advantages that can be gained in new markets where protecting IPR (intellectual property rights) may be less important, where innovative features are introduced to established markets the IPR associated with them is a key element of maintaining the competitive advantage they create.
- Loss-leaders – this is the idea of selling the products very cheaply at first to get their presence established in the market, and to buy or create a market share. This is an approach frequently used by manufacturers and distributors of fast-moving consumer goods distributed through multiple supermarket outlets. Typically the suppliers pay the supermarkets a premium price to place their products in a prime position in the shops; they use a high-profile launch, often supported by TV advertising, in-shop free samples or tastings, and big discounts or special offers on multiple purchases. Once the customers have got into the habit of buying the products, which have become established alongside their rivals, the price is increased to the normal level. Another technique used by supermarkets themselves is to almost give away products or sell them at an unprofitable price to create “foot-fall”. The idea is to get the shoppers into the retail outlet to buy the special offers, and to get them to buy other products whilst they are there, rather than to going to a competitor’s shop.
- Acquiring competitors – this involves buying another business to get an established share of the market without the pain and cost of market entry. This approach is sometimes used by a large corporation wanting to establish a presence in a different market (or country) without the time and expense of setting up a totally new business structure and distribution network. On a different scale, it is also used by smaller companies in an emerging market, for example to buy an established competitor’s customer base to introduce their own superior product.
- Merging or cooperating with competitors and using their market position to launch complementary products – this is a situation that is quite common in wholesaling or distribution environments where, for example, small rivals operating in overlapping geographical areas and selling similar products may collaborate initially. This might take the form of sharing deliveries to reduce costs, or selling each other’s products in the parts of the sales areas that don’t overlap. If that process works well, there may be scope for further collaboration to achieve further economies of scale, such as joint purchasing to achieve better prices or discounts. This, in turn, may eventually lead to a merger between the two companies to make them stronger in the face of their larger competitors. In the UK in the 1980s and 1990s, this tactic was used by a number of small regional brewers and wholesalers to resist the aggressive expansion and acquisition activities of the five big national breweries that dominated that market.

Planning the Marketing Mix

The marketing plan for any product or service is concerned with formulating the right mixture of characteristics and the way in which it is supplied and presented, in order to maximise its value and interest to the target groups of customers which have been identified within the market research process.

The marketing mix defines the tactics that will be employed to achieve the market penetration. As a marketing theory, it is traditionally expressed in terms of the “Four Ps”. These are the four key elements of the marketing mix.

- Product.
- Price.
- Promotion.
- Place.

It has been argued (Broome and Bitner 1981) that for service industries three further Ps should also be considered.

- People.
- Process.
- Physical.

The idea is that for each product or service being offered, there is an appropriate combination of these factors that will optimise the sales potential to the respective market segments. Where a product or service is relevant to more than one segment, the components of the marketing mix will be modified to match the needs of the respective segments. In reality, it is a common-sense, problem-solving process applied to the needs of marketing, the value of which is acknowledged by the fact that it has been in use without challenge or major modification for many years

Product

The Product element of the marketing mix is concerned with the customers’ perceptions and expectations of the goods or services. It covers a broad variety of aspects, such as the basic quality of the product, its durability and whether or not it will be fit for the purpose for which it was acquired. The warranty and after-sales service are also relevant here, in the event of there being faults or problems with the quality of the product or service.

The product may be of a very satisfactory or high quality, but there is also the question of its perception by the customer as giving value for money, i.e. whether the perceived quality corresponds to the cost. If the quality is seen as being low compared with the cost, it will constitute poor value for money; but if it is perceived as being high in relation to cost, it will be good value for money. This aspect becomes particularly significant where the price is more sensitive, e.g. at times when money is tight, at the lower or utility end of the market, and when competitors’ products are abundant. Also related to value for money is the extendibility of the range of applications or uses of the product, i.e. the uniqueness or relative usefulness of the goods or services. A good example of this is the gadgets or extras that are offered with goods such as food processors and electric drills to make them appear more versatile than competitors’ tools.

The Product part of the marketing mix is not just concerned with the quality and utility of the goods or services; it must also consider aspects of style and appearance as perceived by the potential customer. In particular the packaging and presentation, the brand name and the image it creates and, again, the uniqueness of the product. This is especially true in premium markets where the image and uniqueness, often coupled with restricted outlets or supply, can attract status value to the product, with commensurately higher prices and profit margins. This is why you can only buy genuine Versace clothes and Gucci handbags in exclusive shops, and not in local street markets – although you may well find some very good cheap imitations there!

Price

In practical terms, price is concerned with finding out how much we can charge for the goods or services to maximise profit margins without reducing the level of sales volume. Again this is a matter of customer perception, as we need to consider the price level in terms of value for money, and in terms of competitors' products and prices. We may be able to charge a higher price than our competitors but only if the customers perceive the quality and value for money of our products as being substantially better than the competition. The less the quality differential between the products, the lower the price difference must be. We may, in fact, choose to undercut the competition to buy market share through increased sales. However, such a move can also adversely affect sales, in that a substantially lower price may encourage the customers to infer that the products are in some way inferior to those supplied by the competitors.

When formulating the pricing policy for the product or service, it is also necessary to consider discounts, credit terms and payment terms, particularly if distribution is via wholesale and/or retailer networks. Credit terms and discounts usually form part of the overall price in the mind of the customer and, if favourable, they can act as substantial incentives to stock or promote the products. Conversely, if poor, the terms and discounts may be a disincentive to sell the product, or result in the vendor selling it at an unfavourable price compared with competitors' goods. Wholesalers and retailers are as much concerned with their profit margins as the suppliers are with their own.

Place

The Place aspect of the marketing mix is not just concerned with the physical locations of the business, ensuring customer accessibility, or establishing where the customers can obtain the goods or services. It is, of course, important to define the geographical areas in which the business will operate and to identify suitable outlets and their locations within those areas. However, Place is also about establishing and defining distribution channels and coverage, e.g. via wholesaler or retailer networks, by direct supply and delivery, or by mail order. The choice of distribution channels will also have implications for the availability of the products in terms of transport and supply lines, stock levels and inventories etc, which raises a number of further questions. Will you be supplying retailers through regular weekly deliveries, enabling them to hold relatively low stocks; or will you supply on a monthly basis, where stock-holding will need to be higher, with consequential implications for the payment terms of your distributors? Will you choose to operate on a reduced profit margin to enable you to use wholesalers who will hold regional stocks for the retailers, thus reducing your own distribution costs? Will you be allocating exclusive sales areas to your distributors, or will they be competing against each other?

Promotion

Promotion encompasses the whole range of available sales and advertising activities. A company may decide to employ a sales force to carry out direct personal selling to their potential customers, but that work could equally be carried out by sales agents, or by sales staff employed by distributors. Using distributors may be cheaper as there are fewer of the direct costs of employing staff, but it may not be as effective if those same sales people are selling competitors' products as well.

The Promotion part of the marketing mix also involves identifying the appropriate forms of advertising your goods or services, including:

- the internet
- national TV
- local radio
- newspapers and magazines
- specialist trade journals
- mail shots
- advertising hoardings
- tethered balloons
- Yellow Pages
- exhibitions and trade fairs
- county shows
- telesales calls
- sealed tenders for contracts
- click-and-pay adverts linked to internet search engines
- Facebook pages
- a stall in the local market.

Not only must you identify the most suitable forms of advertising for your product or service, you must select those which are the most affordable, and which are likely to give you the best return on your investment. Recommendation by word of mouth is a superb form of promotion; however, it is both slow and outside of your direct control, so cannot be relied upon to produce results. In contrast, trade fairs and exhibitions are expensive and time consuming but, if chosen carefully, they can offer a captive audience with a potentially high level of interest in your products. There is a good chance of achieving immediate orders, particularly at the launch stage of a new product.

Another aspect linked to advertising is the use of special offers or sales promotions to generate interest in your products and to persuade potential customers to try them. As mentioned earlier in this chapter, in the context of loss-leaders, this is used frequently in supermarkets where new products are launched on the basis of “buy one, get one free” bargains, or tasting sessions for food items accompanied by money-off vouchers. Obviously, these methods are not appropriate for every form of goods or services, so the promotional activity must be designed to match the product. Beauty and therapy treatments are often offered on a “five for the price of four treatments” basis; gyms and fitness clubs offer discounts for annual membership to encourage regular patronage; and magazines offer discounts for pre-paid subscriptions. Breweries offer publicans large discounts for bulk purchases in advance of the busy Christmas period, to ease delivery problems. Effective promotion is all about finding out what appeals to particular types of customers and then using a little imagination to trigger their interest in the product.

People

Where services as opposed to physical goods are being supplied, then people become more important, particularly in terms of the image which they project to the prospective customers. This is more than just a question of the first impressions created by dress or physical appearance; it applies to knowledge, communication and behavioural aspects of their interaction with customers. We are talking about technical knowledge of products and services which, if communicated properly, can inspire customer confidence – but, equally, can destroy it, if absent. It is also about the attitude shown to customers in terms of

interpersonal behaviour – e.g. the friendliness of reception staff, the helpfulness of sales staff, a positive interest shown in solving customer problems and in building long-term customer-client relationships, which together reflect the overall customer-focused culture of the business. The issue becomes even more critical in markets where customers interact with each other, to both encourage growth via customer recommendation, and – just as importantly – to ensure that the reputation of the business is not damaged by negative customer experiences.

Physical

The Physical aspects of the marketing mix include the sales environment, and in particular the impression created by the parts of the premises seen by the customers. Is the reception area clean and tidy, tastefully decorated and welcoming, or are the furnishings tatty and the space cluttered or dirty? Is the space comfortable to be in – not too hot, too cold, or too noisy? Does the organisation project an image of being well organised and professional? In a retail environment, is the space well lit, clean, and are the goods clearly displayed and accessible to the customers? For anyone managing a business, it should prompt the questions: “How would I feel about walking into this environment if it belonged to one of my suppliers? Would I feel comfortable, embarrassed or downright disgusted?”

There is also the issue of health and safety compliance to ensure a safe working and risk-free environment for staff, visitors and customers.

Process

The Process part of the marketing mix is related to the general provision of quality products and customer service. It involves ensuring that company policies and procedures are conducive to meeting the customers’ needs and to providing a service smoothly and to consistent standards. It can relate, for example, to the discretion given to employees to be flexible and to modify procedures in order to meet customers’ needs; or it can relate to involving customers in product development, or in seeking ways to improve the standards of service for them. In a perfect situation, the processes operating within the business should be invisible to the customer. They should be designed to work for the benefit of the customer, rather than for the convenience of the firm or its staff. Above all, the process should facilitate smooth transactions to create a positive customer experience, and must not become a barrier to them.

Accessing Markets and Distribution Networks

One of the biggest problems facing small firms is that of accessing new markets. Their large rivals will typically have the staff and financial resources to spend on investigating new markets, not just through desk-based market research activities but by visiting and meeting potential distributors and customers. The process becomes even more important when the company is considering exporting or establishing an operating base in another country.

In the home country, market research activities and sources of support and information are usually relatively straightforward to identify, although the process itself can still be time consuming. Sources of information, such as trade directories or trade associations, were covered in Section B of Chapter 4. Depending on the country in which the company operates, there will usually be some form of business support service – possibly quite well

developed like the Business Link and High Growth Coaching services in the UK, or maybe along the lines of traditional chambers of commerce that inter-link with each other to provide their members with access to their combined networks.

Accessing markets in foreign countries can be a major challenge. This is not just because of language and cultural barriers, but also because communications systems may not be as well developed as the potential exporters are used to, and there may be legal restrictions or barriers to non-domestic firms. In certain countries, for example, all products must be distributed through native-owned companies or networks, and any foreign-owned subsidiaries may have to have at least one director on the Board that comes from the home country. There may also be import restrictions or tariffs limiting what can be exported to those countries, particularly if those products include pharmaceuticals or medical devices.

There are a number of ways potential exporters can tap into both public and private sector organisations that may be able to assist them with making contact with potential customers, distributors or sales agents in foreign countries.

- Most countries which have foreign embassies or consulates abroad usually have at least one member of staff in those locations – often called a trade attaché – that is responsible for supporting companies that want to access overseas markets. The number of staff and the level of support available will, of course, vary from embassy to embassy, but these people can provide valuable assistance through their own contacts with local ministries, inward investment agencies or chambers of commerce. UK Trade & Investment (UKTI) is one such example, and has at least one specialist trade adviser in just about every British Embassy around the world; in some of the larger embassies, such as Washington, there are a number of advisers, several of whom look after the development of trade in specialist sectors such as finance, homeland security and biotechnology. These advisers are employed to help UK companies research and access new markets by connecting them with regional development agencies, chambers of commerce and large corporations. They also act as links for foreign companies that wish to trade with, or set up subsidiary companies in, the UK.
- Inward investment agencies are organisations that assist companies that want to set up trading operations in a new country by establishing a subsidiary form there. They will assist the companies to find suitable locations and premises, to set up banking facilities and access legal services and development funding, and to develop trading partnerships and distribution networks. Their objective is to bring investment into the areas where they are located, and to create new employment opportunities, and for that reason they are very much in competition with each other. Some very strong examples of these include Locate in Kent (UK), Fairfax County Economic Development Authority (Virginia, USA), Toronto Economic Development Corporation (Canada), Norinnova (Norway), Vantaa Development Corporation (Finland) and Technoport (Poland).
- A number of the economic development organisations also have reciprocal “soft-landings” support arrangements to support incoming and outgoing companies in accessing new markets. Examples include the Montpellier Business Innovation Centre (BIC) (France), Euronova BIC (Spain), ATP Innovations (Australia) New River Valley Economic Development Alliance (Virginia, USA), and LEDCOM (Northern Ireland). They use their network of contacts to help companies to find similar agencies in the target countries that can assist with setting up overseas activities.

- There are a number of international organisations that also provide support for international trade. The EU-funded European Business & Innovation Centre Network comprises over 150 business incubator operators across Europe and some associate members in North Africa and the Middle East. The NBIA, based in the USA, is a similar but much larger network with over 1,900 members in 60 countries around the world. The World Association for Small and Medium Enterprises is more focused on SMEs in developing countries and has members in 87 countries. The Enterprise Europe Network is another EU-sponsored organisation that specialises in making business-to-business connections to encourage international trade.
- One type of support that is often overlooked is the banking industry, and in particular the larger banks that operate on an international basis such as HSBC, Standard Chartered, and the National Australia Bank Group. The banks can not only help with managing international payments, currency exchange, and export guarantees; but because of their international or global coverage they are able to provide businesses with support with export documentation, and specialist advice on trading in particular markets, especially in China and the Far East.

B. DELIVERING CUSTOMER SERVICE AND QUALITY FOR CUSTOMER RETENTION

Customer Retention

It is not sufficient just to carry out market research, and to define a marketing policy and the tactics to implement it. It is essential to monitor the quality and efficiency of the service provision **as the customers perceive it**. This is the key to customer retention.

Replacing lost customers is expensive in terms of both sales effort and actual monetary costs, and all the time that sales effort is focused on replacing lost customers instead of expanding the customer base by gaining new and additional customers, the firm's potential for growth will be restricted. It is much more cost-effective, therefore, to develop a strategy to retain existing customers and to focus the sales effort on generating new customers. The introduction and use of a long-term customer retention policy will enable the sales effort to focus on new business development, allowing the business to grow.

Consider a theoretical comparison of customer retention situations.

At the start of Year 1, Company A has 100 customers, each spending £10k per year (Table 5.1).

- It employs a sales person who gains 50 new customers per year, but the company loses an average of 40 customers per year.
- The cost of sales activity to find each new customer is £1,000.
- Customer service activity is negligible apart from routine sales visits, and emergency responses when things go badly wrong.

Cumulative net sales revenue over for Company A over five years is **£6,250,000**.

Table 5.1: Company A

	Year 1	Year 2	Year 3	Year 4	Year 5
No of customers	110	120	130	140	150
Sales revenue £	1,100k	1,200k	1,300k	1,400k	1,500k
Sales activity costs £	50k	50k	50k	50k	50k
Net sales revenue £	1,050k	1,150k	1,250k	1,350k	1,450k

At the start of Year 1, Company B has the same customer base of 100, each spending £10k per year (Table 5.2).

- It employs a sales person who gains 50 new customers per year.
- The cost of sales activity to find each new customer is £1,000.
- It employs a customer service person to support and advise customers at a cost of £30k, and as a result of having the customer service support in place, it only loses an average of 20 customers per year.

Cumulative net sales revenue over five years is **£9,100,000** – almost 46% more than Company A over the same period of time.

Table 5.2: Company B

	Year 1	Year 2	Year 3	Year 4	Year 5
No of customers	130	160	190	220	250
Sales revenue £	1,300k	1,600k	1,900k	2,200k	2,500k
Sales activity costs £	50k	50k	50k	50k	50k
Customer service costs £	30k	30k	30k	30k	30k
Net sales revenue £	1,220k	1,520k	1,820k	2,120k	2,420k

Customer Relationships

Customers are usually lost because they are dissatisfied with the quality or functionality of the products or services themselves, the reliability of the supplier in delivering them on time, poor after-sales service, or because of a breakdown in the customer–supplier relationship. It is this relationship that is the most important as if it is strong it will normally be possible to sort out problems or complaints that the customer has. So, the process of building long-term relationships with customers is essential for customer retention. This might include:

- having named people to make regular contact with the customers, e.g. through regular telesales calls or account management. Having a specific contact person has several advantages: it makes the interaction much more personal when the customer can go to a person they know will help them; the one-to-one communication helps to develop a trusting relationship between the individuals; and it makes the customer feel valued and important – after all they **are** important to the business
- monitoring service provision and seeking regular feedback from the customers about the quality of goods or services. The customers' perceptions may well be very different from those of the supplier but that will never be known unless the right questions are asked – or the customers have gone elsewhere, at which point it is too late

- responding promptly and positively to any negative feedback from the customer, and keeping the customer informed of what remedial action is proposed or is taking place
- establishing a quality and/or customer service policy with defined standards that the company, its managers and staff, and the customers can use to evaluate the products or the services that are being provided
- always being totally honest and open with customers and not making promises that can't be kept. Customers don't like to be let down by suppliers but they like being lied to and let down even less so, for example, if a delivery deadline is likely to be missed, it is better to warn the customer in advance so they can perhaps make contingency plans, rather than have staff and resources standing idle waiting for a delivery that is not going to happen.

Understanding Customer Perceptions

When you as a customer deal with a shop or business, ask yourself what factors are likely to impress you about the transaction, and what factors are likely to put you off dealing with the business again. Think in terms of:

- the business itself – does the firm appear to be professional in the way it conducts its business and deals with customers? Does it have a good reputation? Does it give you confidence that your order will be handled efficiently?
- the business premises – are they clean and tidy, appropriately laid out and furnished, with good lighting, and do they appear to comply with health and safety requirements? Alternatively, are they scruffy, cluttered, gloomy or untidy? These questions must, of course, be taken in the context of the type of business that is being considered, as you would not expect farm buildings to be as pristine as the reception area of a large corporate company.
- the staff – do they greet you or acknowledge you as you enter; are they pleasant, polite, knowledgeable and helpful; are they smartly dressed; do they appear to be interested in you; and do they respond quickly? Or do they ignore you and appear uninterested; fail to smile; seem unwilling or unable to answer your questions; or keep you waiting?
- the products or services on offer – are they good quality, appropriately priced, fit for the purpose you want them for, and available when and where you need them?
- the business operations or service provision – how pleasant and efficient was the transaction; was it a positive or negative experience; would you want to deal with the business again; and would you recommend them to someone else?

The challenge is for entrepreneurs and business owners to use these perceptions of other businesses and apply them to their own business situation; this allows them to evaluate just exactly what their customers' perceptions and expectations might be about their own businesses.

Developing Customer Care Policies and Quality Standards

The primary objectives of customer care policies are as follows.

- To retain customers for repeat business. The use of sales staff and advertising etc to find new customers is expensive so – as explained in the Company A and B examples earlier in this chapter – if customers can be retained or the rate of natural

turnover of existing customers can at least be reduced, then sales effort can be invested in finding extra new customers. Overall, this will increase the sales revenues and profits of the business.

- To increase the level of trade with existing customers by improving their confidence in the business and its products or services. Dealing with the business should constitute a pleasant and problem-free experience. This, again, will generate extra sales revenue and profit in the longer term.
- To enhance the reputation of the business and its product or service quality to increase customer loyalty and recommendations; this, in turn, adds to turnover and profit. Even customers who complain, but who are treated well in response, tend to not only continue to buy in the future, but also to tell others about their positive experience. In contrast, poor service leads to loss of reputation and customers, and consequential reductions in turnover, or the need for extra sales effort to replace lost trade.
- To reduce the costs of business operations, over the longer term. By using quality management systems and processes to eliminate faults or mistakes, it is possible to reduce the need for checking and inspection, leading to a reduction in the cost of quality control, as well as the associated costs of rectifying those faults. Similarly, a good customer care policy tends to reduce the occurrence of problems and to correct them before they get out of hand. Customers who don't complain often tend to go elsewhere anyway, so the idea is to avoid complaints arising in the first place, to prevent the loss of customers. Overall, the process should result in a reduction of costs as the need for inspection and remedial action is reduced.
- Within the business itself, to increase the job satisfaction of staff. This is both because of the positive interaction with their customers, and by avoiding the stress and aggravation which accompanies customer complaints.

The key to developing good practical quality standards is to ensure that they are both specific and measurable. By definition, if a standard cannot be measured in some way – whether by time, cost, shape or size, cost savings, performance, profitability, etc – then it is not a standard at all. Quality standards do not have to be complex systems of standard operating procedures and technical specifications as are often seen in formal (and expensive) ISO/BSI/CE Mark accredited products or processes. They can in fact be quite simple and straightforward, although the process of breaking down the product into component parts and related tasks, or the service into specific individual activities, is basically the same as for formal accreditations.

Specifying quality standards is probably easier for products than for services, as products can be specified in terms of the type and quality of raw materials, the dimensions, shape, weight etc of each component, the assembly process and the functionality and durability of the assembled product. The process is basically the same for services, but may be more complex in that the criteria for assessing quality may be much broader – for example, using timescales, response times or deadlines, or standards of personal behaviour.

Essentially the process of identifying where standards are required is determined by the question: “What can possibly go wrong?” If something can potentially go wrong, then there is a place for a quality standard to ensure that it either does not happen at all or, in the unlikely event that it does, there is a defined procedure for remedying the situation. For this purpose, it often helps to break the service provision down into three parts.

- Pre-transaction processes – the standards required to create the right first impressions, for greeting customers, responding to the initial contact or enquiry, preparing quotations for specific contracts etc.

- The transaction process itself – the standards required for the service delivery, ensuring the service is supplied to the specification, by trained and competent staff, at the right time and place, and at the correct price.
- Post-transaction processes – the standards of after-sales service, support or warranty, correcting any faults or problems, seeking feedback and addressing any negative issues, and paving the way for repeat business.

Butler (2006) uses the following example of a small mobile catering business providing wedding reception services to illustrate how customer care policies and quality standards can be developed using this three-stage process.

Pre-transactional standards.

- All enquiries will receive a telephone response within 24 hours.
- The owner will arrange an appointment with the clients within seven days to discuss their needs, and will provide sample menus and photographs and references from previous functions.
- A written quotation will be posted to the client within 48 hours of the visit, giving a detailed schedule of the services to be provided, any options available, and a firm estimate of costs for those items, and a summary of payment terms etc. This will form the contract with the clients.
- On receipt of confirmation of the booking, a letter of acknowledgement will be sent to the clients requesting the agreed deposit or booking fee.
- Four weeks before the event, the client will be contacted to confirm any variations to the requirements, and an invoice will be raised for the balance.
- A week before the event, the client will be contacted again to finalise details of access arrangements, times, and any special requirements, e.g. vegetarians, young children or wheelchair-users.
- All necessary food and sundries will be ordered five days before the event for delivery on the day before the event, or early the same morning.

Transactional standards.

- All food items will be fresh, of high quality, and will be stored in suitable containers at safe temperatures prior to preparation and before they are served, in compliance with environmental health regulations.
- Food will be prepared as close as possible to the time of the event to ensure freshness and safety. It will be prepared in hygienic conditions, under the supervision of staff trained and qualified in food hygiene.
- Tables will be laid with clean cloths, crockery and cutlery, with decorations in the colours and designs prescribed by the customers.
- Waiting staff will be clean, tidy, polite and friendly. They will be dressed in a standard formal style appropriate to the event. Food will be served promptly and tables cleared quickly once the diners have finished eating.

Post-transactional standards.

- After the meal, all items will be cleared promptly, washed, and removed from the site. Kitchen areas will be left in a clean and tidy condition, and all rubbish will be bagged for disposal.
- At the end of the event, the clients will be approached by the person in charge, to check that there are no further requirements, and then thanked before departure.
- A week later, the clients will be sent a letter enclosing a brief questionnaire and pre-paid envelope, requesting their feedback on the service provision.

The last of the post-transactional standards is particularly important as there is little point in establishing a comprehensive list of standards and associated targets without some form of monitoring to ensure that they are being achieved. The feedback should be evaluated and used to modify the standards or to develop new standards. Above all, where the feedback reveals that customers are not satisfied with the quality of service provision, or that the standards are not being consistently achieved, it is essential that the business firstly addresses the problem, and secondly informs the customer that it is responding positively to the feedback.

C. THE SALES PROCESS

Marketing is concerned with identifying the level of demand for the goods or services, where potential customers might be found, the competition which exists, and creating a mixture of product features and means of delivery that will ensure the goods or services are desirable. Sales is about actually persuading the customer to buy the goods, to pay the right price for them, and then to come back to you for more at a later date. It is quite possible to make excellent goods for which there is a potentially high demand in a ready-made market; however, without the sales skills to actually make the customer buy them they will just sit on the shelves.

The Sales Plan

The Promotion section of the marketing mix should provide the basic structure for determining the most appropriate methods of sales activity for reaching the customer target groups. Typically, this includes several of the following.

- Internet advertising can, in its simplest form, comprise a simple website with keywords or phrases that will ensure a prominent position when any potential customers use the most popular search engines. On a more sophisticated basis, it may involve a secure interactive website through which customers can place orders and pay for them securely. This could be promoted via a pay-per-click facility with primary search engines to ensure prominence on the first page of any keyword search. A company website is really an imperative for any small business now that internet searches have largely replaced conventional directories such as Yellow Pages as the preferred method of researching sources for products or services.
- Cold-calling by telephone is basically a numbers game in which sales staff make a large number of unsolicited calls to contacts. The unit cost is relatively low but cold-calling usually results in quite a low rate of positive interest or response, even when the calls have been carefully targeted. The normal approach is to try to identify categories of businesses that might possibly be interested in the product (often from Yellow Pages or Thompson Local listings), and then to make telephone contact to find the appropriate person or decision-maker within those organisations. In recent years, the double glazing industry has given this type of sales activity a bad name. The results largely depend on the skills of the individuals who are making the calls – they need to be both competent at doing the job and able to talk convincingly about the product if they get through to the right person. To achieve positive indications of interest from 5-10% of those called would generally be regarded as very good, and to subsequently convert 10% of those into an actual sale would also be high rate.
- Mail shots, like cold telephone calls, have seriously declined in value in recent years, simply due to the sheer proliferation of junk mail which falls through our letter

boxes just about every day of the year. Many people just treat circulars and junk as rubbish to be thrown away with no more than a cursory glance, and any obvious circular remains unopened in the envelope. Circulars containing personalised letters are sometimes read to the bottom of the first paragraph, to determine whether they are relevant or useful, before being discarded. Sadly, this constitutes a huge amount of wasted material, even if a proportion is recycled, and for businesses the cost of printing and posting all that waste material is huge. All too often, mail shots are used because business owners don't make the effort to take a more proactive approach towards considering other methods of sales or promotion.

- Cold-call visits by sales people are time consuming and costly; therefore, they need to be carefully planned to avoid wasted effort by calling on the wrong type of customer. They also need to be well organised to minimise the cost of travelling between calls and to optimise the use of the sales person's time. For this reason, a good sales person will often fit them in between other booked appointments in a specific area, if only to gather information or contact names for future reference. Occasionally, cold-calls do result in sales, but more often they serve other purposes: to maintain the profile of the company by regular contact; to seek information about future possible needs which will lead to subsequent sales; and to update or make new contacts which can be followed up at a later date. Cold-calling, therefore, is essentially a longer-term sales activity which is best used to complement other sales effort. It is not the easiest thing to do: it takes time and practice and quite a bit of nerve to do it well, which is why many people dislike doing it. However, as a long-term process, it can produce positive results.
- Planned sales activity involves a combination of the previous methods, and constitutes a much more professional approach, which results in better use of time and a higher proportion of positive results. For example, a cold telephone call might be used to do no more than find the name of the key person or decision-maker in an organisation. This should be followed by a concise personal letter of no more than one page which outlines the products or services offered, and tells the key person that they will be contacted within a few days to request an appointment for the sales person to meet them. After this, it is down to the skill of the sales person and the quality of goods or services on offer.
- Advertising on national or regional TV or local radio is relatively expensive but does guarantee coverage of a wider audience. National TV is excellent for consumer products but highly expensive. Local radio stations are cheaper, but with lesser coverage, although they always seem to do quite well in promoting regional events.
- The national press is again expensive and often too broad to be of value to many businesses, although the travel industry always seems to find it productive. Local papers are good for local products and, in particular, local services, and are more reasonably priced. Most specialist products or services are advertised in trade journals or magazines where the cost is justified by the readership which will have been identified as a potential customer group.

Setting Targets and Measuring Achievement

The sales plan is, then, about defining the range and combination of promotional activities which will be employed to persuade the customers to buy the products. The hardest part, however, is actually setting the targets for sales volumes and revenues. If the market research has been done properly, there should be some positive indications as to the overall size of the market and the potential volume which can be achieved within it. The next problem, then, is to try to identify how much of that potential volume could realistically

be achieved. This may be influenced not just by sales capacity, but also by restrictions imposed by the capacity of production and/or distribution facilities, or the time available for the provision of a service. For example, a consultancy firm employing three staff may be able to offer up to 120 hours of service per month per member of staff, giving an overall total of 4,320 hours per year; however, it could not meet a contract requiring 2,500 hours of work in just a three-month period without bringing in external help.

Monitoring of the sales and marketing performance can be carried out as part of the ongoing financial monitoring of the business, as described in Chapter 10, and by some fairly simple methods of evaluating the effectiveness of sales activities.

- In preparing the budgetary plan for the business, certain sales volumes will have to have been identified and formulated. These in effect establish the targets against which actual performance can be monitored on a monthly basis.
- The budgetary plan itself constitutes a summary of sales revenue targets which, again, can be monitored on a monthly basis.
- The budget will also include forecasts of expenditure for advertising and promotion, so the monitoring process will examine how the actual expenditure compares with those forecasts. This is to check that when money has been spent on promotional activities, the expenditure has resulted in the corresponding increased in sales that it was designed to generate.
- It is also important to monitor the response rates that are achieved by different sales activities – for example, in terms of the numbers of enquiries generated by each advertisement, and the numbers of those that were converted in actual sales. Similarly, the response rates and achievement rates for things like cold telephone calls, cold sales calls, planned sales visits and mail shots can be measured against targets and monitored for changing trends. Where targets have been set for the various activities, they can be compared with the outcomes, perhaps using the results to set more realistic targets for the coming year. If there were no initial targets, the analysis will provide data to enable targets to be set for the future.
- From expenditure figures, it is possible to calculate the relative costs of different sales activities, for example cold calls, telesales, mail shots, and various forms of advertising. The figures showing response rates and rates of conversion into sales can then be applied to these various activities to identify, for example, the cost per enquiry for each advertisement, or the cost of each sale resulting from cold calling.
- Finally, the relative costs of the various sales activities can be compared to the revenues generated, to determine the most cost-effective methods. This will then feed into the marketing and sales plans for the forthcoming year.

Sales Skills

For new or aspiring owner-managers with no previous sales experience, the most daunting prospect is that of having to sell their goods or services. Sales skills have to be learnt and practised if they are to achieve good results on a regular basis. The biggest mistake that most new sales people make is to try to push and sell to the client the range of products in their portfolio, whereas someone with more experience will listen carefully to the client, and probe to identify their specific problems and needs. Only then are the products revealed, and in such a way that they offer potential solutions to the customer's needs. In the 1980s, when Dexion was the world leader in materials handling, their new sales people were instructed "to sell solutions to problems and benefits to the customer, not storage and materials handling systems". It is important to sell on quality and benefits rather than on

lowest price. If nothing else, there is then still scope to negotiate on price at a later stage; however, if a competitor can beat you on both price and quality, the sale is usually lost.

It is also important to be open and honest with the client, to establish credibility and retain the opportunity of returning at a later date. It is foolish to promise what you can't deliver, and there is no shame in admitting that you cannot meet the client's requirements on this particular occasion. Buyers are as much professionals as sales people, and they not only appreciate an honest answer which saves their valuable time, but they will also usually be receptive to a later approach when your product might be the real answer to their problem.

Finally, it is also important to remember that not all business is good business, and it is perfectly reasonable to walk away from a contract or a sale if you are not happy about the terms of trade or the potential profit margins. Every supplier should expect to make a reasonable profit just as much as the customers to whom they are selling, and most professional buyers appreciate this fact. The sale should be treated as a potential starting point for a longer-term customer–supplier relationship and, as such, it needs to be established on equitable terms.

Some Basic Techniques of Selling

The following list of tips will help less experienced entrepreneurs or new business owners to develop their personal sales skills and their ability to engage customers successfully.

Before the sales meeting.

- Rehearse your sales pitch so that you can deliver it fluently. It often pays to have what the Americans call an “elevator pitch” – a succinct summary of your business or products that can be described in the time it takes for a lift to get from the ground floor to the tenth floor of a building.
- Research the target company – make sure that you understand what they do and the markets in which they operate; or with the public sector, the services they provide and the clients who use those services.
- Find the decision-maker(s) and get contact names and titles. This can often be achieved by searching the company website or by a cold telephone call.
- Arrange an appointment with the right person (decision-maker or key influencer) – with adequate time to talk.
- Plan what you want to achieve from the meeting before you arrive, but be aware that those objectives may well change during the meeting, or may not be achieved in just one visit.
- Have suitable information/literature/ website information available so that you can provide it if asked.

The meeting itself.

- Dress appropriately for the type of organisation you are visiting and the seniority of the person you are meeting. Casual wear may be fine for an informal meeting in a social setting but not when presenting to a board of directors, even if they themselves are informally dressed.
- Arrive early – not just to avoid the stress or risk of being late, but to allow time for exploratory conversations with reception staff, or to examine the visitor book to see if any competitors have been visiting and whom they have met.

- Introductions – take note of who is present and their roles. Be wary if their roles are not explained at first as they may be the real decision-makers.
- **Briefly** outline what you are offering and why it will interest the potential customer (the elevator pitch), then **promptly** ask the customer a question about their business – get them talking as soon as possible.
- Listen out and probe for any problems or difficulties the customer is having: you may be able to sell them a solution, so look for ways in which your offering will solve those problems.
- Avoid technical data unless the customer specifically asks for it – you can leave technical specifications with them at the end of the meeting.
- Check to ensure that you have answered all of the customer's questions; remember that if the customer's response is: "Just put some information in the post", this often indicates that the sales opportunity has passed.

Closing the deal.

- Sell your product on benefits and solutions – emphasis quality and value for money, not price.
- **Check** that the benefits and solutions you've outlined meet the customer's need.
- Ask the customer if he/she agrees that your offering can provide what is needed, and **check** that he/she has no doubts or reservations about this.
- Talk about costs and delivery times – **but don't mention discounts**.
- Most importantly, **ask the customer for the order**.
- If the customer declines, ask why.
- If the customer places the order, you can discuss costs and delivery arrangements.
- At the end of the meeting, thank the customer for the order and for taking time to see you.
- After the meeting, confirm details of the order and/or respond to any queries as soon as possible.

Many people who are new to sales find it hard or embarrassing to close the deal, or to actually ask the client for an order. In fact, some buyers will make a point of waiting to be asked before committing themselves, particularly with young or new sales people. If you are uncomfortable about asking outright for an order – "Can I take your order today?" – then try: "When can I expect to receive our order?" or "When would you like us to deliver?" Another approach is to ask the question: "Can you see any reason why our products will not meet your needs?" If a reason is given, then you have an open opportunity to answer and overcome it. If the client has no objections, then you have a direct lead in to asking for the order.

D. ICT AND SOCIAL NETWORKING OPTIONS FOR SALES AND MARKETING

There are conflicting opinions about the value and importance of sales and marketing using ICT in the form of the internet and/or social networking. One school of thought suggests that internet selling is the only way forward; this is, to some extent, substantiated by the meteoric rise in the number of new websites, many of which do not actually sell anything but offer paid-for advertising space to businesses. The opposing view is that internet marketing is a very valuable additional option to existing and more traditional forms of marketing but should not be seen as the only alternative to them. This view is exemplified by the evidence that approximately two-thirds of websites with business

models based on revenue derived from advertising are likely to fail in the first year of operation. This does not mean that internet marketing does not work, but it does prove what has been known to newspaper and magazine publishers for many years: even with years of experience, selling advertising space is a very hard thing to do, and the proliferation of free advertising on the internet has made that sales process even harder in the past few years.

Websites and Search Engines

As described earlier in this chapter, internet advertising and sales in their simplest form can comprise a simple website with keywords or phrases that will ensure a prominent position when potential customers use the most popular search engines. For smaller businesses, this is a very cheap and cost-effective way of reaching a potentially huge audience, and for those firms the website has become an essential part of their sales and marketing activities. For larger organisations, the website is a must but for different reasons. It is more a place to showcase and provide information about what they offer, and to be without a website would be perceived as a major weakness when compared with their rivals.

A company website is really an imperative for any small business now that internet searches have largely replaced conventional directories such as Yellow Pages as the preferred method of researching sources for products or services. Simple websites can be just about providing information on what goods and services the businesses offer, but without a mechanism to turn that offer into a potential sale, the website is really wasted. An interactive website, through which customers can place orders and pay for them securely, can generate real sales revenue on a regular basis. However, when every other competitor is trying to do the same thing, the website has to be more sophisticated – using selected keywords and links to other sites in order to optimise its prominence on search engines. When a keyword search may potentially produce two million results, and most searchers will rarely look at more than the first 20 or 30 of those, optimisation is essential.

Unfortunately, it doesn't stop there: when everyone is optimising their websites, it is easy to get pushed back down the search list. The remedy to this problem is to pay the search engine providers to push the website to the top of the list, through banner sponsorship or through Google Ads where the website is displayed prominently at the top of the search results. You can also buy a prominent position on a pay-per-click basis wherein you pay a small fee for every visitor that clicks on to visit the site. Sponsored listings and Google Ads can be quite costly but the cost is generally known up front; however, pay-per-click advertising, although it appears cheap, can become unexpectedly expensive if you get large numbers of visitors, especially if they do not actually buy anything.

Electronic Newsletters and E-zines

Well-established companies with significant customer bases and mailing lists often circulate regular newsletters to their customers, which also promote their products; or they provide them with a regular electronic magazine (e-zine) which may contain informative editorial material, as well as company news and product information.

A large number of magazine publishers now produce electronic versions of their printed magazines which contain the same adverts as the printed versions. These are sometimes

free, where the extra advertising revenue pays for the circulation (and potentially reduced sales of the printed versions) or, like some specialist trade magazines, they are circulated on a subscription basis like their printed equivalents. Some more innovative independent magazine publishers are also now offering the electronic equivalent of the printed “reader enquiry card” that used to be found in most printed magazines, for which the advertisers pay an additional referral fee.

Social Networking

Blogs were a very popular form of social communication for public sector, educational, and business people to inform their friends, colleagues and networks of news, activities, and opinions. They became very popular in 2006-08 but have been largely displaced (possibly because some bloggers were quite long-winded and dull?) by Twitter which is a much more concise means of spreading news or passing on opinions because there is a limitation of 140 characters on each message. The Twitter website describes itself as “an online information network” that uses short bursts of information or “Tweets” that can be generated by businesses as well as individuals in order to contact customers.

Social networks have proliferated since about 2005. Initially they consisted of web-based organisations such as Friends Reunited, and individual college or university social websites for young people. However, several market leaders grew out of this including Facebook, which now has a huge international coverage across a broad range of age groups, and LinkedIn, which has become the international network for business and professional people. Businesses can set up Facebook pages to promote their products and services, and presumably it will only be a matter of time before this is extended to online sales so that they can target their adverts at audiences based on age, location or interests.

If you talk to individuals and businesses that are in or are linked with the ICT sector then you may frequently be told that social networking is the way of the future and should be an integral part of the marketing plan (although at the present time its capacity may be limited to marketing rather than actual sales). Facebook and Twitter are particularly popular with younger people, perhaps under 30, but even with a potential audience of 800 million, that is well below the capacity of the overall internet audience. There are still many people around who prefer not to engage in social networking; and its critics argue that it will never provide a better long-term alternative to websites and conventional methods of sales and marketing.

One of the factors that may sway the use of social networks for marketing is the development of dedicated applications for Facebook, Twitter, LinkedIn, etc, on smart phones, where access to a networked laptop or computer is no longer necessary for online purchasing. However, at present these phone apps are primarily aimed at consumers rather than for business-to-business use.

E. SOURCES OF SUPPORT AND INFORMATION

The following websites are just a few examples of potential information sources that are available for market research and for obtaining market access advice and support.

Websites for market research and competitor information.

- Frost & Sullivan – market research reports – www.frost.com
- Mintel – market research – www.mintel.com
- Key Note – market research – www.keynote.co.uk
- Kompass – company listings – www.kompass.co.uk
- Dun & Bradstreet – company listings and credit ratings – www.dnb.com
- UK Registrar of Companies – company listings and annual reports – www.companieshouse.gov.uk
- Equifax – credit ratings – www.equifax.co.uk
- Experian – credit ratings – www.experian.co.uk
- Fame – UK and Irish business database – <https://fame.bvdinfo.com/>

Examples of national and international chambers of commerce.

- British Chambers of Commerce (BCC) – lists of accredited UK chambers of commerce and BCC chamber locations abroad – www.britishchambers.org.uk/
- Russo-British Chamber of Commerce – www.rbcc.com
- China UK Business Association – www.cccb.org.uk/
- Paris Area Chamber of Commerce & Tourism – www.parisilchamber.com
- Japanese Chamber of Commerce and Industry in the UK – www.jcci.org.uk
- British Romanian Chamber of Commerce – www.brcc-ccbr.org

Websites for international market access information.

- NBIA – international business incubator network – www.nbia.org
- European Business & Innovation Centre Network – www.ebn.be
- World Association for Small and Medium Enterprises – www.wasmeinfo.org
- Enterprise Europe Network – www.enterprise-europe-network.ec.europa.eu/
- UK Trade & Investment – www.ukti.gov.uk

Examples of inward investment agencies.

- Locate in Kent (UK) – www.locateinkent.co.uk
- Fairfax County Economic Development Authority (Virginia, USA) – www.fairfaxcountyeda.org
- Toronto Economic Development Corporation (Canada) – www.tedco.ca
- ATP Innovations (Australia) – www.atp-innovations.com.au
- Montpellier BIC (France) – www.montpellier-technopole.com/bic

International banks.

- HSBC Bank – www.hsbc.co.uk
- National Australia Bank – www.nab.com.au
- Standard Chartered – www.standardchartered.com

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Chapter 6

Planning and Organising Physical Resources

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INTRODUCTION

Planning the resource requirements and costs of a business, to identify what resources need to be in place from the outset, is an essential part of quantifying the initial investment required to start the business. The hardest part for many budding entrepreneurs is to make the distinction between what is absolutely essential, what could wait for a few months until revenue starts to flow, and what would be nice to have but is not really justifiable until the business is making a good steady profit. It is equally about affordability. For example, a second-hand delivery van might be essential and affordable at the time of start-up, and a second larger van may be needed as sales grow, but brand new vans and a new Ferrari for the CEO to drive are luxuries that can wait until the first million of profits have been banked.

As businesses grow, their physical resource requirements will constantly change, particularly if they have to employ and find space for more staff to support the growth, or if they open up new business locations. The size, volume and extent of physical resources may well pre-determine the premises requirements; conversely, the availability of premises may place limitations on the physical resources which can be used. This chapter will, therefore, examine some of the issues relating to planning and organising the various resources that are needed by early stage businesses.

A. LOCATION, PREMISES AND SPACE REQUIREMENTS

Identifying Suitable Locations

The type of premises required and the appropriate location for its base will depend primarily on what goods or services a business is offering and how they are delivered to the customers. For example, a mobile hairdresser who visits the clients in their homes may be able to simply work from their own home, with just the need for some small space for storage. A self-employed professional consultant may be able to do likewise by converting a spare room at home into an office; however, a small office in a business centre might create a better image for clients and customers should they need to visit. An engineering or manufacturing process would almost certainly be looking for premises that were designed and approved for industrial use, particularly if the work involved noisy machinery, dusty or dirty processes etc. For a retail business, location will be a primary factor, as the business will need either to be in a place where the customers already go, such as a shopping mall or arcade, or in a place which is easy and convenient for them to get to, such as a retail park. A wholesaler would need to be in a central position from which the customers could be supplied, and ideally close to a good road network.

There is no specific formula for finding the ideal location for business premises although the nature of the market will have fundamental implications for the location and vice versa. With the exception of e-commerce and mail order firms, the business needs to reflect the community it serves and, therefore, its location within that community must be selected to match local needs. A business selling commercial hydraulic hoses and their fittings is ideally situated in an industrial estate where commercial clients can call and park easily,

but it would be as much out of place on the high street as a fine china shop would be on an industrial estate.

Equally, the location of competitors must be considered. Where the market community is large, it is not unusual to see competing businesses located near each other; however, in a smaller community, two rivals competing for the same small market would probably put each other out of business as neither would make enough profit to survive. It is also important that the location matches the image of the product or service on offer, and that the premises themselves reflect that image. It is not enough for an up-market clothing shop to be located in the main street of a town; it also needs to be on the right side or end of the high street where more affluent customers are likely to be found, and it must project an image of up-market quality.

The cost of retail premises is largely determined by their location. Town centre shops are normally expensive to rent, lease or to buy, but those same high rents also mean that town centre shopping malls or arcades frequently have a proportion of empty properties due to the high turnover rate as businesses either fail, or move to out-of-town retail parks because of the high rents. Shops located in retail parks can still be quite expensive to rent because of the cost of the infrastructure of access roads and parking, but the ease of access and the free parking tend to generate larger customer foot-fall that outweighs the costs. The relative cost of premises on industrial or commercial estates will depend on a number of factors including their proximity to road networks and motorways, the age and condition of the premises themselves, and the extent and quality of customer parking, security and services. The same basic principle applies to storage and warehousing. To rent space in a farmer's barn may be very cheap, but remote locations and muddy access roads may not be so good in winter. On the other hand, a modern warehouse will be much more secure and accessible, but correspondingly more expensive to rent.

Premises

When considering the various options for acquiring premises there are a number of factors that need to be considered.

- The type of business which is proposed and the type of premises most appropriate to that business. The physical environment may be important to the product or process – e.g. hygienic and easy to clean for food preparation, secure for storage of valuable products, or a specialist environment for sterile services.
- Whether or not customers will need access to the premises on a regular basis, where those customers will be coming from in terms of distance, and how they might be travelling – e.g. for car parking or public transport links.
- The visual appearance of the premises, particularly if they will be visited by customers on a regular basis. This was discussed in Section B of Chapter 5 in the context of customer perceptions and expectations.
- The need for easy access to motorways, road networks, rail links, airports etc, particularly where the premises will need to accept large-volume deliveries by truck, or where it uses a fleet of vehicles to deliver to customers. When the cost of vehicle fuel is high, choosing a central location can be critical to controlling operating costs.
- The likelihood of obtaining planning consent for the proposed use. In countries that have strict planning regulations for use of premises, there may be restrictions on what business activities are allowed in certain areas, e.g. on industrial activity in residential areas or protected rural areas, and on the use of domestic premises for

retail or commercial use. There may also be restrictions on parking or access by delivery vehicles during the daytime when businesses need that access the most.

- The availability of suitable high-speed and high-capacity broadband access for ICT businesses. This is often lacking in rural areas and remote locations.
- The need for security to prevent intrusion, or to protect valuable stock from theft or damage. Quiet rural locations may be desirable working environments and possibly cheaper than urban sites, but if high-value stock is being held, they may be too isolated to be effectively secured outside of working hours. The cost of insuring against theft could also be disproportionately high.
- The space requirements and affordability of the premises, both present and future. At the point of start-up, the need for space may be quite modest and the money available to pay for it may be limited; however, it is still necessary to look at what will be needed in the future. Relocating to larger premises can be expensive in terms of legal and removal costs, and it can be very disruptive to the business and possibly to the customers, so that potential cost and disruption needs to be factored in when selecting premises. It might, therefore, be more prudent at the start of a new business to look for a location that is possibly larger than is needed right at the outset, but would facilitate growth of the business without the need for relocation in the medium term. An alternative would be somewhere that has potential or adjacent space for expansion at a later date.
- Convenience of access for the owner and staff. This can be quite an important issue for staff recruitment as what may be an idyllic location for the owner of a business, and perhaps conveniently close to where he/she lives, may be a different prospect for staff that need to travel substantial distances from their own homes, or lower paid staff that rely on public transport, particularly in rural locations. The issue is not just about the convenience of staff travel, but having staff on site at the right times to interface with customers and deal with enquiries.
- Specific environmental requirements for the space. This may be determined by the products being stored, for example in terms of ambient temperature or humidity, or the need for sealed and bunded floors to prevent potential leakage of toxic substances into watercourses, or the need to be vermin-proof. There may be a need for positive air pressure in rooms where biotech research is carried out, to prevent cross-contamination from the air outside, or fume cupboards to prevent toxic fumes from leaking into the work space.
- Special physical requirements. These are often found in industrial buildings where, for example, floors may have to be reinforced to withstand heavy loads from large manufacturing machines or point-loads for the upright frames of pallet storage. Similarly, there may be specific headroom or width requirements for fork-lift truck access, or reinforced roof beams for overhead cranes.
- Not least when considering premises are the issues of cost and method of occupancy. For short-term needs, the best option is usually to look for rented premises, where the arrangement is typically based on an annual contract, or perhaps a very short-term contract, which is often available in business incubation centres where the contract can be ended at perhaps one or three months' notice. Such sites are ideal for start-ups as the licences issued to occupants by incubators often allow flexibility for expansion (or contraction) into alternative space in the same incubator to meet the needs of growing businesses. For medium- to long-term occupancy, the normal contract arrangement is for a 10-, 15- or 25-year lease with rents reviewed annually and payable quarterly in advance. This is particularly common with retail premises. If the business has substantial reserves or funding, it may be viable to buy the freehold ownership of the premises either outright or through a commercial mortgage that would normally be spread over 10-15 years.

Although purchasing premises ties up capital, the premises would appear as an asset on the firm's balance sheet and could be used as security for further borrowing, particularly if the premises grew in value over time.

- The availability of public utilities. Electricity, gas, telephones, water, sewage disposal and waste disposal services may not be readily available in all locations. It is usually possible to obtain competitive prices from suppliers, or to take advantage of a "bundled supply" where perhaps gas, electricity and telephones are supplied by a single provider, but that situation will vary widely according to location, particularly in developing countries where options may be limited. It goes without saying that when buying plant and machinery, for example, check first that the appropriate sources of power are readily available.

B. MACHINERY, EQUIPMENT, FIXTURES AND FITTINGS

Capital Equipment

People tend to think of capital equipment in terms of the plant and machinery used in manufacturing or industry, such as heavy rolling or milling machines, printing presses, foundry equipment, steel presses and moulds; however, the label is much broader including items used in materials handling such as pallet or fork-lift trucks, weighing, packaging and labelling equipment, pumps, cranes, lifts and pulleys, conveyor belts and rollers, power tools and hand-held equipment. In a retail environment, it might include catering equipment and ovens; or in agriculture, it would be tractors, ploughs, harrows and combine harvesters. The term really relates to the type of purchase, in that a capital item is bought with the expectation of it being used regularly over an extended period of time and, therefore, depreciated over that same period. A "revenue" purchase, on the other hand, is something that is only expected to be used, or to last, for the current financial year.

There are a number of questions to be considered when planning resource requirements, all of which will have a financial implication for budgets and cash flow.

- What plant or machinery is required to manufacture your products or processes? Do you already own any of this, or do you need to buy it?
- Is it essential, or more cost-effective over time, to buy the item new, or can it be bought second hand?
- If the item is very specialised, will there be a long lead time for delivery, or will it take time to install and commission before becoming fully operational?
- Will the premises need to be modified to accommodate it, e.g. reinforced floors, or the need to install three-phase electricity? Are there any specific safety issues that need to be considered?
- Will you also need to maintain a supply of tools and spare parts for the machinery, and to train or employ staff to maintain it?
- What special training will the operators need, if any? Can that be delivered on site or will they need to go away for training?
- Are there any implications for insurance and the safe and secure storage of the equipment, particularly if it is valuable and easily moved (or removed)?
- What is the best way to finance the purchase? Will you pay for it from reserves, by means of a bank loan, by hire purchase, or perhaps by leasing? Will you need to make a substantial down payment when ordering it? How will you finance the period between ordering and becoming fully operational?

- Which is the most tax-efficient way of acquiring the equipment – e.g. lease as opposed to hire purchase?

Fixtures and Fittings

Fixtures and fittings are the items within the premises which are attached to the structure, or which are necessary to the production of the goods or services, but are not directly involved in their creation or provision. Fittings include such things as lighting and heating systems, electricity or water supply pipes, telephone or broadband cables, sinks, toilets and drainage and air-conditioning, which have been fitted to the premises to make them habitable. It may be that these are inadequate or need to be replaced or repaired. Perhaps extra power points are needed in the office, or the water supply has to be extended, or new toilets built for additional staff. When considering this, you should think of the installation costs as well as the purchase cost of the materials.

Fixtures within the premises are items such as safety rails, storage or racking systems, lifting equipment and mezzanine floors, which have been fitted or installed within the building, to facilitate the operation of the business. Questions to ask here include the following.

- What fixtures do you need for immediate use, and what additions will be required as the business grows?
- Is it cheaper to install them all from the outset or is this beyond the capital currently available?
- Will deferring the installation result in higher costs and potential disruption to business operations?
- If you take out a loan for the additional requirements, will the savings on installation costs and later disruption to your business, outweigh the arrangement fee and interest payments on the loan?
- If the fittings include storage facilities, are they of adequate size or capacity to meet current and forthcoming needs, and are they capable of being used in such a way as to ensure proper stock rotation to avoid waste and additional expense?
- Are any air-conditioning or humidity systems adequate to provide any specific environmental conditions required for goods in storage?

Office Equipment and Furniture

The category of office equipment and furniture includes items within the building that are not used for production or storage, but which still count as capital equipment because of their cost and long-term usage. This will include the furniture, storage and IT equipment within management or administrative offices, and also the carpets, easy chairs, and display materials in a reception area for visiting customers, and, of course, tables and chairs, tea and coffee cups, and the kettle, toaster or microwave oven for staff use.

Within an office space, we are talking about items such as desks, chairs, filing cabinets, storage cupboards, computers, a safe or petty cash tin, telephones, fax machines and answering machines, franking machines, cleaning equipment, and the multitude of minor items such as staplers, hole punches, laminators, and even the stress-busting toys used by the boss. These are the things that are most often taken for granted or underestimated

when planning a new business; individually their costs may be quite small, but when aggregated, the total costs can be very high.

ICT and Admin Support Systems

There may be some overlap here with the previous section. Some businesses classify ICT equipment, such as PCs and laptops, as office furniture, especially if they are used solely in the office, whereas other businesses will classify them as ICT equipment, particularly laptops, smart phones or media projectors are used away from the main business location by sales people, or staff working from home. Again, by virtue of the cost and duration of usage, ICT equipment is usually classed as capital expenditure.

As well as the ICT hardware that has just been described, admin support systems also include other resources used by staff such as office telephone systems, fax machines, photocopiers, printers, and administrative software such as accounting packages, payroll systems, order-processing systems, databases and customer records. Depending on the nature of the business, there may also be a need for sector-specialist software, or bespoke systems.

When buying any items of furniture and equipment, ICT and admin support systems, similar questions need to be asked as when making other capital purchases.

- What is essential as opposed to nice to have?
- Does it all have to be purchased new or can we make use of good quality second-hand furniture in some offices?
- What is the most appropriate or cost-effective way of purchasing, e.g. through loans, hire purchase or leasing? Whilst hardware can be financed externally, software is usually purchased outright as it becomes outdated quickly and has little residual value.
- What staff training will be required to enable them to use the systems effectively?
- Which items are important for public appearance and visibility to customers, e.g. in the reception area, to create the right impression of the business?

Consumables and Miscellaneous Expenses

Consumables and miscellaneous expenses are the day to day minor purchases of things like cleaning materials, office stationery, printer inks, toiletries, tea and coffee for the staff kitchen, and water for the office or reception water-cooler. These are basic small but regular expenses, not directly associated with the supply or provision of goods and services, which add to costs and reduce profit. If not monitored carefully, they can easily get out of control, and hence they should be included as a budget item in the financial plan alongside the more substantial expenditure items. In particular, miscellaneous expenses, such as regular sandwiches for office meetings, business lunches, or wine bar meetings, can mount up to four-figure sums over the course of a year.

C. SOURCING RESALE STOCK OR RAW MATERIALS

Any business that is manufacturing products, importing them for sale and distribution, or wholesaling or retailing products that are sold by other companies will need to establish

formal arrangements for the supply of either the raw materials and components, or the finished goods. It is essential to ensure that the sources and lines of supply (the supply chain) are sufficiently reliable and robust to avoid problems in subsequently providing reliable sales to the end user or next company on the supply chain. This process of establishing the supply chain raises a number of issues including sourcing, reliability of suppliers, relative costs, frequency of delivery and levels of stock-holding, bulk discounts, advance ordering arrangements, seasonal requirements, storage implications for premises, effect of stock levels on working capital and cash flow.

Finding and Contracting with Suppliers

In the days before internet searches became available, finding suitable suppliers was frequently difficult, especially if they were located in distant countries. In established business sectors, there are usually trade associations or trade magazines that can assist with finding the right supplier; however, where, for example, components are needed for new innovative products, an imaginative internet search using a range of keywords may be the best solution, especially if that component needs to be designed and manufactured for the first time. Sometimes even just asking colleagues or contacts in other businesses or at networking meetings can help. One interesting example of this was a highly specialist small business in Sussex, UK, that manufactured high-precision nanotechnology equipment and needed a supplier to manufacture a component from a rare metal to very fine tolerances. He searched the internet and trade sources for several days and was telling his neighbour on the industrial estate about the problem – only to be told that there were two such firms in the UK and his neighbour was actually one of them. Problem solved!

One-off purchases aside, any longer-term arrangements need to be properly documented, ideally with formal contracts if substantial sums of money or regular supplies are involved. These documents should specify terms of trade between the two parties including agreed prices, quantity-related discounts, credit terms, minimum order quantities, order lead times, delivery deadlines, and any penalties that might be incurred by default.

There are a few basic principles to be considered when negotiating and dealing with suppliers.

- Your suppliers are just as entitled to make a reasonable profit as you are. Don't be afraid to push them for a bit more credit or discount when the time is right, perhaps if your purchases from them are growing, but respect their position if they turn you down. They almost certainly still want your trade, but not at any price. Sometimes, when a customer pushes too hard, you just have to walk away from the business if it ceases to be worthwhile.
- The objective in dealing with suppliers should be to develop a long-term, honest and reliable relationship that will ensure continued supply of quality goods or services at a mutually acceptable price. Suppliers should be treated and respected as stakeholders in your business, just as you would treat your own customers, the bank manager, or your accountant. They have an interest in the profitability and survival of your firm, just as you have in theirs, in that both businesses need each other as part of the supply chain to the end user. The cheapest price from a supplier is not always accompanied by the best quality and reliable products, and long-term continuity of supply can be just as important to your business. It also pays to keep in regular contact with them, not only to find out about new products or

opportunities, but to talk about any trends or changes in the marketplace which might affect you both.

- If you have cash flow problems, don't lie to your suppliers or ignore their calls. They are not stupid and they can read the signs as well as you can. Be honest, contact them promptly and tell them about the problem, ask for their cooperation, and give them a firm and realistic date for payment, then honour it. If you can, make a payment on account in the interim period, to show your goodwill. Sometime later it may be your supplier with a similar problem asking for a prompt or early payment, in which case you should return the favour, if you can afford to. This is what building long-term business relationships is all about, and it will do you no harm at all when a bank or another supplier asks you for a trade reference from an existing supplier!
- Although price is important, it is not the only area for negotiation with suppliers. If the supplier is unwilling or unable to improve discounts or prices as the volume of your purchases increase, then look for alternatives, and be imaginative. Can you get better payment terms, e.g. a longer period of credit, or a higher credit limit? Is there some advantage to you in varying delivery arrangements, such as weekly instead of fortnightly, to reduce the levels of stock that you need to hold? Will the supplier contribute to some of your marketing costs – e.g. by paying towards the cost of a trade exhibition, sharing advertising costs, or by giving you some point of sale material or free samples for your customers? These are the sorts of possibilities that will benefit both you and the supplier.
- You should ensure that you have suitable monitoring systems in place to check on the quality of goods received, and that quantities, prices, discounts etc are correct. Any discrepancies should be recorded and notified to the suppliers immediately. You can't realistically expect your suppliers to take responsibility for problems with goods which have been out of their hands for any length of time, so by reporting problems promptly you can avoid potential disputes. Again, be honest with them and don't try to cheat them by claiming more than is properly due. If your suppliers regard you as being fair to them, then they will tend to treat you fairly in future, and they will be more likely to respond to a request for help when you have a problem, or need an urgent delivery.

Planning and Managing Stock Levels

For providers of services, where the only stock which is held is likely to consist of stationery or consumables, stock control will probably not cause any major problems; however, for manufacturers, wholesalers and retailers the situation can be totally different. Anyone involved in wholesaling or retailing will need to identify what stock has to be held at any one time. There will of course need to be a purchase of opening stock and an ongoing holding of a reasonable level of core stock – those items that will be in constant demand. The costs of buying this opening and core stock have to be built in to the budgetary plan. As stock is sold, more is bought in to replace it and as the business grows, so the average level of stock held may need to be increased. This can have implications for both storage space and equipment and for the availability of adequate working capital to fund the additional stock-holding.

Stock-related problems can include:

- having inadequate volumes of raw materials to produce goods
- having inadequate volumes of completed goods to meet sales orders
- having the wrong types of goods in stock

- having too much money tied up in slow-moving stock, causing cash flow problems
- being unable to obtain stock from suppliers (particularly imported goods) on a regular or reliable basis
- having to handle a high proportion of returns of faulty or unsatisfactory stock
- being left with unsaleable or outdated goods
- careless storage or handling, resulting in damaged stock
- inaccurate invoicing of stock sold or poor stock control, resulting in inaccurate stock records
- theft of stock, or slippage (e.g. removal of stock by staff for their own use).

Most of these problems are fundamentally concerned with operational issues relating to the ordering processes, and the physical storage and stock management systems used by the business. However, all of them will have an impact on the profit margins of the business. Stock levels need to be monitored carefully to ensure that they maintain a balance between the need to meet foreseeable demand and the need to not tie up working capital unnecessarily for long periods of time. This will involve both regular liaison with sales and marketing staff to assess future levels of demand, and an efficient system of ordering replacement stock, e.g. by identifying both minimum acceptable levels of stock, and levels at which new stock must be ordered, allowing for delivery lead times etc. It is no good waiting until the stock reaches the minimum level before re-ordering, if that stock is likely to run out before the delivery is received. If the delivery takes two weeks to arrive, then the re-order level must be set at the minimum stock level plus the amount of stock that would typically be used during that two-week lead time.

Many larger organisations, particularly in the automotive industry, use just-in-time ordering and stock delivery systems, whereby stock can be ordered and delivered at short notice. This works well for them as it saves them the expense of holding large quantities of stock, but it often results in their smaller suppliers having to bear the cost of holding that stock on their behalf. Mitigating that problem requires close liaison between the customer and supplier so that, as part of its forward-planning process, the customer will provide the supplier with estimates of its needs at regular intervals. This means that the supplier can plan and adjust its own stock levels ahead of receiving the actual just-in-time orders.

Whilst the physical monitoring of stock is important to detect any theft, damage resulting from storage or handling, and deterioration due to poor stock rotation, it is also important to monitor the financial aspects of stock control. Wholesalers and retailers that handle a large number of stock lines have to deal with a constant stream of changing prices, discount structures, special promotions etc, all of which affect the purchase price of each of the stock lines. Unless these constantly changing costs are monitored on a regular basis (ideally on the receipt of each purchase invoice), then profit margins can unknowingly become eroded. The larger the range of stock lines, the more important it is to use some form of database or financial stock control system to record the cost prices, profit margins, and selling prices, and to flag up any changes in the purchase price of goods.

It is also useful to monitor the rate at which stock is being turned over. For example, if a business holds an average of £10,000 of stock and makes average sales of £60,000 per month, then it is effectively turning that stock around six times per month, or every five days, which is an excellent use of its working capital. If, on the other hand, it holds the same level of stock but only sells £20,000 per month, and is only turning the stock over once every 15 days, it is probably holding more in stock than is really needed and may also have too much money tied up in stock, which is poor use of working capital. Obviously

the ideal turnover rate will vary from one industry to another – for example, fast-moving consumer goods such as foods will turn over far more quickly than retail furniture that is held in stock for some time – but the basic principle remains the same.

At the end of each financial year (and frequently at the half-year stage) it is necessary and usual to carry out a full and detailed inventory of all items of stock, in order to determine the full value of the stock (at cost). The annual stock-take forms part of the process of preparing the annual balance sheet of the business, and there are a number of ways in which the stock values can be calculated. Under the Last In First Out (LIFO) method, stock is valued at the price pertaining to the oldest items held. This can be a complicated process if stock has been received at different prices over a period of time. Under the First in First Out (FIFO) method, stock is valued at the latest price, which presents an easier method of calculation but with the risk of over-valuing the stock, particularly if much of it is old. A more practical and realistic method is to divide the total value of all items of stock by the number of units, giving what is called a weighted average cost, which reflects the true value of each line of stock. It is important to remember that the choice of method of valuation will influence the cost of goods sold in the profit and loss account; this, in turn, will affect the gross profit calculations, and subsequently the taxable profit of the business.

The frequency at which stock can be replenished, and the minimum order or delivery size from suppliers, may also impact both on the need for storage space, and on the required levels of working capital. For example, a supplier based at some distance may only make periodic deliveries so either larger volumes of the stock items have to be held, or the retailer may have to pay additional carriage costs for intermediate deliveries. This is typically the situation with the import of goods made in China or Taiwan into the UK or USA, where the suppliers normally insist on orders being sufficiently large to fill a container or to share a container with another importer. The result is that if the importer wants the best price, the cost advantage is offset by the need for working capital to be tied up in stock that may take many months to sell. The alternative is to buy smaller quantities at a much higher unit price and transport cost.

Some suppliers only offer free delivery where the order is above a certain minimum value, and others relate discount levels to the size of the order. Here the savings from free delivery and better discount rates have to be weighed against having extra working capital tied up in stock, and the space which that stock is occupying. A related issue is the planning of re-order levels to ensure that enough time is allowed to place an order for the next delivery before stock runs out. The problem is complicated when there are multiple items coming from the same supplier. The items that are needed urgently by a specific date may not be of sufficient quantity to be eligible for bulk delivery discounts or free delivery, so the customer has to either accept the small quantity at a higher price, or an interruption to production plans until the larger volume is needed.

Purchasing Raw Materials

Purchasing raw materials is a similar situation to purchasing and holding stock for resale; however, the initial purchase costs may be relatively larger, particularly if credit is given to distributors or customers, and the time the stock is tied up, as either raw materials or work in progress until it can be sold, may be longer. There is a need to buy an initial opening stock of raw materials and components, and whilst these are being turned into the finished product, further raw materials and components will need to be ordered to replace them. The wider the range of products offered, the greater the range of stock items will be, as will

be the cost of buying them; once again, as the business expands, so usually does the need to increase the average levels of stock-holding. Depending on the source of raw materials and components, there could be implications for delivery lead times, especially, as described earlier, if components have to be shipped from the Far Eastern countries that usually constitute one of the cheapest potential sources of supply.

Once again, the initial costs of buying the raw materials and components have to be realistically estimated and built into the budgetary plan and cash flow forecast for the business. The process would normally include identifying the various alternative suppliers, the range and quality of their respective products, and their costs, discount structures and terms and conditions of trade. For example, given that the product quality and basic cost of a component are the same from each of two suppliers, it may be that the extra 2% discount offered by one is more than offset by the extra 30-days' credit offered by the other, if working capital is freed for use elsewhere. If, however, the discount were much larger, then it might pay the business to borrow money from the bank to pay for the components, as the costs of borrowing would be outweighed by the extra profit generated by the better profit margins. This is the sort of cost-benefit analysis that a bank manager will understand and may normally be willing to accommodate. If adequate working capital is available, and interest rates are not excessive, then the benefits of cash discounts are usually better than extended credit terms.

D. TRANSPORT AND DISTRIBUTION

Vehicles

The selection of vehicles required will depend not just on the type of goods or services which are being produced, but also on the distribution channels and the relative locations of the customers. If the goods are being sold on to wholesalers who trade them on to a retail network, then large articulated delivery trucks might be the most appropriate form of transport. For the wholesalers themselves, a medium-sized truck (e.g. seven-tonne gross weight) which can access narrower roads to reach the retailers might be more appropriate. This size of vehicle is popular because it is not regarded as being a full Heavy Goods Vehicle, and can be driven on an ordinary driving licence in the UK. If the customers are concentrated in a fairly tight area, or if access is a problem or the goods are small and not too heavy, then vans with a payload of 1,000-1,800 kg are a better option, and unlike the seven-tonne options these do not even need to have a tachograph fitted. There may also be requirements for specific adaptations to delivery vehicles such as the addition of vehicle-mounted cranes or specialist containers for hazardous products.

The choice of the type of vehicle and its payload or size is basically an operational one, but like other options for capital expenditure, as described earlier, the decisions to buy new or second hand, or to lease or buy, will be determined by available working capital, interest rates on finance, tax allowances, and the availability of the vehicles.

The same applies to cars, as the type of car (estate or saloon) will be determined by what it has to carry, the engine size by the fuel consumption and type of driving involved (local or long distance) and the model of car by what the business can afford. For example, a mobile hairdresser working locally might need an estate car or hatchback for ease of transporting equipment; as the business is local, a small economical engine would be fine, and it would not matter too much if the car was a few years old, so long as it was reliable.

In contrast, if you were buying a car for a sales person to drive long distances around the country, you would almost certainly pick something new or nearly new for purposes of reliability. This could be a saloon car so that samples could be kept locked securely and out of sight in the boot, and with a 1.6, 1.8 or 2.0 litre engine, giving sufficient power for comfortable distance driving, but without excessive fuel consumption. In Europe, there is a great deal of pressure on businesses to use vehicles that are economical and have low gas emission levels; however, this does mean that firms that use diesel-engine cars for economy are penalised with higher taxes because of the higher gas emission levels, whereas petrol engines with lower gas emissions typically offer lower fuel economy.

In addition to issues of economy and gas emissions, as part of the purchasing decision process, vehicle operators need to evaluate the capital expenditure costs alongside the other operating costs such as road tax, insurance, MOT tests, repairs and maintenance etc. These costs also need to be built into budgets.

Parking Space and Access for Loading/Unloading

One aspect that is sometimes overlooked when making decisions about vehicle purchase is the practicality of actually accessing the business premises.

- Is the access to loading bays or warehouse doors sufficiently wide and clear for vehicles to get in?
- When they get in, is there sufficient space for them to turn around easily to get out again?
- Is space needed for fork-lift trucks to access the vehicles for loading/unloading?
- Is there enough secure parking space for vehicles to be left safely overnight?
- Are there any parking restrictions in the proximity of the premises that would affect any vehicles waiting to load/unload?
- Is the height of the loading floor of the vehicles compatible with the height of loading bays in the premises?

Options for Outsourcing Distribution

Consider the cost of running just one delivery vehicle for a year: the capital outlay and depreciation, interest on finance, road tax, emission charges, insurance, breakdown cover, fuel, tyres, repairs and maintenance, delays caused by traffic jams and breakdowns, hiring replacement vehicles, the drivers' wages and employment taxes, sickness and holiday pay, cover for lateness and absence, the cost of the supervisor who plans the deliveries and organises and administers the vehicles, etc. Once these costs are identified, it might be a valuable exercise to total up all of them and divide them by the number of packages or items delivered by that vehicle in a year to obtain a unit cost per item delivered. This can then be compared with the postal or contract delivery alternatives.

What are those alternatives? For small items and infrequent orders, mail order by conventional postal services is often the easiest method. For high-value or fragile items, contract courier deliveries (such as UK Mail, TNT, UPS, DHL or Amtrak), which use a network of international and local depots offering an overnight service throughout the country, are relatively cheap and efficient. By making prompt and efficient deliveries to your customers, these firms aim to retain you as one of their customers, so the interest in good service is mutual.

Contracts can be set up with the couriers for regular deliveries just like any other supplier, and it should be possible to negotiate discounts on large volumes of transactions, or credit terms to weekly or monthly payments. Even if there is no need to use a regular delivery service, most courier firms offer parcel collection services, or operate delivery and collection points for non-regular customers that might want to send individual parcels to remotely located customers or across long distances and where the use of a delivery van is not cost-effective.

E. SECURITY

Risk Assessment

The first step towards implementing a business security system is to carry out a risk assessment. One of the easiest methods to use is the “onion-peeling process” which examines the risks of three main areas of business – buildings, property, and people. The process involves looking at the three layers and implementing appropriate security measures for each one to delay and deter criminals, to protect or remove any potential targets for crime, to reduce the potential rewards of crime, and to eliminate any potential excuses for criminal behaviour.

It is important to remember that efficient security systems not only help to prevent crime, theft or damage to business property, they also offer the positive benefit of reducing the costs of business insurance. This can help offset the costs of implementing the security.

Before even considering acquiring new premises, it is good practice to carry out some basic checks, such as the following.

- Postcode checks of the locality, e.g. via www.police.uk/. These checks can reveal both the volume and the types of crime in a local area, e.g. theft, burglary, violence and anti-social behaviour.
- Whether any local businesses have been victims of crime. This can be achieved by contacting and asking the owners of adjacent businesses, or local chambers of commerce.
- Whether there are any business crime partnerships in the area, e.g. where shops collaborate with each other and the police by telephone to report any suspicious activity.

External Security and Buildings

Starting from the vicinity in which the premises are located, use a map of the area to identify both pedestrian and vehicle access routes to your premises – for criminals, these are also potential escape routes. Think about the streets or alleyways that border your premises, and which of them might lead towards residential areas that have a reputation for crime.

Think about the perimeter of the premises and how an intruder might gain access from an adjacent public space. Look for any weak areas in the boundary, such as broken fences or holes, or walls or fences that could easily be climbed. Your insurers may insist on improvements to boundary security – perhaps the installation of steel fencing, railings or

walls that are at least 2.5 metres high as a deterrent to intruders; or possibly barbed or razor wire, rotating vanes or electric fence alarms at the top of fences or walls, and anti-climb paint on poles or drain pipes to make access more difficult.

Moving inside the boundary, keep the area clean and tidy so that boundaries are visible. Identify any bins or other objects that could be used for climbing or could be targets for arson. Check for poorly lit areas, blind spots or other possible hiding places for criminals. Don't leave out any ladders, tools or materials that could be used to break in. Remember, a clean and tidy environment also gives a good first impression and increases the feeling of security for staff and visitors.

Consider whether security could be improved by the use of private security patrols at night, or remotely monitored CCTV. It may be possible to share the costs of this with adjacent businesses.

As part of broader company strategy, the security risk analysis should also consider the issue of business continuity, i.e. how will the business continue to operate if there is a major fire or other disaster at the premises, and what arrangements are in place for the use of temporary premises to maintain services to customers? Also, what back-up facilities exist for ICT systems – not just for fire or damage to premises, but in the event of external hacking into computers or databases?

Internal Security and Protecting Property

Place yourself in the position of a potential thief or intruder, perhaps at night or when the business is closed. Consider first the shell of the building.

- Are there any weak spots in the structure itself? For example, on the roof, the loading bay, via a cellar from an adjacent building, through thin side or rear walls or an attached outbuilding.
- Are all entry points secure? Are there any unsecured doors or windows that could provide access to an intruder? Specialist security locks can help to secure access points but may be more effective and may reduce insurance costs if coupled with burglar alarms on door that are activated when the business is closed.
- What improvements are needed to prevent or delay an intruder from gaining access, such as reinforcing walls or doors, and putting security bars on windows?
- Are there any fire hazards that need to be addressed?

Within the building there are a number of practical security measures that can be used.

- Intruder detection or motion detection alarms triggered by movement (but beware if the building has rodents). Intruder alarms may need to be supported by other devices such as smoke alarms or chemical marker systems.
- CCTV cameras for monitoring internal and external space, with the more expensive option of live remote monitoring by external security companies that can also monitor intruder alarms, and fire detection alarms. These systems can also have wireless operation to prevent intruders from cutting alarm wires.
- Safes for storing cash or small valuable items.
- Secure reinforced storerooms for high-value items or explosives, and wire cages for hazardous materials.
- The use of overnight security staff located within the building to monitor the internal and external security systems.

- Speed dial telephone numbers for the police and fire services and private security companies.
- The use of externally hosted servers for data storage (ideally with duplicate system cover) if high volumes of confidential data are held as part of the business activities.

A number of these security options can individually be expensive, but the costs of security can be kept under control by planning the security requirements in conjunction with the firm's insurance company and any approved or associated external private security businesses that work with the insurers.

People as Security Risks

There are two totally different aspects to assessing the involvement of people as security risks. First, the employer has a duty of care to staff not to expose them to any risk or hazard including aggravation or violence from visitors or intruders; and second, the employer needs to ensure that the staff themselves are not able to commit any theft or breach of security against the business.

From the health and safety perspective, every company has a responsibility to protect its employees, visitors, and customers from harm. It should, therefore, consider all areas of security including potential targets and the effects on them, such as financial loss or staff morale. In terms of security, this may consist of a combination of activities.

- The provision of one or more security guards on the premises to prevent unauthorised visitors or intruders during working hours.
- The use of security vehicles and guards to deliver or remove large amounts of cash or high-value articles.
- The use of security screens or glass to protect staff from the risk of attack, for example in banks or businesses that carry out a lot of cash transactions each day.
- The provision of personal alarms for staff (particularly women) who may work alone, or travel alone at night.

Amongst the staff actions that will have a negative effect on the business are: theft of stock items, embezzlement of cash, the theft of intellectual property by passing over company information to rivals, and poaching customers. Most of these breaches of security can be avoided either by removing the incentive to steal, or by removing the opportunity.

- Encourage an honest working culture, perhaps by educating staff about the potential costs of theft, or the consequences of being caught; also make staff feel valued by the business.
- Keep cash or high-value items out of sight and secure, and restrict access to them to a very limited number of staff.
- Incorporate non-disclosure clauses in contracts of employment to prevent the theft of company "secrets", such as technical specifications for new innovations, or the poaching of customers by a sales person who is leaving the business.
- Shred or incinerate confidential or sensitive documents that are no longer needed.
- When employing new staff, check the identity of the staff member and their references thoroughly.
- Carry out regular stock checks and maintain records of incoming and outgoing stock and any damaged or wasted stock.
- Keep stock away from exit doors, and ideally in a place where it takes a noticeable action to reach it, such as collecting a key from a supervisor. Within those spaces,

-
- use mirrors or CCTV to keep stock and equipment monitored, and if there is a major theft problem use CCTV and security checks in staff car parks.
- Restrict access to warehouses and stockrooms so that only specified staff can use them. Regularly change staff who control stock to avoid collusion or bad practice.

Chapter 7

Planning and Organising Staff Resources

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INTRODUCTION

The skills required to start and operate a new business are quite different from the conventional supervisory and management skills that are taught in business schools and colleges to managers or aspiring managers in larger organisations. In the early stages of a business, the entrepreneurs or owner-managers need a breadth of business knowledge – budgeting and accounts, market research, selling, operations planning and negotiating with banks and customers to name just a few. That knowledge does not have to be very deep; it just needs to be sufficient to get the business by until it can afford to employ specialist managers. In contrast, larger organisations usually employ finance, marketing, sales, operations or personnel managers with the in-depth knowledge to deal with the specialist functions of business.

As small businesses develop and start to employ more staff, the entrepreneur's/owner-manager's role gradually changes from being directly involved with most aspects of the business to a more managerial role where more and more operational work is gradually delegated to other staff. For some owner-managers (more so perhaps than entrepreneurs), the process of letting go of direct control can be difficult as they are trusting someone else with the cash and assets they have personally risked by investing them in the business.

This chapter is about the need for new and growing small businesses to regularly review their constantly changing skills requirements, in order to keep working efficiently.

A. SKILLS REQUIREMENTS OF THE BUSINESS FOR INITIAL START-UP

Skills for Business Survival and Success

The first question to consider is what skills does the business need to make it successful? When attempting to answer this question, it is important for those planning a new business to remember that they should not just be looking at the skills which are needed at the start but also those which will be required as the business starts to expand. As a guide, the smaller the business, the wider the range of skills that the entrepreneur/owner-manager will need to operate it, particularly in the early stages of its development. It is important, therefore, to draw up a skills profile for the business to identify the types of expertise required. These might include the following.

- Technical knowledge or expertise – this covers the goods or services which the business plans to offer, and how the customers will make use of them. From the customer's perspective, the supplier is the specialist who is expected to answer all of the awkward questions about use and functionality.
- Marketing skills – to facilitate market research and to design a marketing plan to promote and distribute the goods or services. The importance of these activities to the business is covered in Chapters 4 and 5.
- Sales skills – these are often assumed to be the same as marketing skills, but there is a distinct difference. You may have an excellent product, and a market ripe to take it, but you still need the skills to persuade your customers or your distributors

that it is your product they should be using or retailing, rather than one supplied by a competitor. In the early stages of developing the business, there may not be enough working capital to afford to employ a sales person.

- Organisational skills – the ability to plan and organise yourself and your business, to ensure that the staff, resources, materials, finished goods etc are in the right place at the right time. Careful planning and attention to detail enables you to make the most productive use of time and resources, and to avoid costly waste.
- Decision-making – the facility to analyse problems, identify and evaluate options, and to make objective and rational decisions, including how they will be made to work effectively.
- Financial skills – keeping day to day accounts is not necessarily the best use of the owner-manager's time. A part-time book keeper or accountant would probably be much more cost-effective and would free up the owner's time to focus on other priorities. However, it is still important for the owner to be able to understand the accounting procedures and it is essential to have a basic understanding of budgetary planning and control in order to keep the business on track, and to spot any potential problems.
- Customer service skills – this is not just a case of keeping the customers satisfied by providing a consistently high standard of service. For small firms, one of the biggest headaches in dealing with customers is debt collection, and persuading your customers to pay their bills on time without offending them or losing their business. This activity, although necessary, can be another distraction from business development activities.
- Staff management – the ability to supervise, delegate work, train and motivate staff to get the best out of them. The importance of this is often underestimated, and for new owner-managers who have never previously been involved with managing staff, one of the hardest aspects is that of delegation – trusting the staff to get on with their own jobs without constant close scrutiny, so that the owner can get on with the job of running the business.
- Management of information and computer literacy – the use of word-processing, spreadsheets, databases, desktop publishing, accounting software, e-commerce and internet sales and marketing, project management, etc. This also covers the need for compliance with data protection regulations.
- Interim management – the process of hiring experienced managers for a fixed period of time to manage functional areas of the business, to guide the business if it is going through a period of change, or perhaps to assist an innovator who has little business experience to commercialise the innovation.

The process of planning staffing requirements involves a number of stages.

- Objectively analysing and identifying the skills needs of the business during the early stages, from start-up until the business reaches a profitable level of trading. This relates to the management, administrative and technical skills required and their relative importance to each stage of business development. They should be listed individually and quantified in terms of the amount of FTE staff time each activity requires per week, and the number of people required to cover the various roles. At start-up stage, those people ideally need to be as multi-skilled as possible to keep the total wage bill low.
- Identifying the entrepreneur's own personal goals and objectives, accurately analysing and evaluating his or her own skills and resources in relation to them, and producing a realistic personal training and development plan for the owner, e.g. to manage the staff that will be employed to fill the other skills gaps.

- The skills gap analysis involves comparing the people available and the existing skills they share with the total needs of the business to identify the gaps between the two. The owner can then produce a strategy that will provide the right levels of expertise in the right quantities at the right time and at an affordable cost. This may well involve several different types of employment contracts, covering both core and peripheral staff.
- Once all the skills that the business will need have been identified, the next stage is to identify which of them the owner-manager or staff (if any) already possess. Where there are gaps in the skills, they might be filled by training or developing the owner or other staff members. However, there is often little spare time for training at the point of start-up so it may just be easier and more convenient to buy in the skills, e.g. by employing a part-time book keeper or a sales person who is paid commission against results.
- Monitoring and reviewing staff numbers and changing skills requirements at regular intervals. Once the business has achieved stability and profitability, it needs to revisit the skills gap analysis to start planning the requirements that will be needed to support the future growth of the business. This includes skills development for staff, for the entrepreneur and for any managers who have been appointed as the business has become profitable.

Core and Peripheral Options and Outsourcing

The concept of the “flexible” firm was developed by the Institute of Manpower Studies in the UK during the 1980s. It became very popular in the early 1990s and remains an ideal model for young and growing businesses. It was based on the idea of employing just enough “core” members of staff to cover the roles in which people were needed to deliver the work on a daily basis, or the roles that needed specialist knowledge or expertise that justified employing permanent members of staff. Core workers are permanent staff and have the full range of benefits and job security.

In contrast, the “peripheral” roles were those aspects of the work that did not require permanent staff or specialist expertise, and where staff might be employed under a range of different contracts. The flexible firm model splits peripheral workers into three groups.

- Regular employees engaged in relatively low-skill, routine work (e.g. back office administration in banking). Wages are fairly low and these jobs are insecure – the next wave of technology could eliminate the need for these people.
- Contingent employees performing high-skill tasks, perhaps on short-term contracts or employed to work on specific projects. Pay is high but there is no job security; this is compensated for, though, by the freedom to pick and choose projects.
- Low-skill, low-pay contract workers, often provided by an agency for cleaning, routine security, catering, etc.

The original examples of peripheral staff have expanded in recent years, particularly for ICT activities for which work is frequently outsourced.

The law relating to contracts of employment has also changed, giving staff on short- and fixed-term contracts more rights. Examples of more modern peripheral contracts include the following.

- Part-time staff to cover work that does not justify a full-time worker, perhaps a book keeper working for just two days per week initially until the workload increases to a level that justifies a full-time employee.
- Agency staff for less skilled roles, employed on a short-term basis as and when required to meet customer orders. Agency staff can be relatively expensive compared with employed staff, especially on a short-term basis, but they are ideal for covering staff sickness or absence, or for meeting unexpected demands from customers.
- Temporary seasonal workers – in some industries where products are seasonal (agriculture, horticulture, holidays and tourism, Christmas etc), the use of temporary staff to meet seasonal demand is well established.
- Short-term contracts, where a person is employed for perhaps six months. This may be on a work-trial basis to see if the person is capable of filling the job role before making the job permanent, or it may be where the long-term need for the job role is uncertain. These contracts are also ideal for covering longer periods of staff absence, such as maternity leave, where the regular employee is away for a known period of time.
- Fixed-term contracts for specific projects – these are common where the company is contracted to provide services to a customer for a fixed period of time, for example the training or provision of security staff for the Olympic Games, or the loan of a member of staff to a customer to supervise a development project.
- Outsourcing of specific expertise – this is frequently used by small firms that have a need for occasional specialist expertise but cannot justify employing a full-time or part-time specialist themselves. One of the most frequent examples is in human resources management services where the small firm may employ the human resources specialist as needed for staff recruitment support, drafting of contracts of employment, or to deal with individual issues of discipline and grievance. In some cases, this type of arrangement is replaced by an annual contract for which a monthly fee is paid for a specified level of service.
- Outsourcing of ICT support services – this is again used where the employment of in-house specialists cannot be justified. The outsourced work might include hosting web servers, developing bespoke applications software, or website design and maintenance.

This model of using flexible options for obtaining staff resources as and when needed is ideal for small firms as it relieves them of the overheads burden of employing too many staff when they are not needed on a permanent basis. This avoids putting pressure on what may be limited working capital. It also allows firms to respond appropriately to peaks and troughs in demand from customers.

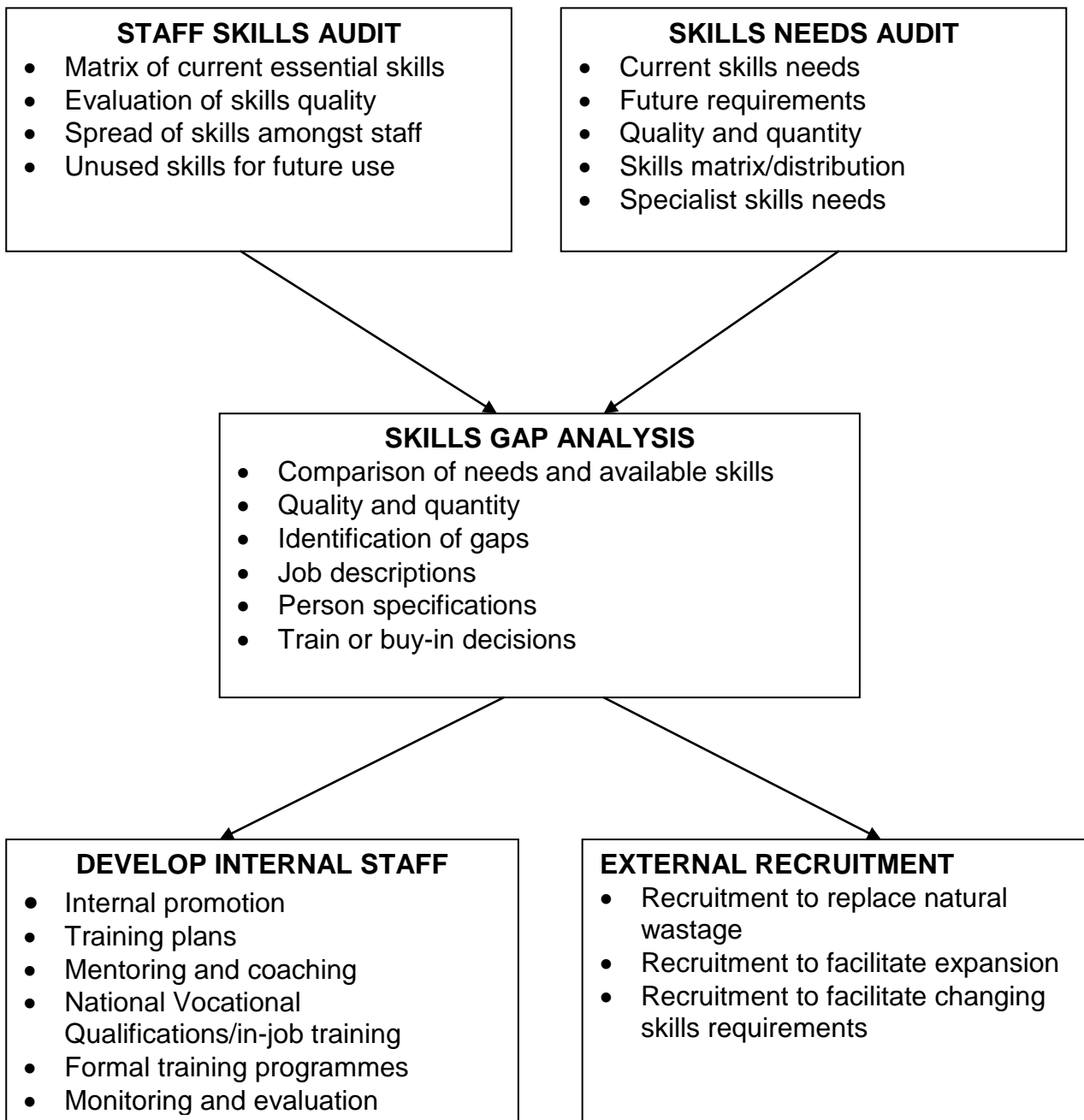
B. STAFF AND SKILLS PLANNING FOR GROWING FIRMS

For small firms that have aspirations of growth or have already started to implement a growth strategy, the process of identifying skills requirements and staff development needs is essentially similar to that of the start-up phase. However, it is usually somewhat more complex by virtue of the extra numbers of staff involved and the transformation from a small and simple business to a more structured organisation that can take the growth forward.

Manpower Planning

Strategic human resources management (more commonly called manpower planning) is all about getting the right people, with the right skills, in the right place, at the right time; and then providing the right structure and balance of motivation and reward to keep them there. This is hard enough to achieve in a large organisation that has the resources to employ human resources professionals; can afford the necessary reward structures and opportunities for promotion or career development; and can make use of highly specialised skills. However, as discussed previously, the average small firm does not have these luxuries, often possessing limited resources or lacking them completely, relying on the limited personnel knowledge of the boss, and the willingness of multi-skilled staff to be flexible in their work.

Figure 7.1: Workforce Planning Process



The workforce planning process is outlined in Figure 7.1. The staff skills audit and the audit of skills needed in the business are identified and compared in the skills gap analysis. This paves the way for decisions to be made about whether or not to develop the skills of existing staff to plug the gaps or to recruit new skilled staff. In reality, where small firms are growing, the decisions usually involve a combination of both.

At a strategic level, manpower planning involves matching the skills of the key executives or managers to the needs of the strategic plan, by identifying those management skills that are needed to achieve the long-term objectives of the business. For example, a policy of substantial growth that involves exporting would normally require the business to have someone at policy-making level who possesses substantial skills and experience in international marketing. The strategic aspects would also involve the monitoring and appraisal of performance to ensure that:

- the managers are performing at a level that will enable the business to achieve its strategic targets
- skills are modified or developed on an ongoing basis in line with the changing needs of the business.

On a tactical level, manpower planning involves designing and creating a reward system that will provide and retain a stable and motivated workforce. It will involve anticipating future problems of surpluses or deficits of staff skills. This might require the development of a more flexible workforce with a core of regular key staff supplemented by peripheral staff: temporary workers, agency staff, and part-time or seasonal workers. The tactical aspects are also concerned with medium-term staff development, career development, training plans, etc, as a means of reducing the dependence on external recruitment when skills are in short supply.

On an operational level, manpower planning is about the day to day recruitment and selection process, induction, staff training to facilitate immediate needs and to create multi-skilled staff to provide more flexibility, and making the best (most productive) use of the available human resources. It is also concerned with performance appraisal, administration, the monitoring of reward structures, and ongoing motivation.

Skills Audit

The first stage of a skills audit is concerned with identifying precisely what skills are needed, and the normal way of doing this is to draw up a skills matrix. On one axis, you need to establish the jobs that are already occupied, and those which will be needed to accommodate growth or diversification. Remember that these must relate to the jobs themselves, and not the people who occupy them. On the other axis, list the range of skills needed for each of those jobs. Sources of information for this process include the job descriptions for the essential and desirable qualifications and experience needed for each post; if they don't exist, now is the time to remedy the situation. Standard operating procedures and product specifications can indicate the need for specific technical skills. Work or shift rotas can indicate gaps in secondary skills such as first aid training, to ensure that there is normally a qualified first-aider on each shift. Minutes of meetings and reports can help to highlight deficiencies in skills that are causing problems for the business, and new product development information can point to future needs. Identifying those future needs is a particularly critical part of the process, because if the right skills are not available for any planned expansion, the whole strategic plan for the business could be disrupted.

Table 7.1: Matrix of Staff Skills Versus Skills Needs of Business

JOB ROLE	TRAINING	Induction	Health and Safety	Manual Handling	Level 3 Engineering	Cert. Supervisory Mgmt	Team Leader	Full-time Driver Course	Driving Licence	First Aid Certificate	Assembly Training	Packing and Despatch	Customer Service	Basic Information Tech.
Production Dept	Ref.													
Assembler 1	A1	#	#	#			#			#	#		#	#
J. Jones		Y	Y	Y			Y			Y	Y		N	Y
Assembler 2	A2	#	#	#							#			
F. Smith		Y	Y	Y							Y			
Assembler 3	A3	#	#	#							#			
J. Davies		Y	Y	N							Y			
Assembler 4	A4	#	#	#							#			
R. Johnson		Y	Y	N							Y			
Assembler 5	A5	#	#	#							#			
Vacant														
Assembler 6	A6	#	#	#										
Vacant														
Packer 1	P1	#	#	#						#		#	#	
E. Vanelpus		Y	Y	Y						N		Y	Y	
Packer 2	P2	#	#	#								#	#	
D.I. Appy		Y	Y	Y								Y	Y	
Maintenance Engineer	Engr	#	#	#	#									
A. Bodger		Y	Y	Y	Y									
Fork-lift Driver	FD	#	#	#				#	#					
R. Ammer		Y	Y	Y				Y	Y					
Supervisor	Sup.	#	#	#	#	#			#		#	#	#	#
V. Bossy		Y	Y	Y	Y	Y			Y		Y	Y	N	Y
Stores Assistant	St.	#	#	#									#	#
S. Tackit		Y	Y										N	Y
Van Driver	Dr.	#	#	#				#	#			#	#	
S. Peedy		Y	Y	Y				Y	Y			N	Y	
Cleaner	Cl.	#	#											
M. Mop		Y	Y											
# = skill needed														
Y = training done														
N = training needed														

The second stage asks the question: who has the skills we need? It involves comparing the actual skills of those people occupying the positions against the current skills requirements of their jobs. The necessary information can normally be gathered from CVs and staff records, training records, and appraisals, or by checking on previous qualifications and experience, courses attended, in-house training sessions completed etc.

Direct discussions with supervisors or the members of staff themselves can also reveal skills that you may not be aware of, that might be useful in the future, as staff can frequently offer useful transferable skills gained in previous work roles.

Table 7.1 is an example of an audit matrix of staff skills compared with the skills needs of a business.

Skills Gap Analysis

The third stage of manpower planning involves using the audit matrix of staff skills to compare existing staff skills with the ongoing and changing skills requirements of the business to highlight gaps between the skills required to adequately perform each job role, and the actual skills that the occupants of those roles can demonstrate. It also defines the skills required from potential applicants to fill any vacant posts; these requirements will form part of the job descriptions if or when new staff are recruited. The skills gap analysis is a useful tool to define:

- the skills gaps that will have to be filled through training and development of existing staff – although some of the gaps may already have been picked up by the firm's appraisal process
- the skill requirements of vacant posts
- which existing staff might be suitable to be trained or promoted into the vacant posts
- the vacancies that will need to be filled by recruiting new staff from outside the business.

The gap analysis should not just focus on current staff and existing vacancies. It should also be carried out for all employment needs in the foreseeable future. This will mean looking closely at the resources that have been identified as essential to meet the organisation's strategic development, and what staff will be needed to operate or support those resources. Furthermore, it must examine the various stages of phases of growth, to ensure that the staff will be readily available when they are needed. No business wants to have staff standing around idle, waiting for work to come in; but equally, no business can afford to be understaffed when that work does arrive. Irrespective of whether the staff are developed internally, or recruited externally, there will inevitably be a lead time before they are fully operational, because both the training and development process and the recruitment and selection process can be extremely time consuming.

The gaps that are identified by the matching process will form the basis for the staff development strategy of the business – whether the business decides to plug the gaps by training and developing existing staff, or by recruiting or buying in ready-trained staff from the labour market. Recruiting staff who are already trained can be very attractive to a growing business. The advertising and selection process does cost time and money, but there can be significant savings elsewhere. For example, training costs can be high. Ready-trained staff provide an immediate saving on the cost and time required for training, and can quickly achieve a high level of efficiency or productivity in their jobs; trainees, on the other hand, may have to work up to that level over a period of time. It is also much more attractive from the owner's perspective to buy in ready-trained staff rather than training existing staff, raising their career expectations in the process, and then seeing them move to a competitor a few months later. Small business owners often regard it as much better and cheaper to poach the trained staff from a competitor rather than facing the costs and time involved in providing training. The counter-argument is that the

approach is short-sighted in that two or more firms competing for a limited number of skilled staff in a small locality can end up causing wages to spiral.

Internal promotion can take time and cost money, but it also has its advantages in terms of the loyalty it can generate from staff who appreciate the promotion or development opportunities they are offered. Internal development also has the advantage of familiarity, in that existing staff are already comfortable with current systems within the business. The time needed to recruit externally can be particularly problematic if there is a fairly low level of local unemployment as local staff may be hard to find, or may cost above-average rates, or may have to be transported in from further away. This is where internal development scores much higher than external recruitment. Equally, when there is a shortage of skilled labour in the locality, there simply may be no alternative other than to develop current staff, and then recruit less-skilled replacements to fill the gaps at the bottom.

In practice, the manpower planning strategy will use an appropriate combination of selecting some staff for development, and recruiting others from outside. The key factor is to ensure that the chosen methods will enable the firm to get the right skills in the right place at the right time, to enable it to meet its strategic targets and objectives whilst keeping costs down to an acceptable level.

C. AVOIDING PROBLEMS WHEN RECRUITING AND EMPLOYING STAFF

Costs of Employing Staff

When you buy a computer, a car, a van or a piece of production machinery for a business, you or your accountant can perform some simple calculations to identify the outputs or benefits you will gain from the investment, how long it should last, the cost per annum over its lifetime, and the payback or return you will achieve on the investment. A delivery van might be good for five years, or a production machine for ten. Either way, you can be fairly sure that if you make the right choice in the first place, you will get a return on your investment.

Unfortunately, people are not like this, and employing them can be both risky and expensive. For example, when you want to recruit a new skilled member of staff, you pay someone to draw up a job description and person specification and to design a suitable advertisement; you may spend time going through hundreds of applications to produce a short-list of applicants; you then carry out a series of time-consuming interviews, select the person you want, and wait until they have worked their notice from their current employment. When they start, you provide them with induction training, and perhaps product or job training. All the time this is going on, the business is running at less than optimum efficiency. Then, three months later, just as your business is returning to full efficiency, the new member of staff decides to leave and you have to go through the whole time-consuming and expensive process again. People are expensive to find, expensive to train, expensive to replace, and inherently unreliable; that is, unless you have the right motivation and reward structure to retain them.

In addition to the basic salary or wages, the overhead costs of employing staff are a significant burden on business finances. In the UK, the additional overheads of National

Insurance, compulsory staff pensions, uniforms, annual leave, cover for sickness absence or maternity leave, etc can easily add another 30% to the annual wages cost for each member of staff. In some EU countries such as France and Germany, the staff overhead costs can be 40-50%. There is also the added cost of administering the payroll systems, tax credits, pensions etc, which small firms are now obliged to provide. It is easy to see why many modern businesses, particularly those involved in manufacturing, prefer to use robotic systems – they don't argue with colleagues, demand pay increases, or call in sick on a busy Monday morning, and you never hear of a robot claiming sexual harassment in the office! The moral of all is that it is imperative to make the right decisions about the recruitment and staff development policies, as mistakes can be very expensive.

Balancing Cost-control with Reward Structures

Good selection and carefully planned staff development policies are an essential pre-requisite for efficient business performance; however, they are ineffective unless backed up by carefully designed reward systems. This is where many organisations go wrong – putting the recruitment and training in place, only to cut corners by offering minimal wages or very basic staff benefits, and subsequently experiencing high levels of staff turnover which push up recruitment and operating costs and reduce the efficiency of the business. A workable reward structure is the final link in the chain to ensure that skilled and experienced staff are retained. Rates of pay and other conditions of employment must be sufficient to attract staff, to retain them, and to motivate them to willingly contribute to meeting the objectives of the organisation. The system must be capable of influencing the internal culture of the business, to encourage initiative and innovation; and it must reward responsibility within the structure of the business.

There is no ideal formula for getting the reward structure right. Performance-related pay (PRP) with annual reviews, if set at the right levels, can encourage loyalty and stability in the workforce, but motivation and performance may be enhanced by team bonuses or profit share systems. Individual bonuses and PRP are highly motivating for individuals and encourage initiative, but can be difficult to administer when all staff are on different pay rates. PRP can also have a negative effect on less able staff, and can often encourage competition rather than cooperation between staff. Satisfactory financial reward can also be particularly important to staff in small firms where there may be no opportunities for advancement due to the firm's size.

It is particularly important for the owner-manager to keep an eye on local wage rates and the supply and demand for skilled labour in the area. If wage rates are high due to relatively low levels of local unemployment, then cost-cutting to reduce wages costs will be counter-productive. It will result in staff leaving for better pay elsewhere, and the costs of replacing them may well exceed the marginal extra costs that would have been incurred in retaining them in the first place. In addition, there is the unquantified cost of the disruption that high staff turnover can cause to achieving the firm's strategic objectives. In summary, a sound reward structure is the key to successful manpower planning, and getting it right is just as important to the business as the recruitment, retention and staff development activities of the business.

Symptoms of Poor Staff Management or Reward Systems

Problems with staff management or reward systems can be easily identified by monitoring levels of sickness and absenteeism and the annual rate of staff turnover within the business. There will always be some degree of natural staff turnover, e.g. resulting from retirement, staff moving to another area, health problems, or family commitments. The acceptable level of staff turnover will vary from one area to another, depending on the stability of the local population, the supply of labour, and the competing demands for that supply. In a rural area where people tend to be less mobile, and jobs less available, the percentage may be low, say 4 or 5%. In an urban area where there are more jobs around and the population is probably more mobile, 10% may be more usual. However, in either case, if annual staff turnover (i.e. the number of leavers as a percentage of the total workforce) is above 15 or 20%, there is a clear problem. This may be due to low levels of reward, or to poor working conditions, or unpleasant or repetitive work. On the other hand, the problem might lie elsewhere: perhaps the recruitment policy of the business results in the wrong type of staff being recruited for the work, for example, or inappropriate methods of selection are being used.

Typical symptoms of problems with reward structures or the way staff are being managed include:

- increased rates of sickness or absenteeism
- regular patterns of staff absence, particularly at the start and end of the working week
- poor motivation, resulting in reduced output, disruption of output, industrial action and, in extreme cases, sabotage to equipment or machinery
- an increased number of arguments between staff, complaints to management and formal grievance procedures.

Unfortunately, these types of problem are usually the result of a combination of factors which can make the real cause of dissonance harder to identify. For example, employees on a very low wage may tolerate the work if there is no alternative local employment; however, if a second negative factor is introduced – such as the removal of overtime work, a bullying supervisor, a work environment that is too hot/cold, or machines that break down resulting in the loss of productivity bonuses – they may start to demonstrate their dissatisfaction through sickness or absence from work.

This brings us back to the importance of innovative and enterprising cultures within the business, as discussed in Section E of Chapter 2. Providing the right combination of leadership and management style, motivation, positive attitudes and appropriate reward structure will create healthy culture.

Chapter 8

Planning and Managing Business Finances

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INTRODUCTION

At some point in their existence, whether it is for start-up, expansion or just survival, the majority of small businesses will need to raise some finance. Apart from friends, families and “fools” who may be willing to lend on a trusting basis, any independent lender or investor will want to inspect records of past financial performance and financial projections for the future.

This chapter is about the range of information that would typically be required by a lending bank or private investor (although an institutional lender or venture capital investor may require a great deal more information), and which any proficient business owner should be generating for their own use as part of the everyday process of running the business. Most of this information would typically be generated automatically by most small business accounting software systems or in the case of budget projections, via relatively simple spreadsheets.

A. INFORMATION REQUIRED BY LENDERS AND INVESTORS

In a business start-up situation, most lending banks or private investors will base their decision to lend or invest on two main factors – the strength and realism of the financial projections, and the quality of the market research and proposed marketing strategy. In the outline of the business plan content and structure in Chapter 3, the typical information required for a start-up business was outlined.

- A spreadsheet showing the first-year budgetary plan and cash flow forecast, and ideally the same for the second year. Where credit is given to customers or received from suppliers, these forecasts should be split to show the proposed budget for income and expenditure in one sheet, and the projected cash flow, taking account of the credit given and/or received, in the other sheet.
- A detailed explanation of the assumptions underlying the planned budget.
- A personal survival budget – to determine the projected salaries or drawings that the owners need to take from the business to pay themselves.
- A break-even analysis to show when the business will reach a level of profitable trading. This may be expressed in terms of the timescale to reach break-even, the number of product units that have to be sold, or in the case of a service-based business, the sales revenue required to break even.
- Profit forecasts for years one and two to demonstrate how profits will grow as the business becomes established.
- The value of any capital available to the business, and investment made by the owners to date, plus any tangible assets or resources that exist or will be put into the business by the owners.
- A breakdown of the additional finance required by the business and the phasing or timetable of that requirement where appropriate.
- Potential sources of finance that have been identified, e.g. medium-term loan capital, short-term overdrafts, private equity investment, hire purchase or lease purchase, and any other options. For most prospective start-ups, a combination of several of these sources will be involved.

- The owners' preferred sources of finance and their reasons for those choices.
- The proposed financial monitoring procedures that will be used within the business to ensure it remains on track.

It must be remembered that these items are general guidelines, and that some potential lenders or investors may require more or less information. For example, not all lending banks insist on seeing a break-even analysis for start-up proposals; however, not only is it valuable for the proposers to actually know and understand their break-even situation, to ensure they have sufficient working capital to reach it, but including such information in the business plan also helps to generate confidence in the proposal.

For an established business, the required information is very similar apart from the fact that any potential investors will want to see evidence of past financial performance as well as future projections. Of course, break-even level will (hopefully) already have been achieved and exceeded, except in the case of R & D technologies where pre-revenue staged funding is involved.

For an early stage or established company seeking funding for growth and expansion, potential lenders or investors would expect to see:

- details of past financial performance in the form of audited annual accounts and financial reports including the three key documents: the profit and loss account, the balance sheet, and the cash flow statement for each financial year
- details of existing financial arrangements – the allocation of ordinary and preference shares including proportions held by the owners and any external investors, details of bank loans, overdrafts or other forms of finance including debentures, invoice factoring arrangements, and lease purchase
- an aged debtor and aged creditor analysis showing details of credit given and received and any bad or doubtful debtors
- spreadsheets showing the budgetary plans and cash flow forecasts for the next two years, and explanations of the assumptions underlying the planned budget
- a summary of projected profit forecasts for the next three to five years
- a breakdown of the additional finance required by the business and the phasing or timetable of that requirement where appropriate
- the potential sources of finance that have been identified, e.g. medium-term loan capital, short-term overdrafts, private equity investment, hire purchase or lease purchase. The preferred sources of finance should be identified.

B. BUDGETARY PLANNING AND FINANCIAL CONTROL

A budget is a financial plan for an organisation, detailing income and expenditure over a fixed period of time, typically an accounting period. So, the primary purpose of setting a budget is to enable us to forecast levels of income and expenditure over the coming year, to tell us where our money is coming from and where it is going to.

Historical and Zero-based Budgets

There are two ways of preparing a budget: the historical and zero-based approaches. The historical approach is the most popular, and involves taking the budget for the previous period and adjusting it for known or anticipated changes. This is quite a simple and reliable

process assuming, of course, that the figures from the previous year have been prepared carefully and have turned out to be realistic. If not, errors can potentially be compounded year on year. Another problem is that any contingencies or slack which had previously been built into the system are usually compounded by the effects of inflation, leading to ever-increasing inaccuracies.

The alternative is zero-based budgeting where the budget is formulated from scratch, ignoring the figures from previous years, and thereby forcing every single budget heading to be carefully analysed and individually justified. This process has tended to be unpopular, partly because it is time consuming if done properly and prone to error if shortcuts and guesswork are permitted to save time, and because very often the justification of parts of the budget will be historically based anyway. However it is particularly good for evaluating the potential costs of R & D situations or where there is competition for limited resources.

Historical budgets can be too loose, leading to inefficiency, whilst zero-based budgets can be too tight, leading to inflexibility. However, apart from the first year when all budgets are by definition zero based, the historical approach is by far the most popular and practical.

The Purpose of Budgets

Why do businesses bother with budgets? The answer is that they are a very useful and practical management tool, and act as a yardstick for monitoring financial performance. They are used for the following.

- To quantify business plans in financial terms.
- To allocate financial resources.
- To monitor and control activities and operations such as:
 - changing operating costs (labour, raw materials, production and distribution costs)
 - changing costs of overheads, management, sales and marketing, administration, finances and borrowing, etc
 - sales activities, market trends, fluctuations and changes in demand, advertising efficiency, the impact of advertising programmes on sales and consequential fluctuations in sales revenue
- To evaluate performance – sales, production and distribution as well as financial performance.
- To plan and monitor cash flow.
- To identify financial needs and working capital requirements – the potential need for additional financing, loans, short-term overdrafts etc.
- To identify potential profits/losses for an organisation or its internal departments/functions/operational locations.
- The effects of changes in interest rates and exchange rates on operating costs.

Preparing Budgetary Plans and Cash Flow Forecasts

The preparation of the budgetary plan involves using a spreadsheet which is basically a grid containing row and column calculations. If the rows and columns have been prepared correctly, then all the totals across, and all of the totals down, should correspond when carried to the bottom right-hand corner. However, even with computerised spreadsheets,

the budgetary plan rarely works out first time around, and will invariably require tweaking or adjustment to achieve a realistic and acceptable result. Table 8.1 shows an example of a budget spreadsheet.

The first stage is to identify the key areas of income, distinguishing between income generated by sales of goods or services and non-trading income, e.g. rent from sub-letting space. You may wish to sub-divide the sales income to show revenue from different product groups, from different types of customer, or carrying different profit margins. For example, a food and drinks wholesaler would want to distinguish between those two major product areas, but the budget headings may also differentiate between sales to retail outlets where a 20% profit margin is expected, and sales to other wholesalers at a 10% profit margin. The revenue figures throughout the year will also need to reflect seasonal trends. In the case of the wholesaler, this might involve peaks over the summer months and at Christmas, and much quieter periods from February to March and October to November. Any other sources of income are identified and included under a separate heading, e.g. capital receipts of loans, and then all items of income are totalled.

The next stage is to carry out a similar exercise for all known areas of expenditure, including overheads, operating costs, stock purchases (which should reflect sales levels), distributions costs, capital expenditure and loan repayments. As with income, these are totalled for each month and for the year as a whole.

The third stage is to calculate the net income or expenditure for each month and for the year as a whole. If done correctly, this can be quite a complicated and time-consuming exercise the first time around. It is particularly important, therefore, that the time invested is not wasted once the bank manager has seen it, by simply filing the budget away and forgetting it until next year. The budget is a working document, but it will only work for you if you use it properly. The monthly figures against each item of income and expenditure are your forecasts, and the benefit of budgeting is only gained by the regular monthly monitoring of actual income and expenditure against those forecasts. By comparing the two, you will be able to identify discrepancies, and in searching for explanations for these you will further identify potential problem areas. Ignore the process, and you may find that the problems continue to grow unnoticed, until it may be too late to rectify them.

The sample budgetary plan in Table 8.1 uses the example of a sole trader who has set up a new business part-way through the previous year to sell clothes from a stall in a local street market. The spreadsheet shows the sole trader's budget forecast for the next 12 months. As it is a cash-based business with no credit given or taken, it also includes the cumulative cash flow forecast at the bottom. It illustrates the content and depth of detail that lenders or investors would expect to see.

For simple businesses operating on a cash or non-credit basis, the budgetary plan can incorporate the cash flow forecast by using an additional row at the bottom of the spreadsheet to reflect the cumulative cash-flow, i.e. showing a running balance of the positive and negative net income/expenditure figures for each month. However, where the business receives credit from its suppliers, or gives credit to its customers, it will be necessary to split the budget and cash flow forecasts into two separate sheets to reflect the difference between the budgeted figures (dates of sales and purchases etc) and the actual cash movements arising from payments to suppliers and receipts from customers.

Table 8.1: Sample Budgetary Plan and Cash Flow Forecast for a Small Business

Item	Jan.	Feb.	March	April	May	June	July	August	Sept.	Oct.	Nov.	Dec.	Totals
INCOME:													
Market stall	9,000	12,000	7,000	9,000	8,000	10,000	9,000	8,000	10,000	11,000	15,000	17,000	125,000
Cash balance b/fwd	9,800	—	—	—	—	—	—	—	—	—	—	—	9,800
Total Income	18,800	12,000	7,000	9,000	8,000	10,000	9,000	8,000	10,000	11,000	15,000	17,000	134,800
EXPENDITURE:													
Stall rent	750	600	600	750	600	600	750	600	600	750	600	600	7,800
Stall wages	500	500	400	500	400	400	500	400	400	500	400	600	5,500
Stall stock	7,700	6,300	5,700	4,800	5,100	5,400	5,700	5,100	5,400	6,300	7,800	9,600	74,900
Bags and wrappings	90	120	70	90	80	100	90	80	100	110	150	170	1,250
Stall fittings	—	—	50	—	—	—	—	—	50	—	—	—	100
Book keeper	30	30	30	30	30	30	30	30	30	30	30	30	360
Admin and expenses	100	80	80	100	80	80	100	80	80	100	80	80	1,040
Advertising	30	60	30	30	30	30	30	30	30	30	30	60	420
Insurance	50	50	50	50	50	50	50	50	50	50	50	50	600
Transport – running costs	250	250	250	250	250	250	250	250	250	250	250	250	3,000
Transport – hire purchase	150	150	150	150	150	150	150	150	150	150	150	150	1,800
Bank loan repayments	100	100	100	100	100	100	100	100	100	100	100	100	1,200
Bank charges	—	—	300	—	—	250	—	—	250	—	—	250	1,050
Personal drawings	1,500	1,200	1,200	1,500	1,200	1,200	1,500	1,200	1,200	1,500	1,200	1,200	15,600
Total Expenditure	11,250	9,440	9,010	8,350	8,070	8,640	9,250	8,070	8,690	9,870	10,840	13,140	114,620
NET INCOME	7,550	2,560	(2,010)	650	(70)	1,360	(250)	(70)	1,310	1,130	4,160	3,860	20,180
Cumulative Cash Flow	7,550	10,110	8,100	8,750	8,680	10,040	9,790	9,720	11,030	12,160	16,320	20,180	

In many respects, the preparation of a cash flow forecast resembles the process of preparing a budget spreadsheet, as the format and calculations are basically the same. However, the purpose of cash flow forecasts is different: the budget is concerned with identifying levels of income and expenditure for each part (e.g. month) of the budgetary period, but the cash flow forecast is concerned with when that income is received, and when payments are made for expenditure incurred. In order to do this, the cash flow forecast will need to reflect:

- cash balances brought forward from the previous period
- payments due to suppliers (creditors) incurred in the previous period
- payments due from customers (debtors) owing from the previous period, and adjustments for bad debts
- ongoing credit being given and received during the year
- receipts of loan income or capital
- capital purchases, lease payments, loan repayments etc
- in the case of sole traders and partnerships, the income tax liability for the business in the previous year; or in the case of limited companies, the corporation tax liability for the previous period.

Profit Forecasts

The inclusion of profit forecasts in the business plan is absolutely essential as investors want to see that they will be able to get a financial return on their investment and lenders want to see that their money can comfortably be repaid from the profits of the business. It is normal to include profit forecasts for at least two years because the first year of trading may include substantial start-up costs so the business will not be trading at full capacity in the initial months; hence its profits (if any) will not reflect a normal full year's trading activities.

A common mistake in business plans is the failure to differentiate between the end-of-year cash balance shown in the budgetary plan and the profit. The budgetary plan includes balances brought forward from the previous year, and possibly tax payments due, owners' drawings which are an after-tax expense for sole traders and partnerships, and loan repayments for which only the interest component can be treated as an expense against profits.

Table 8.2 illustrates a two-year profit forecast, using the financial data shown in the sample budgetary plan (Table 8.1). It illustrates how the presentation of profit forecast information differs from the totals shown in the budget and cash flow forecast.

Table 8.2: Sample Two-year Profit Forecast

	Year 1		Year 2	
	£	£	£	£
Income				
Market stall		125,000		137,500
Expenditure				
Stall rent	7,800		7,800	
Stall wages	5,500		5,500	
Stall stock	74,900		82,500	
Bags and wrappings	1,250		1,375	
Stall fittings	100		100	
Book keeper	360		360	
Admin and expenses	1,040		1,200	
Advertising	420		500	
Insurance	600		600	
Transport – running costs	3,000		3,000	
Transport – hire purchase	1,800		1,800	
Loan repayment interest	200		200	
Bank charges	<u>1,050</u>		<u>1,200</u>	
Total expenditure		<u>98,020</u>		<u>106,135</u>
Net profit before tax		26,980		31,365
Tax due @ 10%		<u>2,683</u>		<u>3,137</u>
Net profit after tax		24,297		28,228
Owners' drawings	15,600		18,000	
Loan repayment capital	<u>1,000</u>		<u>1,000</u>	
Payments after tax		<u>16,600</u>		<u>19,000</u>
Retained profit		7,697		9,228

Personal Survival Budget

Some lending banks request that a personal survival budget is included in the finance section of the business plan. The purpose is to allow the potential entrepreneur to identify how much money he or she needs to live reasonably comfortably (but not in luxury) and which will need to be drawn from the business.

The personal survival budget will include the costs of accommodation and the associated heating, electricity, water and sewage bills, plus the costs of food and clothing for the family, operating a private vehicle, travel expenses, school fees for children, health and medication costs, leisure activities, holidays, and gifts for family on special occasions. In addition, the total cost must be treated as a net income figure after any taxes have been paid, and must be grossed upwards to reflect the total pre-tax wages cost to the business. Needless to say, most people who undertake this exercise are amazed to find their true costs of living.

Once a reasonable figure for total wages is established, this will feed into the budgetary plan as part of the operating costs of the business. In many cases, entrepreneurs will draw the absolute minimum wages from the business in the early stages, and then gradually increase them as the business becomes more profitable. It must be remembered, however, that no entrepreneur should expect to live on a minimum wage for an extended period of time: if that is necessary, the whole viability of the business must be questioned.

C. WORKING CAPITAL, CASH FLOW AND CREDIT CONTROL

Managing Cash Flow and Working Capital

The importance of producing detailed cash flow forecasts and budgetary plans was examined in Section B of this chapter, but apart from keeping the bank manager happy, these are of little value to the business if they are not actively monitored on a regular basis. At least once a month, and preferably as soon as possible after the end of each month, the actual sales volumes and revenues and the actual expenditure incurred in each area of the business need to be compared with the forecast figures to identify any significant discrepancies. Where such discrepancies occur, they need to be analysed to determine the cause, and to identify whether or not they constitute a one-off situation or part of a developing trend which might adversely affect the longer-term prospects of the business. Having identified any discrepancies, it is then necessary to assess the impact that they will have on business operations and profit. If the budgetary plan has been prepared on a computerised spreadsheet, this is a relatively simple process as the actual data can be entered into a copy of the original budget to produce revised out-turn figures.

This process is even more important when forecasting cash flow, as relatively small changes in sales revenue or credit terms can, over a period of time, compound to create a major cash flow problem. However if the problems can be spotted in time, then it is often possible to address them before they become too great, for example by arranging a short-term overdraft, by tightening credit limits or the length of credit given to customers, or by extending the credit received from suppliers – ideally, after consulting them first, of course!

The cash flow of a business can be likened to an old rusty zinc bucket with holes in the bottom that leak water as fast as it can be poured in at the top of the bucket. If the inflow of water slows down or the holes get bigger, the level of water falls; if the inflow increases or the holes are plugged, the water level rises.

Using this bucket analogy, cash receipts pour in to the business through the top, and leak out as expenditure through the holes in the bottom. There are ways in which the rate of flow can be increased, to top up the level in the bucket, and there are factors which cause a faster outflow, thus reducing the level of working capital in the bucket.

- Increased profits or net receipts from trading improve working capital. As trading profits increase, the net profit from trading will increase the amount of working capital available (assuming, of course, that all debtors pay on time); however, any losses or net reductions in receipts from trading will diminish working capital.
- Raising of loans, and repayment of those loans. The receipt of loans increases working capital. When a long-term loan is taken out (or any other long-term liability), the working capital pot is increased; however, any regular repayments of loan

capital and interest will progressively diminish the available balance. Similarly, the repayment of loans reduces the available cash and working capital.

- Injections of capital from investors will increase the availability of working capital but the redemption of capital or the payment of dividends, profit shares and taxation will reduce the available cash.
- Changes in the average balance of debtors and creditors are major influences on the available working capital. Increased creditors (more credit from suppliers) and decreased debtors (faster payment by customers) will both improve the cash flow, whilst conversely a reduction in creditors and any increase in debtors will worsen cash flow. The latter is one of the inevitable effects of any growth in trading.
- Sale or purchase of fixed assets (e.g. land and buildings) or investments releases cash. The sale of fixed assets will increase the cash available to run the business, but any corresponding or subsequent purchase of fixed assets will reduce that sum. When a vehicle is sold at the end of its practical working life, the residual value will be added to the working capital pot. However, any replacement vehicle (which will inevitably cost more on account of inflation over the intervening years) will probably result in a larger sum being taken out of the working capital pot, unless other financial provisions are made.
- The reduction of stock levels can free up cash previously tied up, but increasing stock levels ties up cash. Often the increased stock-holding is a response to expansion of sales, which, if coupled with an increase in credit customers, can reduce available working capital quite quickly and severely, possibly leading to an over-trading situation.

Credit Control

If it is becoming obvious that some of your customers don't want to pay you, or can't pay you, then there are a number of options available for pursuing the debts.

- The "Italian method" was once popular in Mediterranean countries and in the Godfather movies of the 1970s. It involves enforcement via threats of physical violence or injury. Obviously this method is strictly illegal and comes with the risk of legal and/or physical reprisals so should not be the chosen option for a respectable growing business. Unfortunately, there are still some areas of the "grey" economy where this type of illegal and unacceptable violence occurs, particularly in the field of unlicensed credit. New businesses should be aware that dealing with disreputable suppliers can sometimes leave them open to this approach.
- Telephone or send a reminder letter. This is always worth trying as the non-payment may simply be the result of an oversight. However, if the customer regularly pays late this is likely to have no effect at all, as reminders will simply be ignored.
- If there is no further response within 7-14 days, try again, preferably more firmly. Contact the decision-maker or person responsible for payment. Check that the payment is not in dispute. Ask outright if there is a cash flow problem and ask for a firm date by which payment (or at least part-payment) can be expected. Again, a serial bad-payer will probably just make empty promises at this stage, and will stretch their credit to the limit until forced to pay. There are unfortunately still a few people in business who regard this process as a game and seem to enjoy testing the patience of their suppliers to the limit.
- Once the payment becomes 30 days overdue, then – unless there are special circumstances which you are prepared to accept or you have negotiated an

agreement for repayment – you must seriously consider stopping further supplies. Some small firms find this a hard step to take, as they run the risk of the customer going to another supplier. But what is there to lose? A sale is not a sale until it is paid for, and if the customer is slow in paying you, then the same will probably apply to his or her next supplier. You will be better off without that customer in the long term. It may come as a surprise, but some customers even respect this firm approach.

- If the customer is in difficulty, then you may be able to negotiate a structured programme of repayment without a loss of trade. I have found this to work on several occasions where, for example, the customer paid cash on delivery for the regular weekly supply of goods plus an agreed minimum figure to reduce the outstanding balance. This sometimes formed the basis for future long-term trading relationships as once the customers had overcome their current problems, they remained loyal to the suppliers who had worked with them during the difficult period. But if you do agree to take this route, you must not allow the outstanding balance to increase at any stage until the debt has been cleared and normal trading terms have been re-established.
- Once you get beyond the 90-day stage, there is little option but to take formal debt recovery action. Most owner-managers are very busy people, and have little time to spare chasing bad-payers. Solicitors are one alternative, although expensive to employ, and often laboriously slow to get a result. Professional debt collection agencies are often a better alternative: apart from an initial assignment fee and the reimbursement of their legal expenses, they work on the basis of taking an agreed percentage of the money they recover. They also tend to tell you up front when faced with a hopeless situation, whereas a solicitor might run up expensive bills before reaching the same conclusion.
- In the UK, the Small Claims Court is supposed to offer a quick and inexpensive form of redress for sums under £5,000, without involving solicitors. However, the sheer volume of small claims which the courts have to deal with means that the process can still take some months, even if uncontested. For larger debts it is possible to take action by issuing a High Court writ against the debtor, although the cost of doing so is quite high. The High Court tends to move faster than the County Court, particularly when applications are made for Compulsory Winding-up Orders; but once again, the cost of action must be measured against the likelihood of recovering the debt.
- As part of the UK Insolvency Act 1986, the facility was created to issue a Statutory Demand for Payment, whereby if payment for a debt was not made within 21 days of the issue of the Statutory Demand, then the plaintiff could automatically apply for the business to be wound up or declared bankrupt. This is okay in principle if the business has any assets which could be liquidated in the event of bankruptcy, although if that were the case, then the company could probably raise the money to pay the bill anyway. Realistically, it is only worth issuing a Statutory Demand if you are willing to go to the next stage of enforcing it, i.e. applying to have the debtor declared bankrupt or insolvent which will incur further legal costs. Also, bear in mind that if there are no tangible assets against which to claim, the business owners could simply incur more legal expenses in pursuing the claim, only to find themselves alongside a whole host of other unsecured creditors.
- Where goods are supplied to customers, it is possible to write the terms of trade (which appear on the reverse side of business invoices) to include retention of title to the goods supplied until such times as full payment is made for them. The owner, then, has the right to reclaim the goods if payment is not made. However, this does not confer rights of entry to premises to recover the goods, or help if they have

already been sold. It can sometimes be of use when goods are confiscated by bailiffs or receivers in bankruptcy, as those goods cannot be subsequently sold and have to be returned to the supplier once proof of title has been demonstrated.

Aged Debtors Analysis

An aged debtors analysis is a simple monthly report which is readily available from computerised accounting systems, but which unfortunately many small businesses overlook unless prompted to produce one by their bank manager. It does require more effort to produce one from a manual accounting system, but if credit facilities are given to customers it is essential to monitor the effectiveness of credit control at the individual customer level and to gain an overall picture of the debtors and the periods of outstanding debt.

The aged debtors analysis, an example of which is shown in Table 8.3, is used to assess the performance of customers in paying their bills (and the performance of the business in collecting the debts). Each unpaid invoice for each credit customer is allocated to the 30-day period in which it was issued, so taking the fairly standard business credit terms wherein payment is required within 30 days of the end of the month in which the invoice was issued:

- Any invoices issued within the current month are not yet due, and are regarded as current, unless of course they should have been paid cash on delivery.
- Those falling due at the end of next month are classed as 0 – 30 days old, and are within the terms of credit.
- Those which are 30 – 60 days old should have been paid by now, and so are in need of chasing for collection unless they have been granted extended credit.
- Those which are 60 – 90 days old are of major concern, and unless they are part of an on-going dispute, must be regarded as being at risk, or in accountancy terms they are a “doubtful debt”.
- The 90 days plus category is a definite sign of a “bad debt” and debt recovery action should have been taken long before it reached this stage.

Table 8.3: Aged Debtors Analysis

Customer	Current	0-30 days	31-60 days	61-90 days	90+ days	Total
Ardup and Appie Ltd	2,000	2,000	—	—	—	4,000
Bodger and Lashit Ltd	1,500	1,500	1,500	—	—	4,500
Ben Dover and Co.	3,000	3,000	—	—	—	6,000
Evan Elpus and Partners	1,500	3,500	—	—	—	5,000
Gerry Hatrick and Co.	2,400	3,600	—	—	—	6,000
Grabbit and Run Solicitors	1,000	1,500	1,000	500	1,000	5,000
Helen Highwater and Co.	2,500	3,000	—	—	—	5,500
Major Isewater	1,600	1,400	500	—	—	3,500
Mick Sturbs and Sons	—	1,000	2,300	1,700	1,500	6,500
Mustapha Napple Ltd	2,500	1,500	—	—	—	4,000
Totals	18,000	22,000	5,300	2,200	2,500	50,000
% of outstanding debt	36.0%	44.0%	10.6%	4.4%	5%	—

Looking at this example, there are two customers whose accounts must be treated as bad or doubtful debts, one of which (Mick Sturbs and Sons) already seems to have had its supplies stopped. Two other customers have debts in the 31-60 days range but it may be that their credit has been extended to 60 days, or that they are reliable payers who are just a few days late.

It is also important to consider the relative proportion of bad and/or doubtful debt in the context of the total average monthly debt. For example, if the total bad debt (over 90 days) is just 1% of the average monthly debt, then although it still needs to be addressed, the overall impact on cash flow and working capital may be manageable. However, if the bad debt figure constitutes 10% or more of the average monthly debt figure, the business could be facing major cash flow problems. In the example in Table 8.3, 80% of debt is either current or within 30 days, but 9.4% is in the bad or doubtful category which could cause significant cash flow difficulties. However, if the business has a lot of cash sales (e.g. another £50,000 per month in addition to credit sales), that debt may not be a major problem.

The “prudence concept”, one of the basic principles of accounting, requires that profits are not classed as such until they are in cash or near-cash form. Similarly, any doubtful or bad debts must be acknowledged as such at the earliest opportunity.

D. THE IMPORTANCE OF UNDERSTANDING BREAK-EVEN

Break-even Analysis

Although the provision of a break-even analysis is not one of the required items of financial information requested by many lending banks in Western countries, it is something that most private investors would expect to see.

More importantly, it is an absolutely essential piece of information for any potential entrepreneur. Without being able to identify the stage at which a start-up business will reach the break-even level of trading and subsequently move into profit, it is impossible to calculate the amount of working capital that will be required to finance the business up to that point. If the business runs out of working capital before it reaches a profitable level of trading, it will fail in spite of the fact that it may have the potential to become very profitable in the longer term.

Break-even can be expressed in several ways.

- The period of time (weeks or months) it will take to reach a break-even level of trading.
- The number of product units that must be sold per month to break even.
- The value of the revenue from products or services each month that is required to trade at break-even level.

Profit Margins and Mark-up

Understanding the difference between profit margins (as a percentage of selling price) and mark-up (as a percentage of cost price) is a pre-requisite for calculating the break-even

point. However, it is also a subject that small business owners frequently find confusing, sometimes with catastrophic results.

When we talk of **profit margin**, we mean the difference between the selling price and the cost price. For example, if we buy an item for £60 and sell it for £100, the profit margin is £40. This also constitutes 40% of the selling price.

When we talk of **mark-up**, we mean the percentage amount by which the cost price is increased to produce the selling price. Using the same example, if we buy an item for £60 and mark it up by £40, it will sell for £100. However, the mark-up as a percentage of the cost price is 66.7% – and although that figure may look good, it still only constitutes a profit margin of 40%

Hence:

- a mark-up of 100% will produce a profit margin of 50%
- a mark-up of 67% will produce a profit margin of 40%
- a mark-up of 50% will produce a profit margin of 33%
- a mark-up of 33% will produce a profit margin of 25%
- a mark-up of 25% will produce a profit margin of 20%

Failing to distinguish between these two is probably the commonest and most significant mistake made by people who are new to business. If an anticipated 50% gross profit is in reality only 33%, and adding in a few unexpected expenses, some increased costs during the year, and a small drop in sales revenue, an original forecast of 10% net profit on sales turnover for the year can suddenly become a 15% net loss, and there may no longer be any spare cash for bills that are due to be paid.

Methods of Calculating Break-even Levels

In order to define what we mean by “break-even” we must distinguish between fixed costs and variable costs. Fixed costs are generally regarded as overhead costs, but the definition is that they remain “fixed” in relation to changes in the level of sales or output. Typically, they would include things like rent, rates, management and administration costs (including the owner-manager’s own drawings) and insurance. In contrast, variable costs are defined as those costs which vary directly in relation to changes in sales or output. This would include the costs of raw materials, components, labour production costs (particularly bonus pay or overtime), invoicing, packaging and distribution. The break-even point, then, is the point at which the revenue from sales equates to the variable costs incurred in achieving that level of sales, plus the full overhead cost. Here’s another way of putting it.

$$\text{Sales revenue} = \text{variable costs} + \text{fixed costs} + \text{profit}$$

By definition, when we are breaking even, we are making no profit, so our sales revenue must be matching our fixed or overhead costs, plus what it cost us to make the goods we have already sold.

Another useful concept here is that of contribution, which is defined as follows.

$$\text{Contribution (to profit and overheads)} = \text{selling price} - \text{variable cost}$$

This means that the difference between the selling price and the variable cost of an item makes a contribution towards the profit and overheads of the business. For example, if a car dealer buys a second-hand car for £1,000 (variable cost) and sells it for £1,500 (selling price) then the difference of £500 makes a contribution to the dealer's overhead costs and profits.

There are several ways of calculating the break-even point, including a graphical break-even chart, but the two most accurate methods involve fairly simple calculations based on the sales revenue and contribution equations. To illustrate this, we will use an example where: selling price = £10 per unit, variable cost = £4 per unit, fixed costs = £150,000 per annum, and the break-even sales level = Y units.

a) The equation method uses the simple formula mentioned earlier.

Sales revenue = variable costs + fixed costs + profit.

$$10Y = 4Y + 150,000 + 0$$

$$10Y - 4Y = 150,000$$

$$6Y = 150,000$$

$$Y = 150,000/6$$

$$Y = 25,000 \text{ units}$$

So we see that when sales levels reach 25,000 units, the income is sufficient to cover the variable costs incurred, plus the total overhead costs. However, it is only when sales start to exceed this level that the revenue will make a contribution towards the profit of the business.

b) The contribution margin method uses a different formula.

Break-even level = $\frac{\text{fixed costs} + \text{net profit}}{\text{contribution}}$

$$Y = \frac{150,000 + 0}{10 - 4}$$

$$Y = \frac{150,000}{6}$$

$$Y = 25,000$$

c) Some businesses work on a standard mark-up of goods and services to give a standard percentage profit figure, for example where the contribution equals 40% across all products or services. In these cases, the calculation is simply a case of dividing the annual overhead figure by the percentage profit: with annual overheads of £100,000 and a profit margin of 40%, we would divide £100,000 by 0.4 to give a break-even sales level of £250,000.

When calculating profit margins and setting prices it is important to remember the effect that small changes can have on break-even level. Using the above example, let's say that our marketing specialists have advised that a small change in the selling price, (£9 instead of £10) would generate an increase of 10% in sales. It sounds good, but is it worthwhile? Using the equation method – $9Y = 4Y + 150,000$ – we find that the break-even point Y calculates out at 30,000 units. Unfortunately for us, the increase of 10% in sales volume

will only result in a total of 27,500 units, so we are worse off than before, We actually needed a 20% increase in sales to break even at £9 per unit.

E. SOURCES OF FINANCE FOR START-UPS

There are many different types of finance available and they can come from a broad range of different sources. When seeking finance, the entrepreneur must identify a source of funding that is:

- appropriate to the type of funds required (e.g. for start-up, growth, short-term working capital or long-term capital investment)
- interested in providing the funds that he or she needs; for example, banks will provide funding for working capital for expansion and growth, but would not normally consider funding pre-revenue R & D. Commercial bonds are suitable for large blue chip companies to raise substantial long-term funding but totally inappropriate for SMEs.

The following list gives examples of the most suitable sources of funding for small firms.

- Equity or capital.
 - This is put in mainly by the owners of the business, their friends, families (or “fools”).
 - It is usually in the form of cash but can also be fixed assets or stock.
 - Reserves or retained profits are the best way to fund growth but profits have to be made first.
 - Borrowing capacity may be limited by the size of the equity of the business, as lending banks will expect to see an equity investment in place that is at least as large as any required lending.
 - Business angels (private investors) are useful sources of equity funding, especially for start-up or early stage investment, and they will often have sector expertise or be willing to act as unpaid advisers to start-ups.
- Share capital.
 - This is capital raised by the issue of shares by private limited companies, limited partnerships, or public limited companies.
 - Ordinary shares: these carry voting rights and pay dividends based on profits. They are the most common form of equity.
 - Preference shares: these are non-voting shares with preferential claims on dividends (and assets in the event of liquidation).
 - In order to avoid surrendering too much equity and diluting the control of the business through the issue of voting shares, some companies offer potential investors a combination of ordinary and preference shares.
 - There is always a potential difficulty with share trading in private limited companies, as they cannot be traded on a public market. Often when shares are issued, they carry a condition that if the owner wishes to sell, the original investors (or possibly all other current investors) must be given first option to buy the shares before any outsiders are involved.
- Debenture.
 - A debenture is a long-term loan, for which the interest is paid at agreed dates, e.g. quarterly, and the capital is repaid at the end of the loan period.

-
- Debentures are sometimes inked to share conversion options, whereby the debenture holders can choose to convert them into company shares at a pre-agreed value.
 - They are mainly for public or private limited companies.
 - They sometimes involve “peer” investment between suppliers and customers, e.g. when a supplier provides a debenture to its customer to facilitate expansion in exchange for a commitment to purchase specific volumes from the supplier for the duration of the debenture.
 - Mortgage debenture.
 - This is basically the same as a debenture but is secured against specific fixed assets of the business.
 - Commercial mortgage.
 - This is usually provided to purchase land or buildings, typically over a period of 10-15 years, with monthly repayments of interest and capital.
 - Loan from a bank or financial institution.
 - Loans are either short term (1-3 years), medium term (3-5 years) or long term (5-10 years), with monthly capital and interest repayment, which is typically at least 5-7% over the bank’s base rate for SMEs.
 - All but the smallest of loans are normally secured by directors’ assets (property or shares) and/or fixed and floating charges on the assets and book-debts of the business. Some loans to well-established, growth-potential businesses may be secured under Government Loan Guarantee Schemes.
 - Unsecured loan.
 - Apart from short-term loans for small amounts to long-standing customers, banks will very rarely provide unsecured loans. They come more frequently from family sources or friends.
 - Overdraft.
 - This is essentially a short-term borrowing arrangement to cover seasonal peaks and troughs in trading levels. If it is needed for more than 12 consecutive months, a bank loan is more appropriate.
 - Overdrafts incur high interest rates (typically 10-12% over base rate), but interest is only charged when the overdraft is used.
 - They usually incur arrangement fees and annual renewal fees of about 2.5% of the value of the overdraft facility.
 - Hire purchase.
 - This is used for the purchase of fixed assets, and can be shown as an asset on the company balance sheet.
 - Hire purchase agreements normally require a 20-25% deposit plus (in Europe) the full amount of VAT (which is reclaimable); the balance is paid over 2-5 years, after which the firm owns the asset outright.
 - A proportion of the capital value and the full amount of interest paid can normally be offset against company tax liabilities.
-

- Lease or lease purchase.
 - This requires a relatively low upfront deposit payment, typically 3 months' payment in advance; for some assets, e.g. vehicles, maintenance costs can be included in the leasing charge.
 - Fixed monthly payments are made for the duration of the lease contract, after which the contract is terminated and the asset returns to the lessor; the lessee may be able to purchase it for a small one-off payment, though.
 - A lease purchase agreement can be very tax efficient as monthly payments are tax deductible as a business expense.
 - Leased items cannot be shown as assets on the company balance sheet as they are owned by a third party.
- Grant or business incentive.
 - Grants or business incentives may be available in some countries or regions and are usually provided by governments or regional aid sources. They may also be restricted to certain types of business, e.g. for agricultural improvement or tourism development.

F. The FUNDING ESCALATOR: FUNDING HIGH-TECH/HIGH-GROWTH START-UPS

Investment Readiness

There is a fundamental difference between being “ready for investment” and “investment ready”, which often causes confusion amongst the owners of small businesses. Almost any small business may be ready for investment in that it has reached a stage where it needs further funding to facilitate growth or even just to keep it operating. However, the term “investment readiness” has a different connotation that relates to the due diligence process that potential investors or lenders will expect to carry out before making their decision on whether or not to lend or invest any significant sums of money.

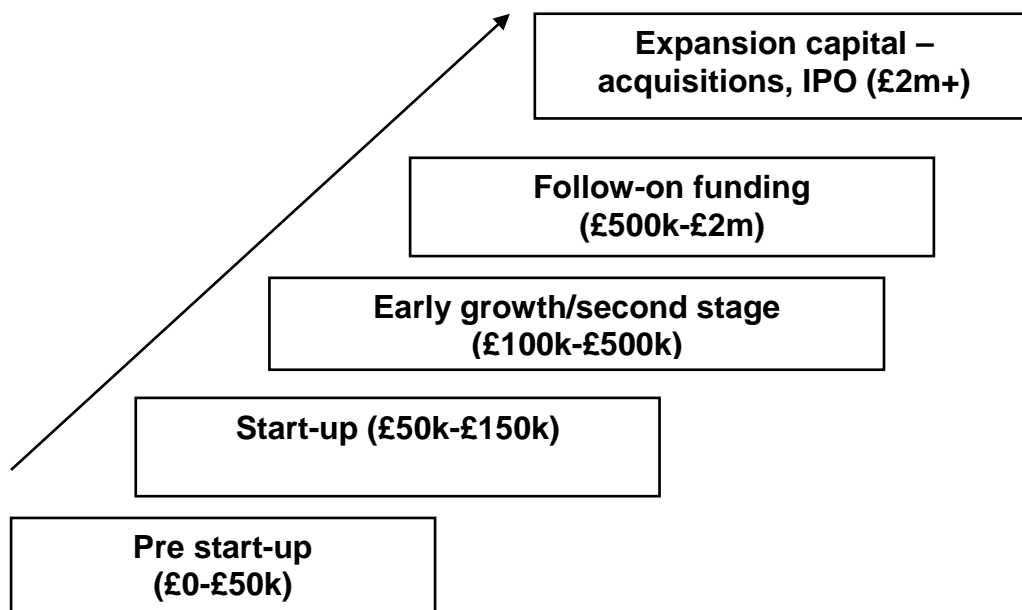
To be “investment ready”, the business that requires funding must have sound information and operational systems in place, as well as evidence of the strength and potential value of its technology and/or intellectual property. The information must be ready for detailed scrutiny by the potential lenders and investors or their appointed independent advisers. It covers far more than just the accounting information, sales records and forecasts, and business plan that would be needed for a conventional bank loan application, and could include:

- audited financial accounts for the previous three years
- detailed and justified financial forecasts
- sound administrative and financial systems
- a strong management team with appropriate expertise
- evidence of patent registrations, or pending applications
- R & D technology that can be independently verified (subject to non-disclosure agreements)
- valuations of research activity of registered intellectual property
- details of suppliers and/or customers, and permission to contact them.

The Funding Escalator Model

The funding escalator model (Figure 8.1) relates to the staged funding that is typically required by technology-based R & D companies (producing, for example, biotech and pharmaceutical products, technical product innovations or nanotechnologies) and by businesses with the potential for high growth. Both of these types of company require different forms of funding for each stage of growth, and may take several years and several stages of funding to reach the point where they start to generate revenue from sales.

Figure 8.1: Funding Escalator Model



Prior to the start-up stage, the requirements may be relatively modest in order to establish the company and develop a basic concept. This might be a sum of up to £50,000, which will typically be obtained from the entrepreneur's own funds, from personal loans, friends and family, university start-up grants, or business angel investors.

For the start-up stage, a further £50,000 to £150,000 might be required for R & D, product prototyping, proof of concept testing, IPR protection, and getting a commercial product ready for market launch. The next phase of this funding might come from R & D grants, proof of concept or follow-on R & D funds or angel investors. The subsequent product launch funding would be more likely to come from short- to medium-term bank loans, second-round angel investments, hire or lease purchase, and invoice factoring.

Once the sales revenue is flowing, further funding for early growth would typically be sought from regional development growth or accelerator funds (loan or equity based), syndicated groups of business angels or private investors, longer-term bank loans (including those covered by government loan guarantees to support business growth), investment group seed funding, and, of course, profit re-investment from the company itself.

Further growth funding would normally involve larger sums and could be sought from the same sources as the funding for post-revenue growth, although it may be too large for individual private investors. For sums in excess of £2 million, the venture capital companies or trusts provide ideal sources, but require substantial equity stakes and normally apply strict conditions (including Board of Directors representation) and specified exit dates and strategies. They are generally seeking to profit from capital growth of at least 25% per annum, rather than receiving annual dividends. One of their preferred exit strategies is the Initial Public Offering (IPO) whereby the company is listed on one of the minor stock exchange listings such as the Alternative Investment Market.

Chapter 9

Legal and Financial Compliance

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INTRODUCTION

This chapter is about some of the practical aspects of the legal and financial regulations that businesses are required to comply with. It also covers some non-compulsory, but nevertheless essential, aspects such as insurance and the protection of IPR that all businesses, whether they are start-ups or established firms, need to be aware of.

Every country around the world will have its own laws and regulations relating to operating a business, and there will inevitably be broad variations between them. In fact, the more socially and commercially developed countries become, the more onerous those regulations tend to be – sometimes to the point where it seems that new regulations are imposed for the most trivial reasons. The EU is a classic example of this: homogeneous regulations have been designed and introduced to make every business equally compliant across the member states, irrespective of the impracticalities of enforcing them or the damage they can do to competition. It is not surprising, therefore, that countries with developing economies that are not constrained by bureaucracy are more able to compete in open markets.

In view of the range and diversity of regulations that govern business activities throughout the world, it is impossible to cover them all within this study manual. The examples that will be used, therefore, relate mainly to UK law or in some cases to how UK law has been modified by EU regulations.

A. ENSURING LEGAL COMPLIANCE

There are two main challenges facing start-ups and early stage companies relating to legal compliance. The first is the issue of identifying which of the many laws and regulations on the statute books directly apply to the proposed business. Whilst some regulations, like those to do with health and safety at work and aspects of employment law, relate to all businesses, there are others that are sector specific and only apply to businesses providing certain products or services. An example of this is food hygiene regulations in the food and catering industries. Most new businesses that operate in specific business sectors are started by an owner or employ an experienced manager with sector expertise. This usually incorporates a basic knowledge of the legislation that applies to the sector.

The second issue is the problem of keeping up with constant changes in the law. This can be more challenging for new or early stage firms that have very limited staff resources, which are focused on internal business operations rather than changes in legislation at national level. Fortunately, forthcoming changes in sector-based legislation (e.g. food labelling or electrical appliance standards) are normally well publicised within the sector, but minor amendments to more generic legislation such as the frequent Directives issued by the EU can sometimes be overlooked.

One of the biggest problems faced by small firms is the regulations that don't actually require direct compliance but which can have an adverse affect on profitability if they go unnoticed. For example, changes in UK tax regulations substantially reduced the capital allowance limits that small firms can use to claim tax relief on purchases. As a result, the

net cost of a truck or a piece of heavy machinery purchased in March 2012 was significantly less than the same purchase one month later.

B. OPTIONS FOR TRADING STATUS

The trading status of a business is the legal format under which it chooses to operate. It is normally selected to be appropriate to the size and scope of the trading activity and the simplicity or complexity of its needs. A small part-time family business with a modest sales turnover can operate quite comfortably with sole trader or partnership status and does not require the protection of limited liability status. In contrast, a company with substantial assets, and with sales revenues from international markets, needs a more robust and formal operating status, especially if it needs to raise finance from the money markets to expand its activities.

Sole Traders

Being a sole trader is not simply a case of operating alone as many sole traders actually employ quite a few staff, for example small local builders or tradesmen. Sole trader status means that the person who owns and runs the business is solely responsible for its profits, losses, legal and statutory obligations, and liabilities.

On the positive side, this means that the sole trader does not have to answer to anyone else (unless married or with other domestic commitments that might influence the proposal), and is solely responsible for decision-making. It is easy to start trading as a sole trader: all that is necessary is to inform the local office of HM Revenue and Customs by completing a standard form, which is available on the internet. All profits are retained by the sole trader, and he or she can determine the hours worked, duration of holidays, etc. With the aid of a good accountant, a sole trader can also minimise tax liabilities, as tax is based on the profits of the business rather than the wages or drawings taken from the business. In fact, the overall operation of the business can be quite simple.

This sounds very attractive, but there is also a downside. As well as retaining all profits, the sole trader is directly liable for all losses, without any limit to that liability. If the business folds, then creditors can pursue the sole trader's own personal assets: home, car, jewellery, savings, and all but the very basic possessions. Attachment Orders can also be made against future earnings. Unless the business is large enough to employ staff, working hours can be long and holidays rare, and there is often no back-up in case of illness or accident. It can also be lonely having to make decisions without anyone with whom you can discuss issues or problems, or ask for an objective and honest opinion. Capital is also hard to raise without security, although that same problem can be true of most new businesses.

Legally, unless they are subject to special registration or reporting requirements for a particular trade or industry (e.g. environmental health registration for caterers), the statutory reporting requirements for sole traders are quite simple. If sales turnover is less than £73,000 per annum, then a short tax return is sufficient; above that level, the sole trader only needs to complete the appropriate parts of the annual self-assessment form for tax purposes, profit and loss account details etc. Once sales turnover reaches £78,000 per annum, then like any other business it is necessary to register for VAT with HM Revenue and Customs, and to make the appropriate quarterly returns and payments. Also, if staff

are employed, Income Tax and National Insurance must be deducted from their wages or salaries under the UK's Pay As You Earn (PAYE) system. Sole trader accounts do not have to be audited by a chartered accountant, but all records do have to be retained for a period of six years. Profits, minus legitimate business expenses and personal allowances, are taxable; and every sole trader must pay Class 2 and Class 4 National Insurance Contributions (NICs; employment taxes).

Partnerships

A partnership is a business involving two or more partners who are trading together as a single business. Typically, the business relationship will be formalised under a legally constituted and legally binding Partnership Agreement under the Partnership Act 1890. A partnership must be registered with HM Revenue and Customs when it commences or is terminated.

Many people find the added security offered by a partnership attractive. With two or more people working together, there is usually a better interaction of ideas when it comes to decision-making. There is also mutual support available in the event of illness or accident, and to facilitate more flexible working hours and holidays. Profits are retained by the partners and, although they are shared, they will often be greater than the same individuals could achieve by working separately. This is because of the savings gained by sharing administration and overhead costs, and by using specialist skills and expertise. For example, one partner may have strong sales skills, whilst the other may have better financial and administrative abilities than the first. A partnership may also provide an easier means of raising finance or a greater sum of available finance – where for example, available monies are pooled or security for loans is shared.

However, there is a negative side to partnerships which should not be underestimated. It is often said that there is nothing like a business partnership to test a friendship, or to divide a family in two. Differences of opinion can arise over what direction the business should take, or over who is working the hardest or the longest hours, or drawing the biggest income from the business. The cracks become more noticeable when the business is under financial pressure, or when individual partners come under pressure from their own spouses or families.

The biggest drawback of partnerships is the liability of the partners for the debts of the business. This is known as “joint and several liability”, wherein each partner is liable for his or her own proportion of any debts plus the debt as a whole. Consider the following example: a two-woman partnership is assessed for a tax liability of £20,000. Partner A pays HM Revenue and Customs her half of the liability, i.e. £10,000, on time. Partner B defaults on her share, and disappears to South America. Partner A now becomes liable for B's £10,000 tax liability as well as the money she has already paid for her own liability.

From the point of view of legal reporting, the requirements for a partnership are very similar to those of the sole trader. The same accounting returns have to be made on turnover, expenses and profits for tax purposes. The PAYE and National Insurance requirements are the same, as is the VAT threshold, and that figure is more likely to be reached when two or more people are generating income for the business.

Limited Companies and Limited Partnerships

Limited companies are generally regarded as being of a higher status than sole traders or partnerships. They can be purchased quite readily via the internet. Blocks of new companies are often set up by specialist firms or solicitors, offered for sale for a couple of hundred pounds, and then renamed as required by the new owner, ready to start trading. Assuming that the proposed trading name is available for use, the company can start trading almost as soon as it has been purchased and the company officers nominated. Alternatively, new companies can be set up very cheaply from scratch under the proposed operating name, in two to three weeks without much legal advice. In reality, given the time delay and administration involved, it is much simpler to pay a little more for a company from a specialist supplier and then simply change the name.

The main documents required in order for the company to operate are the Memorandum and Articles of Association which define the company's legitimate trading activities and powers to raise finance. The company must also maintain a Minute Book which records the share capital, issue of shares, details of company officers, minutes of Annual General Meetings etc. Every limited company also has a company seal which is affixed to official documents and contracts. Responsibilities and duties of company officers are established in law, and the statutory returns (and penalties for non-compliance), as defined within various iterations of the Companies Act, are explained in more detail on the UK Registrar of Companies/Companies House website.

Responsibilities and duties of company officers are established in law, and the statutory returns (and penalties for non-compliance) as defined within various iterations of the Companies Acts, are explained in more detail on the UK Registrar of Companies / Companies House website.

The key difference between sole traders, partnerships, and the directors who own or manage limited companies is that whereas the former are self-employed, the directors cannot legally be so as they are employees of the company. This is because the limited company is a "body corporate" – i.e. it has a legal existence in its own right, irrespective of the persons who own it, invest in it, or manage it. Similarly, whereas self-employed sole traders and partners are taxed as individuals and pay Income Tax, because a limited company has a corporate identity it is liable for Corporation Tax. It is the same corporate status that makes the liability of its owners limited. This means that unlike sole traders and partners where their liability for business debts is total, the owners, investors, shareholders etc of a limited company are only liable for the sums which they have already invested in the company, or which they have guaranteed on its behalf. (That liability also includes the value of any shares which are issued but not fully paid up.) If, therefore, the company becomes insolvent, the creditors can only pursue the assets of the company itself; they cannot take action against the shareholders or directors, except in cases of fraud or negligence.

Overall, this seems a very attractive and low risk way of setting up a business, as the limited company approach ostensibly takes the owner one step back from the potential creditors. However, things are not that simple, because a newly established limited company with no financial track record, and with only £100 of issued share capital, is no more attractive in the eyes of a potential creditor than any partnership or sole trader, and

with the added risk of limited liability, it may take the limited company a good deal longer to obtain credit facilities.

For any start-up business, the two main problems are finding the finance to get started and then obtaining credit from suppliers to trade and expand the sales of the business. It doesn't matter whether you are a sole trader or a limited company, if the business has no proven track record or trade references, and no tangible assets or security to offer, then borrowing money or obtaining credit will be hard. Quite often, suppliers of goods to limited companies will take a harder line than with sole traders, simply because they know that it is easier to recover debt from a sole trader than from the owners of a limited company. It is quite common for initial terms of supply to be cash-with-order, or cash-on-delivery, with credit facilities being withheld until the buyers have proven their reliability. Even then, credit may be limited to a fixed monthly maximum figure, or to payment within a fixed period of time, until a good working relationship has been established.

In terms of legal and statutory reporting requirements, owners of limited companies have more onerous obligations than their self-employed counterparts. For those companies with a relatively low turnover and balance sheet (under £6.5 million and £3.26 million respectively, and an average of fewer than 50 employees), abbreviated accounts can be submitted. For the majority of other companies, it is necessary to submit full audited accounts annually to the Registrar of Companies. In addition, as all directors are employees of the company, all staff fall under PAYE and National Insurance regulations; plus there is an additional requirement to provide HM Revenue and Customs with separate details of all expenses for directors and higher-paid staff. VAT thresholds are the same as for any other business.

For sole traders and partners, tax liabilities are assessed against the profit of the business against which personal tax allowances can be offset. Tax is paid at the standard and higher rates (currently 20% and 40% respectively); Corporation Tax for limited companies is currently 20% on profits up to £300,000 and 25% on profit between £300,000 and £1.5 million.

Limited liability partnerships (LLPs) are a cross between partnerships and limited companies. They are popular with professional people such as solicitors, surveyors or accountants who would previously have used conventional partnerships; in light of the growth of litigation for professional negligence against professional firms, they offer the protection of limited liability, rather than the greater personal liability that exists with partnerships. They combine the simplicity, flexibility and ease of decision-making of a partnership with the protection of limited liability. Partners are jointly liable for the debts but their liability is limited to the extent of the sum invested or the sum outstanding for share purchase (or any sums secured by partners).

LLPs are established by registering the limited partnership with the Registrar of Companies. They make Annual Returns, with audited accounts (depending on turnover) to the Registrar of Companies, and they have to register with HM Revenue and Customs for VAT, Corporation Tax, and the payment of PAYE for employees.

A comparison of the features, advantages and disadvantages of sole trader status, partnerships, limited companies and limited partnerships is shown in Table 9.1.

Table 9.1: Trading Status Options for Small Businesses – Summary of Key Features

	Sole Trader	Partnership	Limited Partnership	Limited Company
Definition	The ownership of the business is held by one person, irrespective of the number of employees. The business and the owner are effectively the same for legal purposes.	Ownership is held between two or more partners.	A cross between a partnership and a limited company. Ownership is held by two or more partners, but the business has a corporate identity that is independent of the partners.	Ownership belongs to the shareholders who have invested money in the business. The company has a corporate identity that is independent of the investors.
Statutory Reporting Requirements	HM Revenue and Customs for VAT, taxation of profits, and payment of Class 2 and Class 4 NICs and PAYE for employees.	HM Revenue and Customs for VAT, taxation of profits, and payment of Class 2 and 4 NICs and PAYE for employees.	HM Revenue and Customs for VAT, Corporation Tax, and payment of PAYE for employees. Registrar of Companies for Annual Returns, with audited accounts (depending on turnover).	HM Revenue and Customs for VAT, Corporation Tax, and for payment of PAYE for employees. Registrar of Companies for Annual Returns, with audited accounts (depending on turnover).
Liabilities	The owner takes on the total risk – including his or her personal assets and property.	All partners are both individually and jointly liable for all the debts (joint and several liability).	Partners are jointly liable for the debts but their liability is limited to the extent of the sum they invested or the sum outstanding for share purchase (or any sums secured by the partners).	Liability is limited to the extent of the sum invested or the sum outstanding for share purchase (or any sums covered by the directors' personal guarantees).
Advantages	Simple to set up and operate: simple decision-making and total control. The owner keeps all of the profits. There are some tax advantages for expenses.	Simple to set up and operate: mutual support and joint decision-making. Governed by the Partnership Act 1890, with clearly defined responsibilities/liabilities for partners. The partners keep the profits and share the risks. There are some tax advantages for expenses.	Combines the simplicity and ease of decision-making of a partnership with limited liability protection.	Investors have limited liability. Corporation Tax for small firms is 10% (20% for sole traders). The tax rate for dividends paid to shareholders is 10% Company status confers perceived credibility as an organisation.
Disadvantages	Exposure – there is no cover for health or accidents or for holidays and sickness. No holiday/sickness cover. The owner has total liability.	There is a risk of partner disputes, especially in family-based partnerships. The partners share the profits.	There is a risk of partner disputes. Partners are employees so pay tax and NICs under PAYE.	It can be hard to get credit in the early stages. Directors are employees so pay tax and NICs under PAYE, Audited accounts can be expensive for larger companies.

Public Limited Companies

Public limited companies (PLCs) are limited liability companies with a minimum share capital of £50,000. They are “public”, as distinct from the private limited companies described earlier in this chapter, because their shares can be freely sold and traded to the public via the stock markets, such as the Stock Exchange or, more commonly in the case of smaller PLCs, the Alternative Investment Market. They are identified by the letters “PLC” after the company name.

PLCs are subject to stricter regulation than their smaller private counterparts. They must have a Company Secretary and at least two directors, one of whom may also be the designated Company Secretary if they have the requisite qualifications/ experience. The shareholding must be at least £25,000 and at least 25% must be in fully paid-up shares. Half-year and full-year results have to be reported to the stock market, and a detailed Annual Return has to be made to the Registrar of Companies, including:

- a Directors’ Report
- details of the directors, Company Secretary, auditors, etc
- details of shares issued and all shareholders who own 5% or more of company shares
- details of any changes to directors or shareholders and changes to accounting practices in the previous year
- audited accounts for the year
- a number of other specified disclosures.

The advantage of PLCs is that they can raise share capital by selling shares on the stock markets; the downside is that external organisations can potentially buy up the shares to take control of the company. PLC status is not normally appropriate for start-ups or early stage companies unless they are heavily capitalised.

Cooperatives, Charities and Not-for-profit Organisations

Another less-common trading status option for smaller businesses is to become established as a cooperative or joint ownership venture. These businesses are owned and controlled by a minimum of seven members, normally but not necessarily its own employees, as there can also be non-working members – this arrangement is usually described as a workers’ cooperative. All of the business policies, the assets, and the profits of a cooperative are controlled by its own members (or staff) who all have equal voting rights in how the business is organised and managed. Wages are paid to staff, and surplus profits (dividends) are shared between them, according to their level of participation in the business. Like limited companies, registered cooperatives are classed as a “body corporate” and are subject to Corporation Tax, although if they are unregistered, they are treated as partnerships with unlimited liability for the losses or debts of the business. When registered in the form of a limited company, their reporting requirements will be the same as those of normal limited companies, as will be the operation of PAYE, tax liabilities, VAT registration, etc.

Involvement in a cooperative usually generates a high level of commitment from its members, as they are effectively working for both the good of themselves and of the

cooperative, and they participate in the management and decision-making processes. At times, however, this democratic process can be counter-productive, when business decisions are based on personal feelings or interests rather than sound business practice. Where a cooperative has been created via a buyout of a failing business by workers faced by possible redundancy, the result is often the continuation of inefficient labour-intensive working methods to maintain employment for members. This can threaten the cooperative's own success or survival.

Not-for-profit organisations are often described as “social enterprises” in that they may operate on a business-like basis but re-invest any surplus revenue to further their objectives. Charities are essentially non-profit-making organisations that exist to provide specific benefits to the communities in which they operate; although they can have subsidiary trading operations for fundraising purposes, they are not expected to charge for their services. In the UK, they are usually registered with the Charity Commission, by virtue of which they can usually achieve tax-free status in the UK.

Under the Charities Act 2006, charitable organisations with an income of less than £5,000 per annum are exempt from charity registration, and those with an income of up to £10,000 can register as charitable associations. This is an ideal status for small voluntary groups and for local clubs or sports associations: it gives them legal status and tax relief without the need to comply with excessive regulations apart from a simple Annual Return to the Charity Commission.

Community interest companies (CICs) are another form of not-for-profit organisation. They are based on the limited company model with directors and shareholders, but they are not allowed to pay dividends to shareholders as all of their trading profits (surpluses) have to be re-invested in the company and used for the objectives for which it was established. CIC status is ideal for larger social enterprises that may have substantial trading activities or revenues and so need the limited company protection for shareholders. Many CICs are also registered charities, although charities can operate as ordinary limited companies, using their charitable status to obtain tax relief on trading surpluses and gift aid donations.

C. KEY AREAS OF LEGISLATION FOR SMALL BUSINESSES

We will examine the range of legislation affecting enterprises under seven headings.

- Company law and business registration.
- Health and safety.
- Employment.
- Finance.
- Fair trading/misrepresentation.
- Anti-discrimination legislation.
- Environmental legislation.

The following lists are not exhaustive: there may be other legislation that applies to specific industrial sectors, e.g. nursing homes, transport companies, catering and hospitality. Anyone who is planning to start a new business should check out their particular business idea to identify the regulations that they must comply with.

Company Law and Business Registration

In the UK, all private limited companies, LLPs, CICs and PLCs are required by law to register with the Registrar of Companies at Companies House. They are also required to submit Annual Returns within a specified time after their financial year end; PLCs must also submit independently audited accounts and an Annual Report by their directors. Each company's information is held on public file and can be inspected by any member of the public on payment of a small fee.

In the UK, all trading organisations (sole traders, partnerships, limited companies, LLPs, CICs, PLCs, charitable associations and charitable trusts) must register with HM Revenue and Customs when they start to operate. If they employ staff, they must register to make regular tax deductions from staff wages under the PAYE system and must pay National Insurance (an employment tax). If they have a sales turnover that exceeds £78,000 per annum, they must register for VAT and must collect it and pay it to HM Revenue and Customs on a quarterly basis. They must also submit an Annual Return, summarising their income and expenditure and any tax allowances claimed.

The main non-financial legislation relating to businesses is as follows.

- Companies Acts 1985, 1989 and 2006. The Companies Act (in its various iterations over the years) formulates the rules under which all limited companies and PLCs operate. It specifies the registration requirements, and the Annual Returns which have to be made, reporting the accounts and financial situation of the company etc. The reporting requirements were summarised in the Options for Trading Status section of this chapter.
- Partnership Act 1890. The main features of this Act were covered in the Options for Trading Status section of this chapter. In addition to the formation/registration of, and reporting requirements for, partnerships, the Act also defines the role of Partnership Agreements. The Partnership Agreement, once signed and witnessed, is a legally binding document. In the absence of a formal Partnership Agreement, the Act specifies that profits and losses will be allocated equally between partners in the business. It also prescribes that if a partner wishes to resign, the whole partnership must be wound up, and a new partnership formed by any remaining partners. This is obviously an onerous process, particularly in professional partnerships (accountants, solicitors etc) where changes are relatively frequent. To overcome this problem, Section 113 of the Finance Act 1988 allowed for the production of a Notice of Election to Continue Partnership, wherein one partner could leave or another join, without having to dissolve or rewrite the Partnership Agreement, thereby simplifying the whole system for Income Tax purposes.
- Business Names Act 1985. The names of limited companies are registered with the Registrar of Companies at Companies House. Before a name is registered, there is a search process to ensure that the name has not already been used by an allocated company, or is not allocated to a newly formed but inactive company. The Registrar can provide advice on names, which must not be offensive or constitute a criminal offence. In the case of partnerships or sole traders, there is no registration requirement by law, and proprietors can use their own names, or can trade under other names, e.g. "John Smith trading as Wonder Web Internet Services". It is a legal requirement, however, for company letterhead and documents to show the registered company name and number, the names of company directors, and the registered office. In the case of partners and sole traders, where they are not

trading under their own names, they must be identified as proprietors on all business documents.

- Legislation relating to the registration of brand names and trademarks is covered in Section E of this chapter.
- Insolvency Act 1986 and Company Directors Disqualification Act 1986. One of the main objectives of the Insolvency Act 1986 was to curtail the legal but improper practice of operating “Phoenix” companies. This involved the company trading for a while, accruing debts, being bled dry of cash by the payment of high directors’ salaries, and then being liquidated overnight. A new limited company would then surface a few days later under another name, with the same directors, operating from the same premises, producing the same goods or services, but free from previous creditors, who were left without much hope of payment. The Insolvency Act made it a criminal offence for any individual or company director, to knowingly continue to trade whilst insolvent. The penalty for failing to take corrective action, or for failing to inform creditors of an insolvency situation, involved the company directors being made personally liable for all company debts, being barred from future directorships and, in some cases, facing charges of fraud. It was also no longer possible for company directors to put businesses into voluntarily liquidation and appoint themselves as liquidators. Businesses that were profitable, but insolvent due to cash flow problems, could continue to trade by virtue of Voluntary Agreements with creditors: if at least 60% of creditors agreed to forestall action to recover debts, the insolvent business could negotiate a planned schedule of repayments to creditors. If the required proportion of creditors agreed, then the Voluntary Agreement was legally binding on all creditors, and on the schedule of repayments. The Act also introduced the Statutory Demand for Payment, whereby creditors could demand payment within 21 days; if payment was not made, they could apply for an immediate Winding-up Order against the business.
- Enterprise Act 2002. This Act covered a range of business areas including competition and mergers, but it also updated the 1986 insolvency regulations in several key areas relating to business insolvency and personal bankruptcy, including:
 - reforming the financial regime of The Insolvency Service, making it simpler, fairer to creditors and more transparent; and streamlining the procedure of administration to make it more efficient and accessible in order to aid the rescue of viable companies
 - restricting the ability to appoint an administrative receiver to lenders holding pre-existing floating charges, or to financiers involved in certain capital and other transactions, where the appointment of an administrative receiver is essential to efficient market operation
 - introducing powers to extend certain insolvency proceedings to foreign companies, Industrial and Provident Societies and Friendly Societies
 - removing the Crown's preferential rights in all insolvencies and making provision to ensure unsecured creditors are major beneficiaries – a major change effectively removing preferential creditor status and downgrading government and local government organisations to the status of ordinary creditors
 - a number of changes relating to bankrupts, including cutting the restrictions imposed on undischarged bankrupts; allowing the automatic discharge of most bankrupts after a maximum of 12 months; introducing Bankruptcy Restrictions Orders to protect the general public and the business community from bankrupts whose conduct before and during bankruptcy has been found to be culpable; limiting to three years the period in which a trustee may deal with a bankrupt's

interest in the sole or principal home of the bankrupt, the bankrupt's spouse or former spouse, before that interest reverts to the bankrupt.

- Contract law (debt recovery etc). This is essentially different from any statutory law in that the laws of tort, or contract, have not been established and precisely defined by Act of Parliament. Instead, they have evolved over a period of time as a result of numerous cases in civil law which have formed established precedents. As a result of this process, there are established procedures within the Civil Courts that facilitate the recovery of debts which are proven under civil law, e.g. where failure to pay within a specific time has resulted in a breach of contract. Some of the issues around debt recovery and credit control are discussed in Section C of Chapter 8.
- Property law. Like the civil law relating to tort or contracts, the laws that affect purchase, ownership, and leasing of property are a mixture of statutes and case law. If anything, this is an area where proper legal advice is more important than just about any other, particularly where legal liabilities are concerned. One example which has always been contentious is that of long-term leases, where a leaseholder who sells on the remaining lease to another party will still remain liable for any subsequent debts on that lease (such as non-payment of ground rent by the new leaseholder). Similarly, if the new leaseholder becomes insolvent, the responsibility for the lease will revert to the original leaseholder.

Health and Safety

Health and safety is an issue that affects all businesses and the way they and their staff interface with each other, their customers and visitors, and the general public. The UK legislation on this topic also reflects similar legislation across Europe and other parts of the world. The main legislation is as follows.

- Health and Safety at Work etc Act 1974. With its many subsequent updates, this applies to all private sector businesses, public sector organisations and charities alike. Employers, or organisations or persons in charge of premises, processes or services, have a duty to ensure they:
 - provide a safe and secure working environment including ensuring a hygienic environment; keeping passageways clear of obstruction or trip hazards; using non-slip materials on floors; providing training for manual handling and lifting; and providing staff and visitors with protective clothing where appropriate
 - protect persons other than those at work against risk to health and safety arising from or connected with the activities of the business operations, or persons in the workplace, including employees, customers, visitors and passers-by
 - ensure that staff can work with trained and competent colleagues who do not pose a risk or threat to themselves or the other staff
 - possess and display a current Certificate of Insurance
 - signpost fire exits, and display warning notices for hazards
 - have a member of staff who is trained in first aid, keep a first aid kit on the premises, and keep an Accident Book on the premises to record details of any accidents, injuries or incidents involving staff or visitors
 - label hazardous materials and store them safely
 - (where there are five or more employees in the organisation) carry out a risk and hazard analysis of the premises, and fire risk assessments and have a written health and safety policy made available to all staff, and an induction training process for all new employees.

- Control of Substances Hazardous to Health (COSHH) Regulations 2002. This legislation relates to the safe use, handling and storage of potentially dangerous substances on the premises, care and safety of staff and visitors, and prevention of damage to the environment. The definition of hazardous substances does not just cover explosives, poisons, poisonous gases or fumes, fragile or sharp items, corrosive or radioactive materials; it also relates to more commonplace substances such as bleach or cleaning materials. Dangerous or hazardous materials must be clearly labelled, identifying the type of potential hazard, and must be stored in safe and secure conditions. Staff must also be trained in the safe handling and use of any such materials.
- Reporting of Injuries, Diseases and Dangerous Occurrences Regulations (RIDDOR) 1995. This covers notifiable injuries and/or illnesses. It is an older piece of legislation that overlaps with the Health and Safety at Work etc Act 1974 in requiring reports to be submitted regarding serious accidents or incidents in the workplace; but it also requires employers to notify the health authorities of any members of staff who contract certain specific serious illnesses or infectious diseases, such as tuberculosis, poliomyelitis, cholera, Scarlet fever, smallpox, typhus, anthrax, meningitis and encephalitis, plus quite a number of others.
- European Working Hours Directive. This seeks to limit the working hours that employees can be required to undertake over a fixed period of time. It is quite a contentious piece of legislation, which was originally conceived in Germany to prevent businesses in other EU member states with fewer restrictions on working hours from being too competitive. However, as the UK had opted out of the EU Social Charter, it was eventually applied to the UK under the guise of a health and safety issue, although it really comes under employment law. In brief, it restricts any person from working an average of more than 48 hours per week in any rolling 17-week period unless they specifically agree in writing to opt out of that right. However for that voluntary option to be valid, there must be no pressure from the employer. Certain professions (such as doctors) are exempted from the Directive. Where it does provide a valuable service is in limiting the driving hours of drivers of heavy goods vehicles, as there is an accident risk from falling asleep at the wheel if they drive for too long or fail to take regular breaks.

Employment

In recent years, the UK legislation relating to employment has been influenced by two main factors.

- The political party in power, its relationship (or otherwise) with the trade unions, and its attitude towards promoting business growth. So whilst one party, influenced by its trade union paymasters, may favour pro-employee legislation, another with a pro-business stance will regard too much employment legislation as against the interests of small firms and an impediment to business growth.
- The steady stream of European Directives, many developed in the interests of promoting human rights, which have created a burden of bureaucratic compliance for businesses. In the case of small firms, this can be disproportionate to the resources they have available. Conversely, some former communist countries (notably China and Russia), which used to heavily regulate private enterprise, have moved towards deregulation to help make their businesses more internationally competitive.

Employment law is a very complicated and constantly changing subject. For that very reason, all businesses are advised to seek professional guidance where disputes or areas of doubt arise. The consequential expenses of facing an industrial tribunal can be crippling, particularly for a small business which is struggling to establish itself.

Many of the provisions of the various employment Acts overlap with other legislation discussed here. Fundamentally, in law the employer is obliged to:

- provide a safe and secure working environment
- pay staff at agreed rates and at agreed intervals, including the observance of minimum pay requirements
- provide staff with a contract of employment
- inform staff of health and safety policies, and discipline and grievance procedures
- ensure that staff do not exceed permitted working hours
- provide staff with paid leave for holidays, statutory sickness pay, paid maternity and paternity leave
- observe the statutory rights that staff have for time off for jury service, parental responsibilities and trade union duties
- pay staff for redundancy as appropriate, and give suitable notice to terminate employment
- treat staff fairly and reasonably, particularly where dismissal is concerned
- not discriminate against staff in any way.

In return, the employer has the right to expect staff to:

- do a fair day's work for a fair day's pay
- observe workplace rules and health and safety policy
- act in a safe, competent and reasonable way alongside other employees
- act honestly, and not against the employer's interests
- take care of the employer's property
- honour the employer's ownership of any patents or inventions developed within work time or in the workplace
- not disclose any confidential information about the business to outsiders
- obey lawful and reasonable instructions from the employer.

The main UK employment Acts are as follows.

- Employment Protection Act 1975 and subsequent amendments. This gives employees who have been with an organisation for at least two years automatic rights to, and guarantees of, minimum levels of statutory redundancy pay, if faced with that prospect. (The period of time is under review at the time of writing.) They are also allowed paid time off work to look for alternative work if facing redundancy. After six months of employment, female staff are entitled to receive statutory maternity pay, and after two years in employment, their jobs must be kept open for them if they wish to return to work after their period of maternity leave. Also after two years, employees have the right (with legal redress via industrial tribunal) not to be unfairly dismissed from employment. Since 1995, all of these rights apply to part-time as well as full-time workers. Male parents are also now allowed to take optional paternity leave for which the employer must pay them a fixed proportion of their wage for up to two weeks.
- Contracts of Employment Act 1972. Within two months of starting employment, every employee must be provided with a written contract of employment which specifies the nature and location of their work, rates and methods of payment, hours of work, holiday entitlement, period of notice, etc. If the employee has not

already been informed of the organisation's health and safety policy, this should normally be provided at the same time, along with a copy of any discipline and grievance procedures. Whilst these do not actually form part of the contract of employment, their provision both constitutes good practice and, in the case of the health and safety policy, forms part of the employer's duty under health and safety legislation. Under the employment Acts, every employee is entitled to a minimum of four weeks' paid leave per year (pro rata for part-time staff) although statutory holidays can be included in the four weeks. Each of the conditions of employment (discipline and grievance, redundancy entitlements, annual and maternity leave entitlements etc) are also specified under the employment Acts.

- Employers' Liability (Compulsory Insurance) Regulations 1972 and 1998. All organisations, whether they are sole traders, large commercial businesses, public sector bodies, educational institutions or charities, must take out Employer's Liability Insurance to cover all staff (full time or part time) for the risk of accident or injury in the workplace. A copy of the current certificate of insurance must be displayed in a prominent position on their premises, where it can be seen by employees. Since January 1999, the minimum sum to be insured for is £5m for any one claim, and employers are required to keep all past insurance certificates for a period of 40 years.
- Minimum wage regulations. In October 1998, under an EU Directive, the UK Government introduced a basic minimum wage for all employees aged over 21, with a slightly lower level for very young employees. The actual rates increase each year under annual reviews. It was argued that this was a positive social move but it has resulted in some employers removing other staff benefits to offset the cost. Over time, others who may have previously paid higher rates now regard this as the industrially accepted standard and have reduced wages accordingly. Certainly for some poorly paid staff such as carers, domestic and security staff, the minimum wage is a positive move; but for many newly established or struggling small firms, it simply increases overhead costs. Either way, it is a legal requirement with which businesses must now comply.
- Stakeholder pensions. From 2013, where a firm employs more than five staff, it must make provision for them to have access to a Stakeholder Pension Scheme, unless it already offers a personal pension scheme or an occupational pension scheme.
- European Working Hours Directive 1998. This is explained in the Health and Safety section of this chapter.
- Trade Union Reform and Employment Rights Act 1993. It is illegal to discriminate against members of staff on the grounds of trade union membership or participation in trade union activities (unless this interferes with normal working duties and has been carried out without the approval of management). You do not currently have to recognise trade unions (although the EU may change this situation) but you cannot prohibit staff from belonging to a trade union. Even if there is no trade union involved, staff consultation is still required where redundancy is a possibility, or where the potential sale of the business would affect the livelihoods of more than 20 staff. You are entitled to receive at least seven days' notice of any official industrial action by trade union members, during which time members must be balloted. Failure to do so could render the trade union liable for any losses resulting from breach of contracts with your commercial customers. Unofficial activity is not the responsibility of trade unions, but would no doubt constitute a breach of the contracts of employment by the participants, possibly justifying termination of employment.

Finance

The laws which relate to the legal format and structure of businesses invariably become involved with the financial aspects of capitalisation and distribution of profits, which in turn have implications for taxation etc.

The Finance Acts are the means by which the Government is able to raise money by taxation, and to operate its fiscal policy. As such, they are effectively revised or modified every time there is a new government budget, which is usually at least once a year via the Chancellor's Annual Budget statement. However, they also define some of the processes and procedures within which businesses must operate, and act as a convenient mechanism to modify or redefine parts of other more significant pieces of legislation, such as the various iterations of the Companies Act or the Partnership Act 1890.

The Finance Acts and annual variations also determine the scope and actions of the government agencies that are responsible for tax collection. These include the following.

- **HM Revenue and Customs' VAT regulations.** VAT is another legacy of membership of the European Community, and its rates have climbed slowly but steadily since its introduction to the current standard rate of 20% (which was set in 2011). There are lower rates for insurance and fuel supplies and some products, such as food, children's clothing, animal feeds and books, are zero-rated and attract no VAT. The tax is based on the concept that at each stage of the supply or production of goods or services, value is added to those goods or services, and that added value is taxed. Currently in 2012, any business that has a sales turnover of at least £78,000 per annum (this is reviewed annually in the Chancellor's budget) must register with HM Revenue and Customs, and must charge VAT on the value of its invoices to customers. Every quarter, it must pay to HM Revenue and Customs the sum of all VAT collected in that quarter, less any VAT which it has paid to its suppliers during the same period. Dates for payment are fixed, and penalties for transgression can be heavy. Be warned, unlike other creditors, HM Revenue and Customs does not need to obtain a court order before sending the bailiffs into premises to confiscate stock or equipment, and they will not hesitate to do so if necessary.
- **Laws of taxation.** These are essentially derived from the Finance Acts as principles in law, but the specific operation of the tax system (in terms of rates of taxation, tax-free allowances etc) is modified by the Government each year as part of the Annual Budget. Amendments to taxes and the introduction of new taxes are usually made under changes to tax Regulations, rather than by introducing specific new Acts of Parliament. The laws on taxation are quite complicated, and this is one particular area where the advice of an accountant or taxation specialist can often more than pay for what it costs. Remember, tax avoidance is legal, tax evasion is not. The two are often finely divided, with the difference between them being only accurately determinable by an experienced taxation expert.
- **The Chancellor's Annual Budget.** The Chancellor uses the Annual Budget to regulate the Government's fiscal policy including raising sufficient taxes or identifying levels of borrowing to cover planned expenditure for the coming year. Apart from determining rates of VAT, this also includes rates of personal Income Tax, Corporation Tax for businesses, National Insurance payments (an employment tax), and a range of other taxes including excise duty (petrol, alcohol, cigarettes, vehicle road taxes, etc), Inheritance Tax, and stamp duty on share and property

purchases. It also determines social benefits such as pensions, welfare payments and unemployment benefit.

Fair Trading/Misrepresentation

Fair trading regulations relate to a wide range of aspects of trading including misrepresentation and trade descriptions, business names, civil law concerning the sale of goods, labelling of packaging and safety of products, pricing and competition. Aspects of fair trading have also been updated as part of the Enterprise Act 2002, including the establishment of an independent Office of Fair Trading. Aspects of legislation relating to fair trading and misrepresentation include the following.

- Sale of Goods Acts 1979 and 1995/Consumer Protection Act 1987. These pieces of legislation are designed to protect the interests of the consumer, and are primarily administered by the Trading Standards Officers employed by local councils. They define the rules under which warranties can be enforced, goods exchanged, refunds obtained etc. Originally, when goods were sold, they were supposed to be “fit for the purpose” for which they were designed, or of “merchantable” quality; however, those terms have now been replaced by “reasonable quality”, which in many ways swings the balance more in favour of the consumer. Essentially, goods must correspond to their description, whether verbal, written or illustrated, and they must be of satisfactory quality and fit for the purpose for which they were supplied. Services must be carried out with reasonable care and skill, in a reasonable period of time, and for a reasonable charge unless previously agreed with the customer. In the first instance, it is the vendor of the goods who is legally responsible to the consumer for any faults or problems, including those inherent in the product itself, but ultimately the cost of repair or replacement goes back to the manufacturer (or importer). In the case of death or substantial personal injury, the liability may extend to all parties involved in the product, from manufacturer, importer, carrier, wholesaler to retailer. Where vendors and manufacturers fail to meet their responsibilities to the consumer, or where goods are considered to be dangerously faulty, then the Trading Standards Officers have powers of prosecution. These days it is quite common for most of the larger high street chain stores to offer refund and replacement facilities which go far beyond the minimum legal requirements; this can reflect badly, though, on the smaller independent traders who do not have the resources to provide the same terms. In the case of online selling, there are further conditions relating to disclosure of facts to potential customers, including requirements that the vendor must display a business name and postal address, must give a description and full price of the goods or services offered including how long that price is valid, must define payment and delivery arrangements, and must state any cancellation rights and the duration of any contracts for services.
- Advertising Standards/Trade Descriptions Act 1968. Advertising Standards are not so much statutory regulations, but a code of standards that is designed to encourage good practice within the advertising industry, and to discourage adverts that are considered in bad taste, offensive, inaccurate, misleading or libellous. The code of practice is administered by the Advertising Standards Authority, which was set up by the Government for this purpose. The Trade Descriptions Act 1968 requires that any description of good or services must be accurate – to provide false or misleading information, or information that is misleading by implication, is an offence with unlimited fines or up to two years’ imprisonment. There is also separate and more specific legislation relating to particular industries or trade

sectors, for example food and drink, precious metals, holiday operators and hotel accommodation.

- Consumer Credit Act 1974. Two aspects of this legislation are of relevance to small businesses. The first is that any business that advises on, arranges or gives customers extended credit, such as hire purchase or leasing agreements, must first be licensed to operate under this Act. The other aspect relates to unincorporated businesses (sole traders and partnerships) where any loans of less than £15,000 that are raised by individual proprietors for businesses purposes are regulated under the terms of this Act. These terms include: appropriate “cooling-off” periods after signing, during which the borrower can change his or her mind; and the requirement that once a fixed proportion of repayments have been made, recovery of goods or enforcement of payment requires a Court Order.
- Other relevant pieces of legislation relate to price-fixing (the Restrictive Practices Act 1976/Resale Price Act 1976), activities that are anti-competitive (the Competition Act 2011, which updated the Enterprise Act 1998), and unfair terms of contract (the Unfair Contract Terms Act 1977).
- Data Protection Act 1984. This legislation is about protecting the confidentiality of customer data, particularly to prevent it being accessed for purposes of theft or fraud. Under this Act, all computer users who store details or information about private individuals, or information of a personal nature, must register with the Data Protection Registrar. This ruling applies whether the holders of the information are private individuals, sole traders, partnerships, limited companies, or PLCs; it does not apply, however, to information about individuals that is stored on manual systems such as a card index file. The onus is on the holder of computer data to register under the Act, and not to wait until registration is queried or challenged. Anyone who thinks that their personal data might be stored within a computer system has a right to be informed whether that is the case, and a right to see the stored information on payment of a reasonable fee. A recent update of the Act was introduced in response to the growth in e-commerce and online trading, to provide more specific guidance about the retention of private data. Businesses may now only hold information that is actually needed and is directly relevant to trading (as opposed to general market research data about individuals that could be sold to other organisations). They must ensure that information is up to date and must review it and delete superfluous information at regular intervals. Above all, data must be stored securely. The latest amendments to the Act also require that data holders must observe subjects’ rights to privacy, and must not mail them without pre-agreement.

Anti-discrimination Legislation

You are not allowed to discriminate against any employees or applicants for vacant jobs on the grounds of age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex or sexual orientation. The legislation covering this topic used to be quite extensive, including the Race Relations Act 1976, the Disability Discrimination Act 1995, the Sex Discrimination Acts 1975 and 1986 and the Equal Pay Act 1970. However, all this legislation has now been incorporated into the Equality Act 2010. This repealed and updated much of the earlier legislation, and also covered further areas of equality such as discrimination on the grounds of age or sexual orientation.

Not only should discrimination be actively discouraged in the workplace, employers and communities should also take a more positive role in giving people the opportunity for employment, promotion and training. The key to this is to judge people on their abilities and potential, rather than any disability or their ethnic origin. The Equality and Human Rights Commission (EHRC) produces Codes of Practice on employment, equal pay and services, public functions and associations, to aid employers.

The EHRC recommends that employers should have an equal opportunities policy from recruitment to dismissal and a corresponding action plan to put the policy into practice and to keep it under review. This is great in theory, and okay for larger employers with specialist HR staff but it is not very realistic or practical for small firms with very limited resources.

Here are some of the key points of anti-discrimination legislation.

- Equality Act 2010.
 - It is illegal to discriminate against individuals on the basis of race, religion or belief. When recruiting, an employer must not discriminate when advertising a job, or in determining the terms and conditions of the job offered. An employer must not knowingly allow discrimination to continue in the workplace, or discriminate against staff when considering training or promotion opportunities, or when involved in selecting staff for redundancy or dismissal.
 - Employers should promote the inclusion in the workplace of employees with disabilities. This does not just mean those with severe disabilities or incapacity: for example, a person with arthritis may be “disabled” in terms of having limited leg movement or lifting capability, but could have excellent analytical, financial, or computing skills which can be exercised whilst sitting down. Individuals with disabilities have the right not to be discriminated against, either during the process of recruitment, or within their employment. This also means that they must be given equal opportunity to receive training and to be considered for promotion. Employers must also provide reasonable means of physical access and working systems to allow them to exercise their rights. This includes access ramps for customers who are wheelchair-users, wide doors, and the provision of disabled toilets for staff and customers, as appropriate, in large retail outlets and commercial buildings.
 - When advertising job vacancies, or when interviewing staff, it is unlawful to discriminate on the basis of gender. Certain exemptions do exist, where, for example, gender is specifically relevant as a genuine qualification for the job, such as mineworkers where the working conditions are deemed unsuitable for women, or rape counsellors where a male counsellor would be entirely inappropriate or unacceptable for the needs of the clients.
 - An employer must pay men and women equal pay – and provide equal employee benefits, pensions, terms of contract, etc – where they are carrying out the same or similar jobs. However, in some circumstances, differences in pay and conditions are acceptable. For example, for jobs that require specialist skills or knowledge, differential rates can be paid to reflect differing levels of qualifications and/or experience; or alternatively extra annual leave may be allocated to a person as a reward for long service. If an organisation pays men and women different amounts for equal work, it is imperative that there is a robust case or justification for doing so. An “objective justification” shows that the reason for the difference is unrelated to gender, addresses a real need on the part of the employer, is appropriate and necessary to the business objectives, and conforms to the principle of proportionality.

- **Disabled Persons Employment Act 1944.** As a result of the many injured and disabled servicemen returning from military service, this Act was introduced to facilitate and improve employment opportunities for them. Any organisation which employs more than 20 staff has a legal duty to ensure that at least 3% of its employees are drawn from those registered as disabled and that facilities are available in the workplace to accommodate them. This may sound quite onerous for employers, but the definition of disabled persons as those who are registered as disabled for employment purposes is actually quite broad, and it does not mean that all such people are wheelchair-users or physically incapacitated. Many people who are registered as disabled for employment purposes are simply restricted in the range of work they can do.

Environmental Legislation

The pieces of environmental legislation are quite diverse but have been linked together as being of public interest and benefit in protecting the living and working environment as a whole.

- **Environmental Health Act 2010.** The Environmental Health Departments of local authorities manage aspects of public hygiene and food safety. In the case of public health and hygiene, the Environmental Health Act empowers local authorities to carry out or enforce the safe removal and disposal of refuse, and the extermination of vermin or other risks to public health. They are also responsible for monitoring and licensing the operation of funeral parlours. In recent years, the food safety role has become much more prominent, with all manufacturers, suppliers, distributors and retailers of food or drink having to register with their local authority. Specific standards are prescribed for the safe preparation, handling and storage of food, and premises are regularly inspected to ensure that these standards are met on an ongoing basis. There is the risk of enforced closure of premises in cases of default, and heavy fines where food poisoning is found to result from poor food handling or contamination (which is quite realistic when we remember that some bacteria found in kitchens, such as clostridium and streptococcus, are potentially lethal). The food handling regulations also prescribe: minimum levels of training for staff and supervisors; the types of washable material suitable for covering walls, ceilings and floors; fly screens for protecting windows and vents; the quality of stainless steel for work surfaces; and the colour coding of knives etc used for different purposes to avoid cross-contamination. Operators of food premises are expected to: produce, adhere to, and record regular planned cleaning programmes for all food production areas; provide staff with all necessary protective clothing; and provide instruction and supervision in safe food handling practice.
- **Town and Country Planning Act 1971.** Any new or expanding business that is planning to occupy premises must ensure that planning approval exists to cover the type of activity for which the premises will be used. For example, in order to convert a room of a home into a shop, permission is required for change of use from domestic to retail. Similarly, to use a farmer's barn to manufacture and sell rustic furniture, approval is needed for a change of use from agricultural to commercial. These approvals have to be gained before any new activities can start; they may be granted only for a fixed period of time, or may limit hours of opening or public access. Applications for planning consent are usually made via the local council offices for the district in which the premises subject to the application are located, and can take some weeks or months to be processed, especially if objections are raised.

- Building regulations. Whereas planning regulations affect the use which can be made of premises, building regulations relate to any changes or modifications to the structure of the premises, including drainage, to ensure that the work complies with specific standards. Again, applications are made through local councils who employ building inspectors or surveyors to approve the structural changes, and to visit the premises at specific intervals to ensure that the builder is actually complying with the details of the plans. The inspectors have the power to stop work or order work to be replaced or improved if inadequate.
- Local Government Miscellaneous Provisions Act 1982. This is an interesting piece of legislation which gives local authorities discretionary powers to license and/or inspect various business activities. For example, in some local council areas, all beauticians and massage parlours need to register with the council; in other areas, only those performing functions which penetrate the skin (such as tattooing, ear-piercing or electrolysis) need to register and be inspected for hygiene purposes. The Act also covers licensing of pet shops, and less common businesses such as zoos.
- Control of Pollution Act 1974 and associated legislation. Initially the Control of Pollution Act was introduced to update and reinforce some previous legislation, such as the Clean Air Act 1956, and to cover emerging problems and gaps in environmental controls. These included the emission of gases and toxic fumes, the pollution of watercourses, and the licensing and control of the tipping and disposal of waste materials including how those materials could be safely disposed of. More recent legislation relating to the reduction of environmental pollution (the Clean Air Act 1993) has been instigated to reduce emission levels of gases, and in particular vehicle exhaust fumes, and gases used in refrigerators. In line with European Commission policies to increase recycling and to reduce landfill, there are now also strict regulations relating to the recycling of packaging materials, and specified minimum levels of component materials of vehicles that must be capable of being recycled. This is something that will grow considerably in the future. The Environmental Protection Act 1990 updated and consolidated much of the previous legislation relating to clean air, industrial pollution, and pollution control. Another environmental regulation, relating to exposure to asbestos in the workplace, is the European Asbestos Worker Protection Directive which came into effect in 2006.

The important thing to remember when considering any aspects of legislation is that the tenets of business and employment law are constantly changing; any attempt to reference legal sources or information must, therefore, be carefully managed to ensure that the information accessed is current, accurate and relevant to the situation. The main purpose of this chapter has been to summarise the purpose and significance of the various items of legislation that are relevant to small businesses. These will continue to change, though, so basic good practice for investigating legal issues requires the following.

- When consulting or using any published sources of information, you must check to make sure that they are not out of date and that the usefulness of the information has not been affected by changes in circumstances, or more recent events. For example, government population census information may be well prepared and quite reliable, but if it is only updated once every ten years, then the data will not remain useful for long. In contrast, internet data is often relatively new and regularly updated, but as it can come from a wide range of sources, its accuracy must be checked and validated.
- The source of the data needs to be checked for its reliability. Again, although very dated, the population census data is generally accepted as coming from a reliable

source, whilst the provenance of more current internet data may be less reliable. Data and statistics can easily be manipulated or modified to prove or disprove a particular argument, so the source and objectivity should be checked and carefully evaluated, particularly if it is to be used as the basis for market research.

D. BUSINESS INSURANCE

When you are planning your business, you will need to consider a number of insurance aspects and options. Some of them are compulsory by law and/or essential, whilst others are optional but important to have, and some are useful to have but not always affordable for early stage businesses. Insurance policies are paid for by an annual premium (payment), the actual cost of which will vary according to the types of insurance cover required.

Essential Insurance

- Employers' liability insurance. This is required by law for all employed staff including self-employed business owners. It is also required for people who may for example work as volunteers for charities or not-for-profit organisations. Essentially it covers the business or charity against any harm or injury to employees or volunteers whilst they are working for the organisation at its own premises, or carrying out their duties elsewhere.
- Public liability insurance. This covers any accidents or harm or damage to visitors to the business, to passers-by, or through accidents caused by staff or acts of negligence by staff. This insurance cover is absolutely essential for businesses.
- The costs of public liability and employers' liability insurance will be influenced primarily by the type of activity the organisation is engaged in (and whether or not it is inherently hazardous), and the number of staff or volunteers it uses. In the UK, most policies offer a minimum cover of £1-2 million for very small businesses.

Optional Insurance

- Professional indemnity insurance. This covers claims for professional negligence and is held by most professional people who provide specialist advice or services, e.g. doctors and surgeons, architects, structural engineers, business consultants, solicitors and accountants. Depending on the profession, the extent of cover required may be from £1 million upwards.
- Premises and buildings insurance. This covers structural damage caused by flood, fire, storm damage or "acts of God", but – depending on location – normally excludes terrorism or war damage.
- Buildings contents insurance. This covers theft of or physical damage to fixtures, fittings, furniture and equipment within a specific building. It doesn't cover stock.
- Goods in stock or in transit. This covers stock held for sale, raw materials, work in progress, or goods in transit (to distributors or customers). As stock levels constantly vary, the insurance premium is normally based on the maximum value of stock held at any one time, and the average value of each consignment delivered.
- Loss of profits insurance. This insures against the disruption of trading activities due to circumstances beyond the control of the business (e.g. flood, fire, or if access to

the business is blocked for a period of time). It can be very useful to cover the cost of overheads and lost profits, but it is expensive and can take time to be paid out, as the “loss” may not be fully quantified until normal business activities resume.

- Key persons cover. This insures against the death or disability of partners or key employees in the business. Lending banks will sometimes impose this as a condition of lending to partnerships.
- Product liability. This covers injury or harm to users or consumers resulting from the products they have purchased, e.g. injury from sharp objects, or food poisoning from food products.
- Vehicles. This is insurance cover for the business use of cars, vans, trucks, etc.

Other Insurance-related Products

- Combined business insurance policies. These are tailored packages (sometimes called shopkeeper’s policies) that offer the core public and employers’ liability insurance plus a range of options for additional insurance, e.g. fixtures and fittings, stock, goods in transit.
- Health insurance for private medical treatment. This is a very expensive option, but can prove valuable to business owners in getting prompt treatment from a private hospital rather than having to wait a long time for state-provided medical treatment, and risk being away from the business whilst they wait. It can take the form of proper insurance covering treatment costs, which is relatively expensive with the level of fees determining the value of treatment costs covered. It can be cover for accident, long-term or critical illness or disability; or for a much lower cost, it can just cover certain basic expenses for medical treatment.
- Life assurance policies. These provide a payment in the event of death, either to the dead person’s estate or as security against borrowing. Term policies cover a fixed period for a fixed period of time; term policies with profits are similar but also provide a bonus payment at the end of the term. Endowment policies provide payment of a projected fixed sum at the end of the term, which might be used to pay a loan or mortgage.
- Private pension plans. These can be personal, provided by the business or a combination of both. Payments are made into a fund which is invested to provide a lump sum at the end of a defined period (or at retirement age). It will buy an annuity to provide a regular monthly income.
- Stakeholder pensions. From 2012, it will be compulsory for larger businesses to offer their staff one of these in the absence of a company pension. This will be extended to small businesses over the following two years.

E. INTELLECTUAL PROPERTY RIGHTS

Intellectual property covers a range of quite different aspects, some tangible and others intangible. It is defined as the property of someone’s mind or intellect, such as:

- an idea or concept
- a new or innovative process
- a design concept for a tangible device
- a new physical device or invention
- a piece of original creativity, such as artwork
- an image such as a logo or photograph

- an original piece of written or musical material or electronic software.

For a business, it could also include:

- patent licences issued to third parties to allow them to produce something
- licences acquired from third parties allowing the business to legally copy someone else's product
- customer databases or customer contact lists
- market research material commissioned or collected by the company
- customised software bought for business use
- training materials/instruction manuals.

The common factor amongst these various items is that the intellectual property is perceived as having some potential monetary value to the owner, or to a third party that could exploit that property commercially. Furthermore, that commercial potential might be extremely valuable: not only does the ownership of intellectual property bestow the exclusive rights to generate revenue and profit from the production and sale of protected inventions, it also enables the owners to license out the right to produce and sell the products to other companies in exchange for payments of upfront licence fees and royalties based on the volume of products sold. The IPR also have a value to the owning company as an intangible asset on its balance sheet. More and more companies are now including intangible assets on their balance sheets. This is not just to increase the overall asset value of the business, but also because that inclusion can change their capital gearing ratio, making it possible to leverage finance for expansion. However, a lending bank would probably want a charge against that IPR asset as security for borrowing.

Main Types of IPR

When a small business owner is asked what intellectual property he or she owns, most will tend to think in terms of patents and copyright, not realising that it can take other forms that are seldom protected. Any sector-based databases of companies, perhaps used for mailing purposes, or detailed customer lists and records have a value to the business; if they are comprehensive, clean and up to date, they may also have a potential value to other organisations. However, the wisdom of selling such information to a direct rival would have to be questioned. Any bespoke software the company has commissioned is also part of its intellectual property and has a value to the business for the function it performs, as is any market research material that the company has commissioned. However, most people think of intellectual property in the form of registered or protected material.

The main types of IPR that can be registered or protected in some way are as follows.

- **Patents.** A patent is an internationally recognised licence that gives an inventor protection for a limited period (e.g. 20 years, or 25 years for medicinal products) to stop others from copying, making, using or selling the invention without the user's explicit permission. To become patented, the invention must be new in that it is not already in the public domain; it must involve some form of inventive step or process; and it must have some form of commercial or industrial application. When applying for a patent to the UK Intellectual Property Office (usually via a Patent Agent who would have the necessary expertise to carry out the rigorous search process to verify that the invention is new and innovative and has not been previously registered), the applicant would have to provide detailed design drawings and descriptions of the invention, and specify the scope of the protection being sought

under the application. Patent registration is a means of formally and legally establishing sole rights to an invention, and any competitors who wish to produce the same products will have to do so under licence from the patent holder. However, patents are usually only granted for a fixed period of time; once this expires, the invention can be produced by anyone.

- Patent licences. Businesses that own patents are able to sell licences to other businesses around the world, to produce and/or market the products or inventions covered by the patents. Licences can cover specific countries or regions and have specific lifetimes, at the end of which they have to be renewed. The method of payment might vary but could typically consist of an upfront licence fee combined with an annual royalty payment based on the volume of products produced or sold.
- Business model patents. These protect business processes or business systems, as opposed to physical products. An example is the Dell ordering system.
- Copyright. Copyright law usually relates to printed material, designs, drawings and graphics, electronic data, films and music. It does not protect the idea so much as prevent the copying of material by giving the owners of the copyright the legal right to sue anyone who breaches it. In Britain, for software the protection lasts for 70 years from the first date of sale; for written material, it lasts for 70 years from the death of the author. The copyright usually belongs to the author or creator of the material, although where this is an employee of a business, the copyright would normally belong to the business. Copyright protection allows the originator (or their estate) to benefit financially from their creation; hence, any use or reproduction requires permission and usually payment. When material is made available to the public, such as library books, musical performances, CDs and DVDs, payment is usually collected by the Public Lending Right organisation (for books and music or film loan or rental) and PRS for Music for musical performance or use. These organisations calculate average use for each item and arrange royalty payments which are funded by charges to the users.
- Trademarks. Under the Copyright, Designs and Patents Act 1988, a trademark is a sign, including logos, words, colour combinations and slogans, that will distinguish the products, goods or services of one provider from those of another. Classic examples are the Coca-Cola design, the Virgin logo, or the MacDonald's golden arches. In the UK, their use is governed by the Trade Marks Act 1994, but they must also conform to Council Regulation (EC) No 40/94 of 20 December 1993 on the Community Trade Mark. Trademarks can also be registered internationally via the World Intellectual Property Organization (WIPO).
- Trade secrets. These are not actually registered like trademarks or patents, but they still need to be protected under confidentiality laws. They could include new designs or inventions that are under development but not yet ready for patenting. Employees who are working on them, or potential investors in new projects, may be asked to sign non-disclosure agreements, which, if breached, could result in litigation and claims for damages. In addition, employees working with trade secrets will often have a clause in their contracts of employment, restricting subsequent employment by rival companies for a period of time, and requiring non-disclosure of any trade secrets to any third party.
- Registered designs. In the UK, by registering a design for a product or a brand or image, a business can protect itself from having the design copied and used by another company, with the potential redress of legal action for infringement of that protection. Applications to register designs are made via the UK's Intellectual Property Office, and come under the Registered Designs Regulations 2006. The design rights last for 25 years and can be reassigned. There is currently no international registration system for designs.

- Domain names. With the rapid growth of the internet and the increasing demand for domain names, it was only a matter of time before people started to buy up potentially desirable names to offer for sale to the highest bidder. The next step was the purchase of domain names that businesses or other organisations would want in connection with their business name or activity. These were then offered to those companies at high prices by unscrupulous individuals – almost industrial blackmail – and this led to complaints and litigation. The Internet Corporation for Assigned Names and Numbers (ICANN) is the organisation responsible for the generic top-level domains such as .com, .net and .org, and for minimising potential disputes. ICANN linked up with WIPO to produce the Uniform Domain-Name Dispute-Resolution Policy (UDRP) as a system for managing domain name disputes. This is administered by WIPO using independent experts to review each case and to make a decision on its merits. This offers a quite fast and relatively low-cost form of resolution, avoiding expensive litigation.
- Geographical indicators. These are products that come from a specific geographical region, the name or brand of which is synonymous with that region. Examples include:
 - Champagne: by virtue of process (the *méthode champenoise*) and locality in a specific region of France
 - Melton Mowbray pork pies: from a specific town in England
 - Rioja, Beaujolais, Moselle: regional denomination/appellation *côntollée*
 - Harris Tweed, Isle of Harris, Scotland: by virtue of location, source of wool, and designs
 - Port from the Oporto region in Portugal and Sherry from Jerez in Spain (but definitely not Cyprus Sherry or British Ruby Wine!)
 - Scotch Whisky or Irish Whiskey: well-known national identities with associated brands (but not the same as Japanese Scottish whisky)
 - Cornish Pasties: from Cornwall in the UK.

In contrast, there are a number of well-known but unacceptable geographical indicators – ie those that are commonly regarded as geographical indicators but are not officially designated as such – including:

- Cheddar: this is a “type” of cheese, but is made in a number of countries and sold under a range of brands: for example, English, Scottish, Irish, Welsh, Canadian cheddars, and the Pilgrim’s Choice and Cathedral City brands. Similarly Camembert, Brie and Feta are styles of cheese from France and Greece
- sparkling wines using the Champagne process (*méthode champenoise*), e.g. Cava from the Penedes in Northern Spain (although Cava itself is a designated geographical indicator)
- wines that are produced, but not bottled, in a specific region, e.g. cask imports that are bottled in the country of destination.
- Plant breeders’ rights. These protect the development of new varieties of seeds and plants, the potential sales value of which can be huge for commercial fruit and vegetables, and even for specialist hybrids of garden plants. To be approved, a variety must be new (different from its predecessors), distinctly identifiable, uniform and stable – i.e. it doesn’t regress to the original plant.

Importance of Protecting IPR

In response to the various problems and issues relating to the protection of intellectual property across the world, there have been a number of treaties jointly signed by the majority of countries. These harmonise the international registration and recognition of patents and copyrights etc, and reduce the cost and time involved in achieving international coverage. This is particularly significant when considered in the context of the Dyson vacuum cleaner that involved something like 2,000 separate patents in its development.

There are two main international organisations that handle IPR registrations and protection: WIPO and the World Trade Organization (WTO).

- WIPO is based in Switzerland, and was established in 1960 as the modern successor to the two international bureaux that were formed as a result of the Paris and Berne conventions. The Paris Convention for the Protection of Industrial Property in 1883 was the first major international treaty designed to help the people of one country obtain protection for inventions, trademarks and industrial designs in other countries; it was signed initially by 14 member states. In 1886, the Berne Convention for the Protection of Literary and Artistic Work covered the copyrighting of artistic works, printed material and music, and payment for their reproduction or use. WIPO now has 181 member states across the world, and administers 23 international treaties relating to intellectual property including some of those established by other organisations. The most significant of these is the Patent Cooperation Treaty (PCT). It allows a single international patent application to be made that has legal effect in the countries that are bound by the treaty and are designated by the applicant. When the application is filed, the applicant is provided with information about the potential patentability of the invention via an international search report before deciding which of the designated countries should be covered by the application. The PCT system streamlines the patenting process, and facilitates broad international coverage without incurring excessive costs. WIPO also has an SME programme aimed at enhancing the competitiveness of SMEs by increasing awareness of the value of the effective management of intellectual property.
- The WTO manages the Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS). This was negotiated in 1984 and applies to all WTO members, as a way of stabilising the management and protection of intellectual property and allowing disputes to be settled more systematically. It established minimum levels of protection that each member government has to give to the intellectual property of fellow WTO members, and subsequently introduced a settlement system for disputes over IPR. The agreement covers five broad issues.
 - How basic principles of the trading system and other international intellectual property agreements should be applied.
 - How to give adequate protection to IPR.
 - How countries should enforce IPR adequately in their own territories.
 - How to settle disputes about intellectual property between members of the WTO.
 - Special transitional arrangements for the period when the new system was being introduced.

TRIPS covers a broad range of intellectual property including copyright, trademarks, patents, geographical indicators, industrial designs, layout designs of integrated circuits, and undisclosed information such as trade secrets. The protection of intellectual property is based on the pre-existing WIPO agreement.

There are several other national and international organisations that manage patents and that interact or integrate with the PCT and TRIPS registration processes.

- European Patent Office (EPO). The EPO handles applications that enable patents to be registered across 40 European countries through a single registration process, which is similar to WIPO's PCT process.
- United States Patent and Trademark Office. This handles patent applications for the USA, although it has a different view of patent coverage from other patent offices in that it permits patent applications for ICT software.
- Office for Harmonization in the Internal Market (OHIM). Whereas EPO is concerned with patents, OHIM is involved with the registration of trademarks and designs that cover the EU area. It is based in Alicante in Spain, and also provides information to European Courts when there are disputes about registered trademarks or designs.
- Universal Copyright Convention (UCC). This is administered by UNESCO, and any copyright registered in the UK automatically falls under its protection in any country that is a member of the United Nations organisation.
- ICAAN. As mentioned earlier in this chapter, this organisation manages the assignment of top-level domains such as .com, .net and .org. It linked up with WIPO to produce the UDRP for settling disputes.

IPR is expensive to protect. Typically, a single patent will cost between £5,000 and £6,000 for the initial PCT application (which is explained in the next section of this chapter), plus a further £20,000 to £25,000 for full publication of the patent. In addition, over its 15 or 20 year lifetime, additional maintenance fees have to be paid. This cost can be prohibitive for small firms.

The biggest problem with owning IPR is the issue of worldwide enforcement against unlicensed copying of the patent. When a company becomes aware of an infringement against its patent, it first has to identify exactly who is infringing it: the vendor of the copied goods, whilst possibly infringing sales rights, may not be the same company that is producing the illegal copies. Second, the company has to issue "cease and desist" warnings via a lawyer, possibly in a foreign country. Third, if the infringement continues, the IPR owner has to take legal action, which can be hugely expensive and time consuming if it is in a foreign country and involves lawyers who speak a different language and operate under a different legal system. Compensation is normally available for loss of profits and damage to goodwill – but enforcement of payment overseas may incur further costs and does not necessarily result in payment of damages anyway if the defendant is able to avoid this by winding up the company and starting another in its place. There is also the issue of time delays during enforcement, as the patent may have expired during the intervening period. An injunction to stop short-term infringement is relatively easy and cheap to obtain, but if the case is lost then compensation may be payable to the defendant for lost trade.

Another issue is that of legal patent copying whereby large companies pay permanent members of staff to scrutinise the details of newly published patents that relate to their markets to see if they can use the patent technology but with sufficient modification to bypass its exclusivity. This is one of the reasons that some firms with innovations that can potentially generate new markets will adopt a first-to-market strategy to launch their new

product and get it established as the market leader before their rivals have time to respond. Not only do they save substantial patent costs, but they might typically have a one or two year lead in the market with 100% market share.

The Patent Registration Process

The key to successful patent protection is being able to demonstrate that the new product innovation is genuinely original and is not already in the public domain in any form – hence the importance of keeping it covered by non-disclosure agreements. The easiest way to start the patent process is to do a simple internet search using several keywords. This should indicate what other similar or substitute products already exist or are protected. A more detailed follow-up search can be carried out using the same keywords via national patent offices or, in the UK, via the British Library, for which a fee may be payable.

If the preliminary search is successful in revealing no significant direct competitors, then a Patent Attorney (a specialist patent lawyer) can be used to carry out a more detailed search. For this, they will usually go through a similar process of using keywords (plus any information resulting from the initial search) to examine patent registers or worldwide patent databases. This may result in finding a number of potentially related or overlapping patents, which the Patent Attorney will examine individually. Only if the new innovation does not appear to infringe these patents will the process move to the next stage.

If worldwide patent coverage is required, the most effective way of achieving this is by filing a registration under the PCT. Initial registrations with the European and US patent offices, coupled with a PCT application, give applicants immediate, effective international protection. This covers the invention for 30 months, to allow sufficient time to carry out international searches to ensure that the invention is new and original. Similarly, applications made under the WTO TRIPS process allow a period of protection whilst international searches are carried out.

Once the application has been made, there is a temporary period (patent pending) during which the invention cannot legally be copied. This provides the applicant with protection until the patent is published. At the end of this period of scrutiny and rejection, if the search process has revealed no potential infringements and if there are no objections raised, then the patent application can move to full publication. This gives full protection for the countries that are members of the treaty under which the patent was filed.

In the UK, the patents system is regulated under the Patents Act 1977 as amended by the Copyright, Designs and Patents Act 1988 and the Patents Rules 1995.

USEFUL SOURCES OF INFORMATION

- The UK Registrar of Companies – for company registration and annual reporting procedures and requirements: www.companieshouse.gov.uk
- The UK HM Revenue and Customs – for Value Added Tax, Corporation Tax and other forms of taxation: www.hmrc.gov.uk
- The UK Intellectual Property Office (formerly the Patent Office) – for information about registering patents and other forms of IPR: www.ipo.gov.uk.
- World Intellectual Property Organization: www.wipo.int/

- World Trade Organization – TRIPS Gateway:
www.wto.org/english/tratop_e/trips_e/trips_e.htm
- Chartered Institute of Personnel and Development – factsheets and HR information:
www.cipd.co.uk/hr-resources/factsheets/

Chapter 10

Implementing the Start-up Process

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INTRODUCTION

The implementation part of the start-up process is the stage where the whole planning process comes together – where the capital and additional finance are put in place to provide the working capital and to pay for the necessary resources, where those resources are acquired, and where the marketing activities start to roll out to launch the business on the market. Unfortunately, this is also the stage where things can go horribly wrong unless the implementation is planned very carefully. In particular, each of the critical stages of implementation need to be identified and slotted into a pre-launch timescale, especially where any one of those stages (such as obtaining investment funds or negotiating a lease on premises) will be a pre-requisite for other stages in the process. This is why each of the critical stages must be risk assessed to identify the potential problems that could have a knock-on effect on other actions and ultimately delay the launch. Any delay creates a subsequent possible risk of the working capital being used up before the new business is able to reach its break-even level of trading.

This chapter addresses the process of planning the implementation process and the ways in which potential problems can be identified, assessed and managed. For potential lenders and investors, to see that these issues have been properly addressed is just as important as the finance or marketing sections of the business plan. They will expect to see that the entrepreneur has planned the process carefully in terms of identifying each of the key stages in sequential order, has allowed sufficient time to carry them all out, has given due consideration to the risks and hazards that could potentially cause problems along the way, and has identified ways of dealing with them.

A. IDENTIFYING KEY STAGES AND EVENTS IN THE IMPLEMENTATION PROCESS

The pre-start preparation will vary widely from one business proposition to another, by virtue of the degree of complexity involved. A window cleaner, once equipped with a van, ladder, buckets, etc, is ready to go and can start knocking on doors to find customers; in contrast, a manufacturing business may need to find premises and negotiate contracts for them, to order and commission plant or machinery, and to source raw materials and skilled staff before work can commence. This could feasibly take three to six months.

The starting point is to identify a date by which trading will ideally start, and then to identify and examine all of the key stages and events that must take place before that date. Some operations managers would say that logically we should start by working out the critical stages and the time involved in implementing them before we even consider fixing a target start date; however, this is not always possible as there may be good reasons for aiming for a specific start date, such as the need to be ready to take advantage of seasonal sales. Someone opening a holiday hotel or restaurant, for example, would want to be ready for the spring to take advantage of the summer holiday season. The last thing they would want to do is to delay the opening until October when the season has ended and there may be little sales revenue for the following few months. For some home-based new businesses, the start date may not be critical at all as they may be initially working on a part-time basis with the intention of working up to full-time activity as the customer base is expanded.

Key Questions to Ask

Assuming that you, as a potential entrepreneur, have identified a viable market and that you have acquired or arranged for adequate finance for your proposed business, a number of practical questions need to be considered before you start.

When do you intend to start trading?

- Have you identified a specific start date?
- Is it realistic for you to have everything in place by that date to launch the business?
- How critical is the start date, e.g. to meet a customer's deadline, or to take advantage of seasonal trade?
- Are you planning immediate full-time activity or a part-time start and gradual build-up?

What factors need to be in place before you can start? What lead times are required for them?

- Staff recruitment – times will vary according to the level of skills and experience required, local availability of suitable staff, and whether or not they need to give notice to a current employer.
- Purchase or rental of premises – negotiating to buy premises can take a good deal of time, especially if a mortgage is needed. Long-term leases can be arranged more quickly (if the lawyers involved don't delay), and short- and medium-term rental of premises can be arranged quite quickly if references and financial deposits are available.
- Design, decoration and fitting of premises – where contractors are to be employed, e.g. for shop-fitting, they may need to be booked weeks or months in advance, and often the better their reputation is, the more notice they will require to be available at the date you need them.
- Production equipment – lead times are important here because complex machinery may have to be ordered from the manufacturer, perhaps six months before it is required, and may take further time to install and commission before it is ready to be used.
- Furniture/computer equipment – lead times are not usually a problem, unless bespoke software is required, or databases of potential customers have to be prepared.
- Pre-start advertising or marketing activities – depending on the type of business, marketing activities may need to start before the launch date, and marketing materials will have to be designed, produced or printed well in advance.
- Contracts with suppliers – these need to be negotiated quite early in the planning stage to allow time to assess the best terms of trade from alternative suppliers. Suppliers may also need to schedule stock into their own production plans. If stock is being imported from China or the Far East, for example, the lead time may be several months including shipping. Stock management can be difficult in the early stages of a new business as it is necessary to strike a balance between keeping sufficient stock available and avoiding having too much working capital held in stock.

What could possibly delay the start?

- Delays in funding – where start-up funds are coming from private investors, there are usually legal contracts to sign and this can cause delays if terms have to be negotiated. Similarly, lending banks will normally require some form of loan guarantee or security against property which again can cause delays in the release of funds.
- Contracts for renting premises – for straightforward rental arrangements, these do not normally take a great deal of time although deposits of up to three months' rent may have to be paid in advance. However, longer-term leases may involve formal contracts via solicitors, which can potentially be a source of delays.
- Planning consents for change of use of premises – these usually take six to eight weeks, but if there are objections to a proposal that timescale may double. There is also the possibility that consent may be refused, of course.
- Production of marketing materials – the more time you can allow for the design and production of marketing materials, the more chance there is of getting the work done at a good price. Last-minute orders cannot always be scheduled into in-house production runs, and may be more expensive if the designer has to outsource work.
- Delays in stock delivery – lead times for delivery from suppliers can vary. Most suppliers will be keen to keep a new customer happy; however, if there is just one supplier of the products you need, you may have to contend with the supplier's loyalty to existing customers (who may be potential rivals to you).

Have you ensured that your business complies with all relevant legal or financial requirements? Legal compliance is discussed in detail in Section C of Chapter 9, but it pays to ensure that any permissions, licences or registrations that are needed to operate a particular business are applied for well in advance of the start date. These could include:

- specific legal requirements, such as environmental health registration for businesses preparing or selling food
- compulsory insurance cover (employers' liability and public liability)
- registration of the business with the appropriate authorities for tax purposes
- planning consents or approvals to modify premises.

B. PLANNING AND SCHEDULING THE IMPLEMENTATION

Planning the Schedule of Activities

When you start to identify the work that needs to be done before the business can start trading, some items will obviously be sequential, in that one must be completed before another can start, whilst others can run alongside each other. The sequential items, such as finding and equipping premises, will typically be the ones that take the longest time to complete, especially if planning consent is required. Others, such as negotiating contracts with suppliers or ordering marketing materials, can be carried out at the same time.

Many of the items or activities will have been identified in the resources section of the business plan but at this stage it is necessary to identify the following.

- Items or activities with lead times, which must be planned or ordered well ahead of when they are required. For example, complex machinery may have to be ordered from the manufacturer around six months before it is required, and may take further

time to install and commission before it is ready to be used. Where contractors are to be employed, e.g. for shop-fitting, they may need to be booked weeks or months in advance; often the better their reputation is, the more notice they will require to be available. Pre-launch advertising and staff recruitment are other items that may require lead times, particularly with recruitment as staff may have to work out periods of notice to terminate other employment.

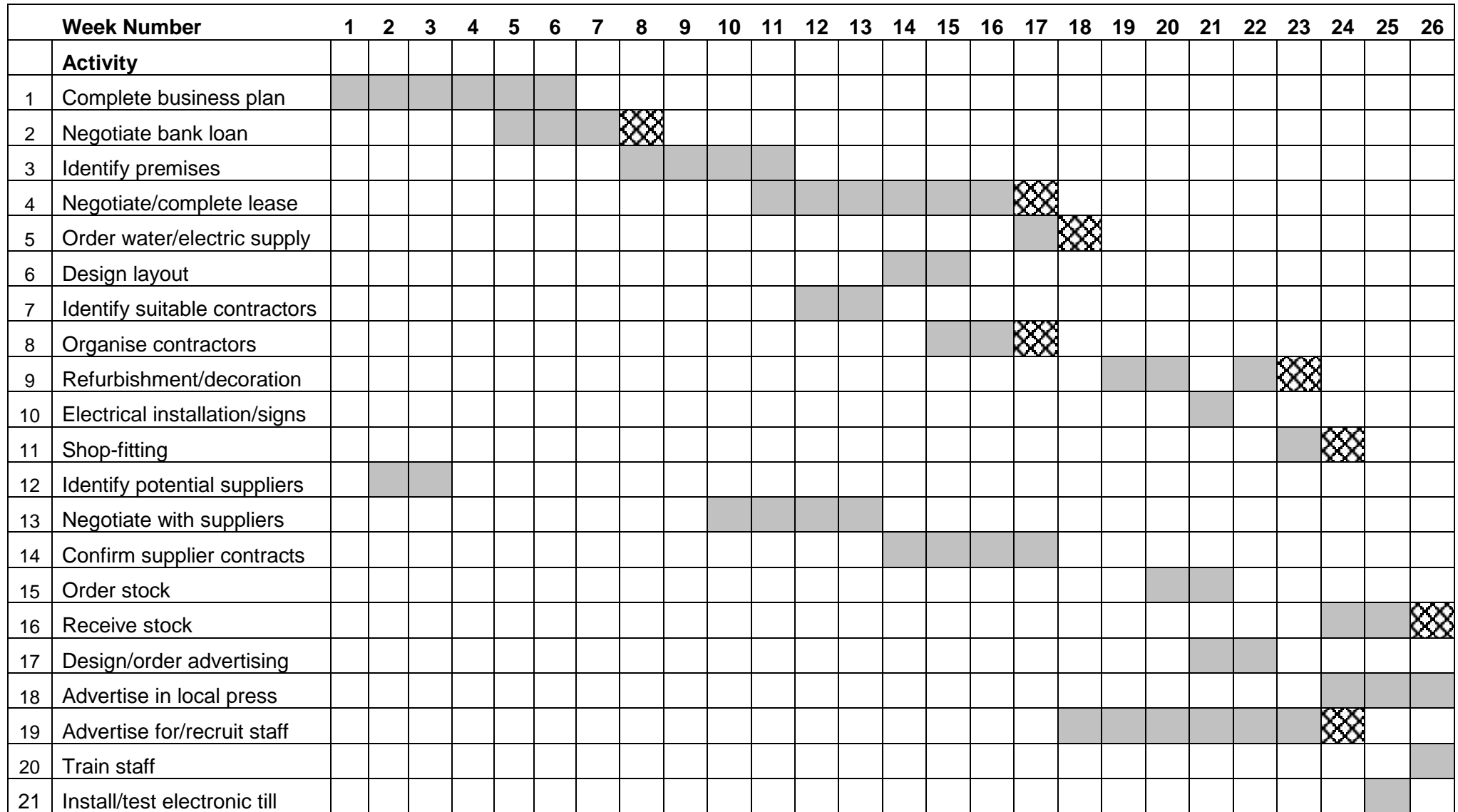
- Items or activities that are critical in terms of having to be implemented or completed before others can commence, and where any delays in their implementation could have a knock-on effect on other parts of the project. In the case of premises, for example, the negotiation of leases or purchase contracts can take weeks or months; likewise, obtaining planning consent for change of use of premises can take months if there are any objections from members of the public, or in the case of listed buildings where changes of use may have to be advertised. Delays can be costly if you have to pay rent on unoccupied and unusable premises. This can also be compounded if, for example, contractors are postponed and then cannot return precisely when you need them, due to their other work commitments.

The Gantt Chart

It is often said of business that what can go wrong, will go wrong, and usually at the worst possible time. The preparation of a Gantt chart allows for the various key events in the implementation process to be presented in a form that enables the planner to identify the events that need to be completed before others can start.

For some businesses, the Gantt chart may be very simple, with just a few lines, but invariably where business premises are required, especially for manufacturing or retail purposes, it will be more complex. The value of the Gantt chart lies not just in the visibility it gives to the timing of the implementation, but because it helps to identify the critical stages that need to be considered as part of the subsequent risk analysis process.

Figure 10.1 is a simple Gantt chart for some of the activities that might be involved in opening a new shop and how they might be phased and implemented prior to the start date. The solid areas of shading indicate the planned activity timescale, and the activities that are followed by hatched shading indicate where extra time has been allowed for possible delays. Note that in addition to the allowances for overrun, there are some weeks (e.g. 7, 9 and 18) when there is relatively little going on. This allows the entrepreneur some leeway to deal with any other issues or problems that arise.

Figure 10.1: Gantt Chart for Preparation Activities Prior to New Shop Opening in Week 27

C. RISK ANALYSIS, MITIGATION AND CONTINGENCY PLANNING

Preparing the Risk Analysis

Risk analysis examines three questions.

- What are the main risks that the new business will face in preparing to start and in the early stages, before it reaches break-even level?
- What is the likelihood/probability of any of those risks actually occurring?
- What impact would they have on the performance or survival prospects of the business if they did occur?

Here are some examples.

- Financial problems – the business runs out of working capital.
- Sales activity – sales revenue grows much slower than forecast.
- Problems with suppliers – it is difficult to get regular supplies of good quality stock.
- Staffing and recruitment problems – the available staff have inadequate skills and experience to do their jobs properly.
- Cash flow problems – working capital is becoming depleted because of the need to give customers extended credit in order to get their business.
- Premises issues – completion of the lease contract is three to four weeks late.
- Operations issues – a key member of staff unexpectedly takes long-term sick leave.

In order to analyse the probability and potential impact of these hypothetical risks, we use a risk analysis grid (Figure 10.2). This evaluates both the probability of the risk occurring and the impact of the risk as low, medium or high. A low risk is rated as one point, medium as two points and high as three points. The points for the two factors are then multiplied together on the grid. Hence, a medium probability incident with a potentially high impact scores $2 \times 3 = 6$ points. Essentially, anything with three or more points constitutes a risk that needs to be addressed and high scores (six to nine) indicate potentially serious risks.

Figure 10.2: Risk Analysis Grid

		Probability of occurrence		
		Low	Medium	High
Impact of risk	Low	1	Irregular supplies 2	Premises delayed 3
	Medium	Inadequate staff skills 2	Slow sales revenue 4	6
	High	Key person falls ill 3	Cash flow problems 6	Lack of working capital 9

Contingency Planning

Once the risk analysis has been completed, there are three further steps that need to be carried out. For each risk that has been identified as needing to be addressed, it is necessary to do the following.

- Identify what actions can be put in place to avoid the risk occurring in the first place.
- Identify what actions could be taken to mitigate the impact of the risk on the business.
- Where the impact of the risk is potentially significant and could disrupt the operation of the business, prepare contingency plans to address the problems if they actually occur.

For example, a business starts up and moves towards break-even level. However, the rate of growth of sales is much faster than planned and more customers than expected are insisting on receiving 30 days' credit. This causes cash flow problems and puts pressure on the working capital. This type of over-trading situation is not uncommon in business start-ups and, although the business is trading profitably, it risks insolvency if it runs out of cash to operate.

What actions can be put in place to avoid the risk occurring in the first place? At the financial planning stage, it is worth preparing worst case and best case forecasts. This means that if sales are slower or faster than expected, the impact on cash flow and working capital is identified in advance, and adequate funding can be built into the financial plans.

What actions could be taken to mitigate the impact of the risk on the business? With the positive sales figures, it may be possible to approach suppliers to see if they would be willing to give credit on purchases. For service-based businesses, where that may not be possible, another option is to consider approaching the company's bankers to set up invoice factoring for regular customers, to improve the cash flow.

What contingency plans could the business have in place to address the problems? If the pressure on working capital was anticipated at the planning stage, then the business could pre-agree an overdraft facility with the bank to fund the short-term cash flow problems resulting from the extra sales. Bankers are always more amenable to requests based on pro-active planning than to those where the business owner is having to react to an actual problem. Another contingency option might be to have a private investor lined up for a second stage investment when sales volume reaches a certain level; or to have a pre-arranged second phase bank loan set up to be accessed at the same level of sales.

D. MONITORING THE PROGRESS OF THE BUSINESS

A further critical part of implementing the business plan is to set up regular monitoring processes across the business. This ensures that it is performing against its targets and that no unexpected problems are occurring. This sounds such an obvious thing to do, but the realities and time pressures of running a small business mean that the monitoring process can be easily overlooked or occasionally postponed or forgotten. The main

monitoring and record-keeping activities fall into four areas: finance; quality; sales and marketing; and staff.

Finance

In addition to providing information about profitability and cash flow, the monitoring of financial information can reveal a great deal about the non-financial aspects of the business, and potential problems that may be emerging.

- Accounting systems – sales and purchase ledgers, cash books, bank statements, etc. These ideally need to be updated daily or at least weekly if a part-time book keeper is used. There also need to be weekly reconciliations of cash and bank figures with the accounts ledgers and cash book, especially in businesses that handle substantial cash sums, where theft may be a possibility.
- Comparison of budget forecasts for income and expenditure with actual figures – this is an absolute necessity and should be carried out monthly, not least because the identification of variances (positive or negative) can be the first indication of potential problems or risks. Budgets are not just about financial figures, as they can also be used to monitor changes or fluctuations in sales levels and sales revenues, down to individual products or services.
- Credit control – this is also a monthly activity to ensure that customers are within acceptable credit limits and to identify potentially doubtful or bad debt. For some customers, credit control may become a weekly activity if potential problems are identified.
- Stock control – if stock is held for sale to customers, it should be monitored on an ongoing basis, ideally through a computerised accounting system; however, it also needs to be physically checked at regular intervals to ensure that there are no problems of error, poor stock rotation, wastage or theft, particularly where any valuable items are held.
- Annual accounts – these will produce the information that bankers and investors will expect to have reported to them (profit and loss account, balance sheet, cash flow statement etc). These documents will be the source of data that can be analysed using accounting ratios to evaluate the performance of the business and its financial stability.

Quality

The monitoring of quality at a baseline level is about ensuring that products or services are of consistent quality to be fit for the purpose for which they were intended. In a broader sense, though, it should be about monitoring the customers' perceptions of the quality of those products or services and of the business as a supplier.

- Monitoring customer retention levels is a good way to identify potential issues with the products or services, but it also reflects the customers' experiences of the business as a supplier. Given that a competitor can offer very similar products at a similar price, the retention of a customer may be down to the quality of service they feel they have received from the business.
- Seeking regular feedback from customers can provide valuable information about their perceptions. This is typically monitored using questionnaires, telephone calls, or other review procedures, although the information they provide may be restricted

by the questions asked. It is important that the feedback is acted upon and that the customers are made aware of this.

- Unsolicited feedback (negative or positive) from customers is a more useful source of information but it is much harder to capture and record, especially if it is verbal.
- Monitoring the volume and nature of complaints offers the opportunity to analyse whether there are any common factors that might indicate a problem area that needs to be addressed.
- Monitoring the performance of the business against its own quality standards gives a good indication of whether the standards are working or not. If they are thought to be working, what is the evidence that will justify that belief? Are staff aware of the quality standards and do they work to them? Are customers aware of the quality standards and if not, why not?
- Client recommendation and growth without advertising is the most valuable form of customer feedback but the hardest to achieve. However, it is a clear indication that the various quality systems and standards are working as they should be. A simple question to ask of all new customers is: "How did you hear about our business?"

Sales and Marketing

- Monitoring revenue from individual products or services against targets can identify changes in sales patterns (perhaps seasonal) or longer-term trends.
- Monitoring the relative profitability of different products or services helps to determine which are contributing the most towards the profitability of the business. For example, a product with the biggest sales volume but a relatively low profit margin may be contributing less actual profit than a product with fewer sales but a good profit margin. This knowledge is essential when planning marketing activities to ensure that the products that contribute most are properly promoted.
- Monitoring advertising and sales activities will show how effective they are in generating new leads or enquiries, and converting them into new clients or increased sales.
- Monitoring special promotions will show what impact they have on sales volumes and revenues.
- Monitoring competitors' activity will provide information about their new products, changing prices and special promotions.

Staff

- Staff appraisals or performance reviews are often overlooked by owners of small firms who may consider themselves sufficiently close to the staff not to need them. However, appraisals are a good way to formally exchange information and review staff performance and objectives and can also reveal issues the owner may not be aware of.
- Small business owners are often reluctant to invest in staff development and training, but small investments can sometimes significantly improve staff performance and their attitudes to the job.
- Levels of absence, sickness and staff turnover are often perceived as just a big inconvenience to business owners when in fact they are symptoms of staff dissatisfaction or of a poor relationship between the staff and the owner.

Chapter 11

Developing Growth in Established Businesses

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INTRODUCTION

The key to growing and developing a small or medium-sized business is to have a strong and well-planned growth strategy. This is broadly similar in structure to the business plan used for start-ups in that it requires market research, development of a marketing plan, analysis of resource requirements, detailed financial forecasts and budget estimates, and an implementation plan. The main differences between the growth strategy and the start-up plan are in the analysis of the business and where it has reached to date, and in the need for the development strategy to accommodate the objectives of the various stakeholders in the business. The stakeholders may be different from or more than the original owners who set it up.

For that reason, there is a good deal of emphasis on analysing the internal business environment, to understand the objectives of the various stakeholders in the business. It also ensures that the business itself is sufficiently robust to facilitate the growth it aspires to, as that growth will need to be underpinned by solid management, administrative and financial systems and procedures.

The process of planning for strategic growth will use the tried and tested three-stage methodology developed by Gerry Johnson and Kevan Scholes in the early 1980s (Johnson, Scholes and Whittington 2008).

- Strategic analysis: where is the business right now?
- Strategic choice: what are the development options available to the business?
- Strategic implementation: how do we make the chosen option happen?

The model has been significantly refined since it was published in the first edition of *Exploring Corporate Strategy* in 1984, with the analysis of strategic options in terms of suitability, feasibility and acceptability, and with the focus on aligning organisational culture with strategy (the “Cultural Web”).

This chapter follows the three-stage model, introducing and examining various analytical models and techniques that are relevant to each stage.

A. IDENTIFYING STAKEHOLDERS AND THEIR OBJECTIVES

Identifying the Stakeholders and their Interests

One of the conventional ways of analysing stakeholders in a business is to split them into three categories.

- Primary stakeholders: these are the people or businesses that are ultimately affected, either positively or negatively, by an organisation's actions.
- Secondary stakeholders: these are the “intermediaries”, i.e. the people or organisations that are indirectly affected by an organisation's actions.
- Key stakeholders: these have significant influence upon, or importance within, an organisation, and can also belong to the first two groups.

The problem with this analysis is that these stakeholders can cut across the boundaries of all three categories. For example, the wife and family of a company director could be directly affected by the company's activities if it is in financial difficulties: as such, they are primary stakeholders even though they are not direct shareholders. At the same time, they could be classed as secondary stakeholders as some company activities may not affect them; or they could be key stakeholders in influencing the director's actions, as often happens in small businesses.

In practice, it is probably easier to split the stakeholders into other groups – although there will still inevitably be some overlap.

- Stakeholders with a financial interest in the business – owners, (sole traders, partners, directors), external investors, banks and other lenders.
- Other stakeholders that have an interest in the continued success of the business – staff who rely on the business for employment, suppliers of products or raw materials, service suppliers (accountants, IT providers), the families of the business owners, trade unions.
- Customers – direct purchasers of goods or services, distributors, wholesalers, retailers.
- Competitors – rival companies or those with substitute products. This may also include potential collaborators in market development.
- External agencies – government tax collectors, local and regional authorities, public utilities, regulatory bodies, trade associations.
- Broader interests – media, the general public.

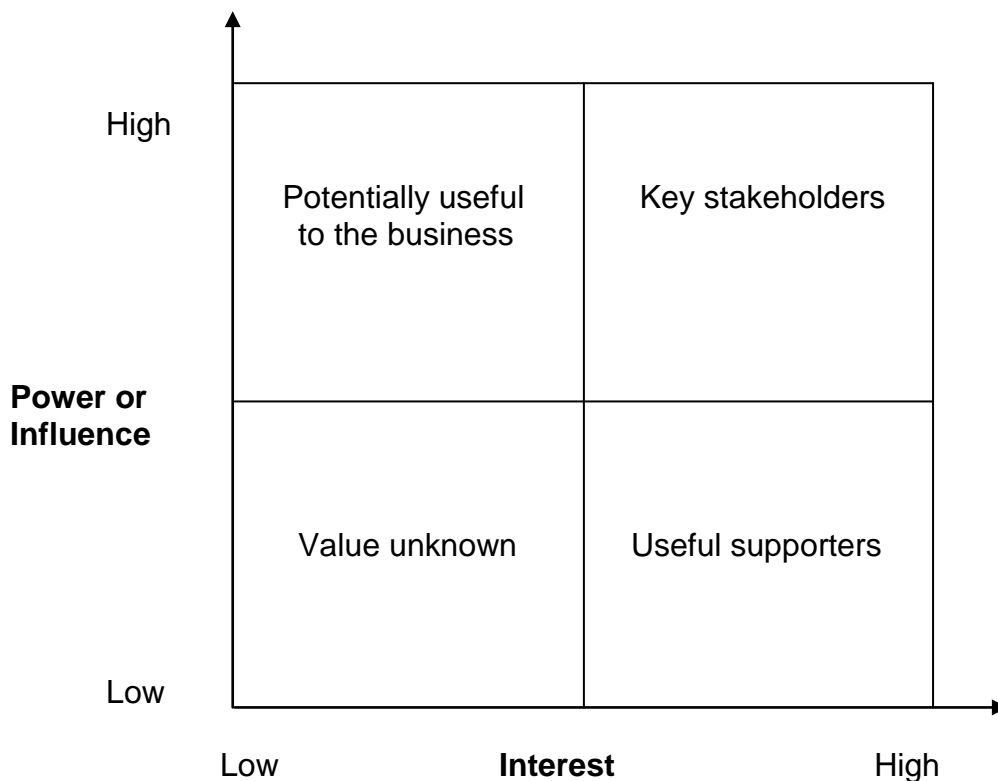
Stakeholder Power and Influence

The opinions of stakeholders can be very important to the business in influencing potential customers, potential lenders or investors, or perhaps the direction in which the business is moving. Obviously, therefore, their opinions about how the business and its key managers and staff are performing are very important to the business.

- What do these stakeholders think of the business's achievements so far?
- Are they satisfied with its performance?
- Has it met their expectations or disappointed them?

The Stakeholder Power/Interest Grid (Figure 11.1) has been attributed to several sources including Bryson (1995) and Eden and Ackermann (1998) and is now widely used.

- High power/high interest stakeholders: key people and influencers to keep on side, and whom you must fully engage and make the greatest efforts to satisfy, as they can potentially offer the business the most valuable support or influence on others.
- High power/lower interest stakeholders: put enough work in with these people to keep them satisfied, but not so much that they become bored with your message. Meet their needs, as they can be potentially useful to the business.
- Low power/interested stakeholders: keep these people adequately informed and talk to them to ensure that no major issues are arising. These people can often be very helpful with the detail of your project. Keep them satisfied.
- Low power/less interested stakeholders: again, monitor these people but do not overload them with excessive communication. Be aware of them and keep them in view, monitor their interests but with minimum effort.

Figure 11.1: Stakeholder Power/Interest Grid

It is important to understand the interests and objectives of the key stakeholders and, in particular, how they are likely to feel about and react to your business development proposals. It is also important to know how best to engage them in the project and how best to communicate with them. Here are some useful questions that can help you understand your stakeholders.

- What financial or emotional interest do they have in the outcome of the project work? Is it positive or negative?
- What motivates them most of all – as individuals?
- What information do they each want or need from you?
- How do they want to receive information from you? What is the best way of communicating your message to them?
- What is their opinion of the business's progress to date? Is it based on good and accurate information?
- Who influences their opinions generally, and who influences their opinion of you and your business? Do some of these influencers, therefore, become important stakeholders in their own right?
- If some of the key stakeholders are not likely to be positive, what will win them around to support your proposals?
- If you don't think you will be able to win them around, how will you manage their opposition?
- Who else might be influenced by their opinions? Do these people become stakeholders in their own right?

Managing Stakeholders and their Potentially Conflicting Interests

The benefits of successful stakeholder management are as follows.

- If the most powerful stakeholders are identified early and their input can be used to shape the architecture, this ensures their support and improves the quality of cooperation and support.
- Support from the more powerful stakeholders can be useful in accessing resources that may otherwise have been inaccessible.
- By communicating with stakeholders early and frequently, they can be kept fully aware of the planning process, possibly avoiding problems or objections at a later date. They can also be used as sources of valuable ideas and opinions.
- The business owners can identify conflicting or competing objectives amongst stakeholders early and develop a strategy to resolve the issues arising from them.

The key to managing potential conflicts with external stakeholders as the business plans, and then starts, to expand is to keep them informed of what is happening, and to discuss with them the implications for the relationship with them (particularly with the customers), and how the business and its stakeholders might cooperate so that both could benefit. For example, supplier-stakeholders could be encouraged to regard growth proposals as an opportunity for both parties, and discussions could explore how both sides could cooperate for mutual benefit; for example, a deal for more flexible deliveries, bulk discounts or credit terms could create more business for the supplier.

When planning to expand and grow a business, the most frequent potential conflicts between the business and its stakeholders, or amongst the stakeholders themselves, involve the financing of the growth and the implications for shareholders. Most growth and development strategies require further funding for the business. For some investors who don't want their shareholding diluted, this might be perceived as a threat; but for others, it could be an opportunity to increase their stake in the business. For a director providing security for a bank loan, this could potentially create more personal financial exposure. This might not be acceptable to that person or his or her direct family, especially if other directors do not share that same financial exposure.

The fundamental part of managing these potential conflicts is to identify them as early as possible, to define the potential problems, and to start negotiating a resolution well before the growth and development proposals are finalised, so that the resolutions are incorporated into those plans.

B. THREE STAGES OF DEVELOPING A GROWTH STRATEGY FOR A BUSINESS

As explained in the introduction to this chapter, the three-stage process of strategic planning has, in its simplest form, been around for a long time, and was based on three simple questions.

- Where are we now?
- Where do we want to go?
- How do we get there?

In the first edition of *Exploring Corporate Strategy* in 1984, Gerry Johnson and Kevan Scholes turned these three questions into a more formal approach, breaking down each of the three stages into three further elements.

- Strategic analysis: this looked at the analysis of the environments (internal, marketing and external) in which the business operated; the resources that it

possessed or that were potentially at its disposal; and the expectations, power and objectives of its owners and key stakeholders.

- Strategic choice: this was based on a three-stage process of generating options (based on the strategic analysis); evaluating the options in terms of suitability, feasibility and acceptability; and selecting the most appropriate strategy.
- Strategic implementation: this focused on getting the right organisation structure in place; planning the required physical and financial resources; and organising the people and systems, including managing the change process.

This process has stood the test of time and has been developed much further. Although it was originally intended as a model for the development of corporate growth strategies, it is probably one of the few “big company” management theories that can be applied easily and successfully in the context of the growth and development of SMEs. It also facilitates the use of a range of other management tools for the strategic analysis, marketing strategy, and change management processes, although not all of those are quite so readily applicable to SMEs, particularly for the strategic analysis stage.

In the corporate context, the conventional approach to strategic planning has been to develop plans on three levels.

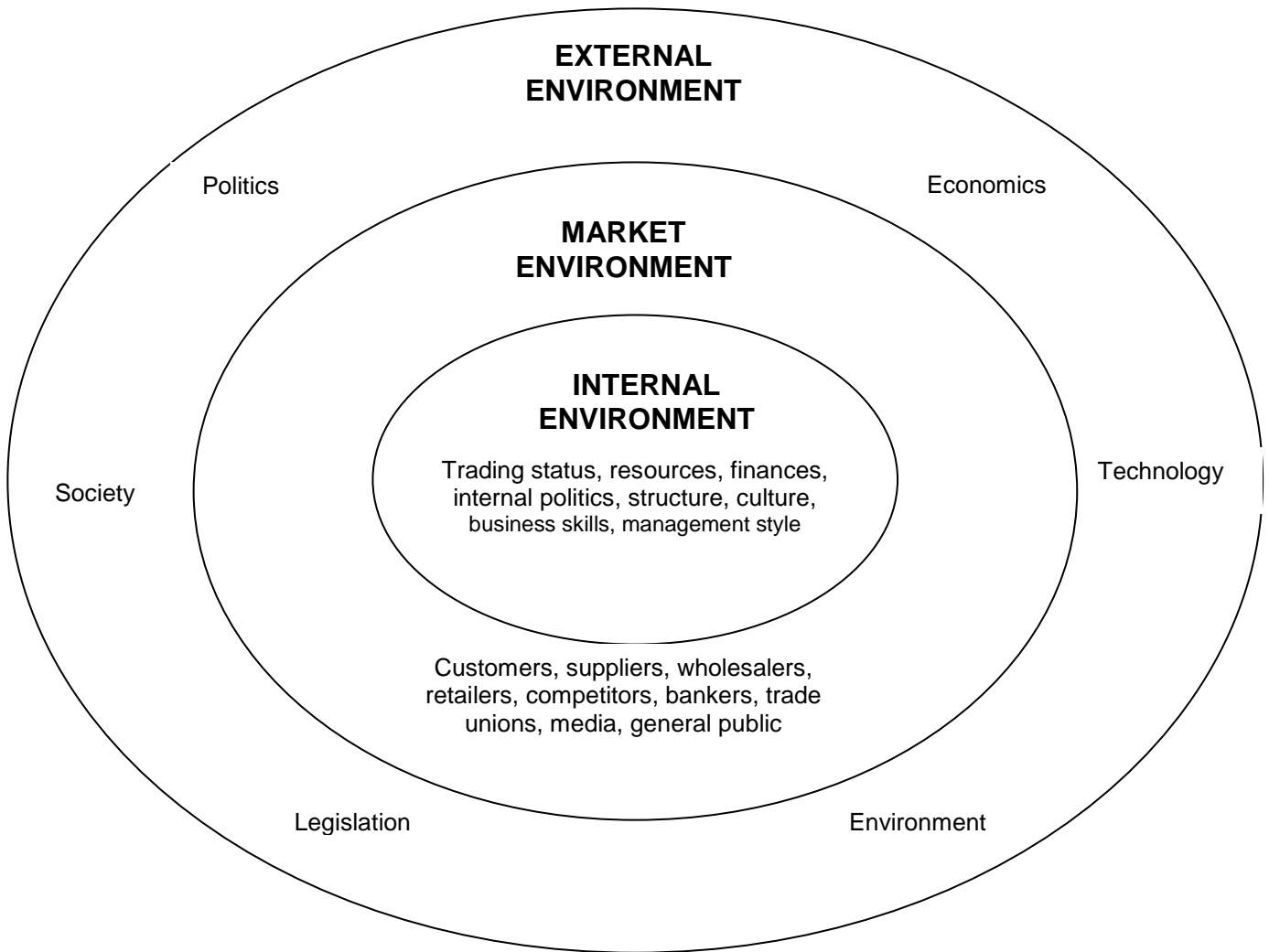
- Corporate strategy plans at the highest level.
- Plans for strategic business units at a more tactical level.
- Operational plans for the day to day implementation of the strategic and tactical plans.

For SMEs, the fundamental difference between the size and scale of their operations and those of a large corporation means that the boundaries between those three levels of strategy become blurred: in smaller firms, it is often the same members of staff who make the strategic, tactical and operation decisions. Sections C, D and E of this chapter examine the Johnson and Scholes model in more detail, along with some of the available analytical and strategic planning tools that are available for both SMEs and larger corporations.

C. STRATEGIC ANALYSIS OF THE BUSINESS

Figure 11.2 illustrates the three parts of the strategic analysis process. The internal environment, i.e. the internal operations of the business itself, is at the centre, but operates within the market environment over which it has some influence; the market environment is within the external environment over which the company probably has very little influence.

The development and growth of a small business are essentially a change process driven by the three environments in which the business operates. The external environment generates changes resulting from a number of sources: the introduction of new and changing legislation; political pressures; the impact of global economics on markets; fluctuating interest and exchange rates; shifts in social demographics; pressures of legal compliance; fiscal policy and taxation etc. Within the market environment, we see constantly changing patterns of demand, the introduction of new technology, the activity of competitors in trying to grow their market share, changing customer demands, the need to meet quality and environmental standards and accreditations, and the need to find new and reliable sources of supply, etc. Within the business itself, there are internal pressures: financial and physical resource availability; staff availability; levels and skills; and changing deadlines and targets.

Figure 11.2: The Strategic Analysis Process

The business analysis stage of strategy is not specifically interested in how the change process will be managed or implemented (that comes later) but it should be concerned with a review of the capacity of the business to handle change, specifically the following.

- What are likely to be the main barriers to change within the firm – from owners, employees and other stakeholders?
- Does the firm's management have the skills, attitude and expertise to handle the substantial changes that could result from growing the business?

Analysing the Internal Environment

The internal environment is all about the structure of the business and the culture that operates within it, the management style, its staff and management skills, internal politics and stakeholder relationships, and its specialist knowledge and intellectual property. It is also about its current trading status being appropriate to its future needs, its physical and financial resources, and the resources it may potentially have access to. The analysis should also include a review of its performance and capability across a number of key areas.

There are a number of tools and models available to help analyse the internal environment, and this chapter will examine some of them, as follows.

- McKinsey 7S framework.
- Skills gap analysis.
- Internal resources, systems and management processes.
- Small Business Performance Review.
- The Cultural Web.

McKinsey 7S Framework

The McKinsey 7S framework was designed by the McKinsey management consultancy organisation as a tool for analysing and understanding the internal corporate environment – for which it can work very well. However, its use is more limited in the context of small firms that do not have the same formal cultures, hierarchical business structures or developed management processes as medium and large businesses. These are the seven component parts of the analysis.

- Structure: how the organisations breaks down its activities into distinct elements, and how those elements are coordinated and managed.
- Strategy: the actions (proactive) and reactions (reactive) to changes and developments in the external environment, e.g. the route to profitability or success.
- Systems: the formal and informal procedures used for communication, coordination and control.
- Style: the philosophy, values and beliefs adopted by the managers in the way they exercise their authority over staff.
- Staff: the quality and quantity of staff employed by the business.
- Skills: the competencies (both available and required) used to perform different tasks to an appropriately high standard.
- Shared values: the values (both written and unstated) that underlie the stated objectives of the organisation, and which are supposed to be shared by all of the members of the organisations; e.g. the “super-ordinate” goals such as ethical behaviour and the quality ethos.

Skills Gap Analysis

A skills gap analysis is a much more focused and practical analysis of a functional area within the internal environment, but one that is essential in order to ensure that the business has the staff resources and capability to implement a growth strategy. The skills audit and skills gap analysis are explained in Section B of Chapter 7.

Internal Resources, Systems and Management Processes

Rather than being a structured method of analysis, internal resources, systems and management processes represent a checklist of the items that together make the business work and define what it is – at least at a specific point in time. It is much broader than the McKinsey framework and most of it can be used in the small business context, although not every heading will be relevant to every business. It can be a very useful tool in prompting small business owners to actually consider aspects of their businesses that may otherwise be taken for granted.

- The trading status or operational format: whether or not the trading status of a business, or the format of an organisation, is still appropriate (trusts, charities etc) to its current activities or level of operations.

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- Internal structure: the formal framework of the organisation that influences lines of authority, decision-making and communications.
 - Internal culture: the formal and informal cultures that predominate within the organisation, involving personal attitudes and perceptions, norms and standards of behaviour etc.
 - Management skills: the breadth and sufficiency of the skills available, and the competency of the managers to exercise those skills for the benefit of the organisation. Also, the identification of gaps that need to be filled.
 - Management style: the ways in which managers exercise their authority, allocate and delegate work, and make decisions that affect their staff. The nature and quality of manager–staff relationships.
 - Current policies and objectives: the organisation's mission statement, whether or not policies are written down and formalised, where it has been going to date, and whether or not its original policies are still relevant to its plans for future development.
 - Current decision-making processes: who makes the decisions and is the process satisfactory or does it need to be changed? Are decisions made in the context of the organisation's long-term objectives, or in response to short-term pressures and influences?
 - Stakeholders' interests and objectives: exactly who are the stakeholders in the business and what are their interests? Has either of these changed recently? Do the stakeholders' interests match the organisational objectives?
 - Financial resources: the capitalisation of the business, its assets and liabilities, working capital, borrowing potential, credit facilities, etc.
 - Financial systems: which systems are currently in use and do they need to be reviewed to match them to the current or future needs of the organisation? Have they evolved or were they designed for the job, and are they still adequate?
 - Past financial performance: has the organisation met its budgetary or profitability targets; if not, why not? Are profit margins adequate? Have recent trends been positive or negative? Are there variances between the financial performance of different parts of the organisation; if so, why? How does the organisation's performance compare with others in the sector?
 - Monitoring and control systems: what systems are in place, why were they installed, and are they still working effectively? What changes are needed to meet present and future needs?
 - Staff resources and their deployment: how many staff and managers are employed? Are they all needed? What gaps or vacancies exist at present? What further skills are needed to meet present needs (skills audit and gap analysis)?
 - Physical location and premises: is the organisation located in the right place to meet the needs of its customers? Are the premises adequate for current needs? Is relocation needed? Are the costs of the premises acceptable? Would an alternative form of premises acquisition (rental, lease, mortgage, etc) be more appropriate?
 - Physical resources: does the inventory of physical equipment meet the current needs of the organisation? Does it need replacement or further capital investment? What policies are in place for maintenance or replacement? Are these working?
 - Stock-holding policy: is stock-holding relevant to the organisation? Are average stock levels too high, too low, or sufficient to meet customer requirements? What is the average cost of stock-holding? Are systems in place for re-ordering, rotation, monitoring and control, checking and valuation? Do problems occur frequently?
 - Current and recurring problems: what problems is the business facing right now? What problems occur within the business on a regular basis, and why is this

happening? What are the effects of these problems? What actions are needed to avoid or overcome these occurrences?

- Ongoing and potential changes: what changes have recently occurred in the organisation, or what changes are ongoing? Are these changes progressing smoothly? If not, why not? What problems were encountered and how were they handled? What problems are anticipated in the future and how will these be managed?
- Risks: what are the main risks facing the business at present and are there any plans in place to deal with them? Does the company have a business continuity plan?

Small Business Performance Review

The Small Business Performance Review is a structured review process that is specifically designed to help small firms analyse their strategic position (Butler 2006). It examines seven Key Performance Areas (KPA's) of the business and is, in effect, a more concise version of the checklist of internal resources, systems and management processes, but with the additional analysis of market performance. It uses a series of descriptors (prompt words) and questions for each of the seven KPA's that are designed to provoke the business owner into critically assessing the performance of the business. It works most effectively when it is completed independently by two or more directors/managers involved in running the company, as this draws out variations and differences in their perceptions of how the business is really performing. As the process can potentially create conflict when opinions differ, it is recommended that a facilitator is used to manage a strategic review meeting of the directors and managers when they compare their results. That process can be a powerful tool in re-aligning the strategic objectives of individual managers and directors prior to developing strategic options for growth.

The seven KPA's are as follows.

- Management efficiency: evaluation of the effectiveness of the owners/managers in operating the business efficiently.
- Sales, marketing and customer relations: analysis of performance in the marketplace and the market environment, and how good the business is at winning new orders and retaining customers.
- Business operations: the efficiency of the day to day running of the business, meeting customer deadlines, managing the physical resources, and identification of any problem areas.
- Finance: financial management and monitoring, profitability, etc.
- Managing staff performance: management and staff relationships, staff productivity, symptoms and identification of problems or staff dissatisfaction, legal compliance, etc.
- Innovation, technology and intellectual property management: the extent and efficiency of use of ICT systems, the management and exploitation of both formal/protected and informal IPR.
- Planning for the future: how the business currently goes about its forward planning or development strategies (if at all).

A pdf version of the Small Business Performance Review can be downloaded from the ABE website: www.abeuk.com.

The Cultural Web

The Cultural Web was a later development of the Johnson and Scholes process of analysing the internal environment (Johnson, Scholes and Whittington 2008). The process involves:

- the analysis of the organisation's existing Cultural Web
- the development of a model of the Cultural Web that the organisation would like to achieve
- the comparison of the two, to generate a map of the differences and facilitate the development of a plan to address and change those differences.

The Cultural Web identifies six inter-related elements that help to make up what Johnson and Scholes call the "paradigm" – the pattern or model – of the work environment. By analysing the factors in each, it is possible to see the bigger picture of the business culture and to identify what is working, what isn't working, and what needs to be changed.

These are the six elements of the Cultural Web.

- **Stories:** the past events and people talked about inside and outside the company. This is significant in that the memories and stories about people and events that stay in people's minds and are repeated reflect what is valued by the business and its staff. The stories also reflect the reputation of the business and what it believes in. The reiteration of the stories to new members of staff helps to sustain the culture and beliefs.
- **Rituals and routines:** the norms of daily behaviour and the actions of people that signal what is acceptable (or unacceptable) behaviour. These routines determine what is expected to happen in given situations, and reflect what is valued by management. This is about what customers, visitors and staff expect when they enter the business premises, and the patterns of behaviour that routines support. It also highlights what might stand out if changed.
- **Symbols:** the visual representations of the company or its corporate image, including brands and logos, the ambience of reception areas and offices, the quality of furnishings and lighting, and the formal or informal dress codes of staff. It also relates to the image associated with the business, and how that is perceived by clients and staff.
- **Organisational structure:** this includes both the structure defined by the organisation chart, and the formal and informal lines of authority, including the unwritten lines of power and influence that indicate whose contributions are most valued.
- **Control systems:** the ways that the business is controlled. These include financial systems, quality systems and reward structures for staff, including the way performance is measured and rewards are distributed within the organisation. It is also important to identify differential levels of control within functional areas of the company.
- **Power structures:** where the real power in the company is located, perhaps amongst one or two key senior executives, a group of executives or a specific department. These people have the greatest amount of influence on decisions, operations and strategic direction.

Analysing the Market Environment

The analysis of the market environment falls into two parts: analysis of the performance of the business in identifying, engaging and retaining its customers (which overlaps with the performance aspects of the internal environment analysis); and the broader analysis of the market potential for future growth.

From the small business perspective, there are six main questions that need to be asked to gain a basic understanding of the company's customers, its market and the way it interfaces with them.

- Who are the customers? Do we know precisely who they are? Do they fall into any stereotyped groups or segments? How many customers are there of each type, and where are they located? What do we know about their buying patterns? What aspects of our services are most important to them? Do they buy on quality or price or both? How do we distribute the goods or provide the services to them?
- How strong are our customer base and customer loyalty? Do they trade regularly, periodically, or on a one-off basis? What are their perceptions of our organisation? Do we obtain feedback from them, and how responsive are we to negative feedback? Could they be easily persuaded to adopt a substitute or competitive product in preference to ours?
- How strong is our market share and is it growing? How large are our markets and are they growing or declining? What is our position in the overall market compared with our competitors? Has this changed recently, and were the changes positive or negative? How reliable are our sources of information? Are there any trends or changes in the market that we need to monitor closely?
- Who are our competitors and what are they getting up to? Who are our competitors, and how many are there? Do they compete directly with our services? What methods of advertising and promotion do they use? Are they developing new products or market strategies? Is the business proactive in competing with them, or are we always acting in response to their sales activities or initiatives? Do any of them pose a strategic threat to the business?
- Are our sales and promotion activities working effectively for the company? What methods does our organisation use to promote its goods or services? Are they monitored for effectiveness, and when were they last reviewed? What alternatives have been considered?
- Are our quality standards and policies satisfactory? Do we have defined standards of quality and customer service? Are they still appropriate? When were these last reviewed? Are our staff and customers aware of them? Are they working properly to avoid complaints and/ or returned products? If not, why not?

There are a number of much more comprehensive models used for the analysis of the market environment, some of which focus on evaluating the potential of the business to access market growth whilst others concentrate on analysing the potential of the market as a target for the business. However, most of the mainstream marketing theories and models were developed for large businesses and corporations and are not always appropriate for use in analysing or explaining marketing in the small business sector. For example, the Boston Consulting Group Growth-share Matrix (known as the Boston Matrix), which compares market growth for products with market share, was aimed at strategic business units within corporations and has been criticised for having several drawbacks. These include the assumptions that higher profits are proportional to higher market share,

and that strategic business units in corporations are not usually based around individual products.

Porter's Five Forces analysis, which is discussed in some detail in Chapter 4, is ideal for use by both large and small businesses to evaluate the potential barriers to market entry. Ansoff's Growth Matrix for Competitive Strategies (Ansoff 1957) was designed to evaluate potential diversification strategies; hence, it is ideal for evaluating strategic choices, but is of less relevance to analysing the internal market. Similarly, Porter's Generic Strategies consider the use of cost leadership and differentiation to achieve competitive advantage; again, these are more appropriate as tools for evaluating strategic choice. Bowman's Strategy Clock (Bowman and Faulkner 1996) uses price and added value as criteria for evaluating marketing strategies.

Marketing Assets Analysis

Drummond, Ensor and Ashford (2008) treat the analysis of marketing assets as an essential first step in developing a marketing strategy. These assets fall into four categories.

- Customer-based assets are those that are important in the eyes of the customer: the image and reputation of the business in the marketplace, and any brands the business owns that are strong enough to generate customer loyalty (and, therefore, a potential competitive advantage over rival businesses). The customers' perceptions of the business as a market leader or brand leader are also significant: in the case of fast-moving consumer goods, such perceptions of business brands can generate opportunities for them to access prime locations within retail outlets. Drummond, Ensor and Ashford also mention the country of origin as being relevant, quoting as an example the German reputation for quality car manufacturers such as BMW and Mercedes. Whilst this may be relevant to the international motor trade, it is probably not important for small firms unless they are producing or selling premium goods for the top end of the consumer market. It is certainly less applicable to service industries. The key features to focus on are the unique features of products and services that distinguish them from the competition: for example, price, quality, design or a combination of them.
- The size and strength of the distribution network in key geographical areas is seen as a key asset. This is not just an issue of the size of the area covered, or its depth of coverage, but the speed and efficiency with which the business can respond to its customers. The other aspect of distribution is whether or not the firm has any influence or control over the distribution network. The example Drummond, Ensor and Ashford quote is that of Coca-Cola, which used its global influence to keep the relatively small but very popular Scottish Irn-Bru (a soft drink product) out of McDonald's restaurants. This illustrates well one of the major problems facing small firms in large international markets. Even where the barriers to market entry can be overcome, it is very seldom the case that small firms can achieve any degree of market control, unless they can gain the approval of the large global organisations.
- Cost structure advantages, such as economies of scale or the application of technology, can provide valuable internal assets to a business, although in small firms the economies of scale are much less likely to be as significant as the ability to make use of innovative technology. Equally, the information systems used for market research are likely to be less significant to small firms, apart perhaps from those working in the information technology markets. In contrast, western supermarkets such as Tesco have the ability to analyse customers' purchasing

patterns and to develop targeted marketing of specific products and promotions to individual customers

- Alliance-based assets involve the advantages gained from external relationships with other organisations, and this is one area where small firms can potentially score highly. For example, many small firms gain access to larger markets via partnerships or contracts with other distributors or suppliers in those markets, sometimes involving exclusive supply agreements with major players in the market. Such relationships can also involve savings from shared product development. In this respect, suppliers of venture capital can count as an asset in terms of both the networking opportunities and the management expertise they can offer to the companies they invest in.

Five-stage Marketing Audit Process

Kotler outlines a five-stage model for the marketing audit process (Kotler, Armstrong, Saunders and Wong 2008) which can help managers of both large and small firms to carry out an audit of their own organisations. The model is really designed to challenge any comfortable assumptions that all is well in the marketing context. It does this by highlighting each of the possible areas where problems could have crept in since the marketing policies were formulated or last reviewed. This is especially pertinent to small firms where policy reviews are not automatic, usually because of the lack of specialist functional managers to deal with marketing, and where the entrepreneur may be the primary decision-maker.

- The Marketing Strategy Audit looks at the compatibility of current marketing activity with the overall marketing objectives of the organisation, and whether or not sufficient resources have been allocated to allow the objectives to be achieved. Do the activities fit with the strategies or have they diverged over a period of time? Have the marketing activities inadvertently diverged from the original plans over the past year or so? Are the differences just minor or has there been a major change in direction, and what impact has this had on sales volumes and revenues? What were the reasons for the change? Do the current activities now need to be brought into line with the overall strategic objectives of the business?
- The Marketing Structures Audit looks at the role of the marketing function within the organisation as a whole, its representation within the management and decision-making process, and its relationships with other functional areas of the business. In theory, the sales and marketing function should be of prime importance to the owner as it is the lifeline of the business; however, in many small firms, it is relegated to a secondary position, particularly if the owner comes from a technical background, or lacks marketing expertise. Conversely, owner-managers from a sales background tend to place a strong emphasis on marketing, although with a strong awareness of the importance of the product itself in the marketing mix, and the need for technical expertise is not relegated to a lower priority in the same manner. Where then, does the marketing role fit within the business, and is it treated appropriately alongside other management priorities?
- The Marketing Systems Audit looks at the planning and control systems the business uses, and its new product development. Is the business able to monitor and evaluate the returns achieved by sales and marketing activities, for example in terms of enquiries or actual sales generated by an advertising campaign, or by the regular activities of sales staff? Does the product development policy of the business follow from market information and research, or more from the inspirations of the owner-manager and technical staff? There is nothing wrong with the latter, but the former does a great deal to validate its potential benefits and to guide it in

the right direction. This audit should also include a review of the market research activities and capabilities of the organisation, in particular with an examination of the depth to which research is carried out. Market research is not an activity that comes easily to many small business owners and there can be a tendency, often driven by experience in a particular industry or service, to assume that there is little more to learn beyond what the owner already knows. The updating of market research is particularly important prior to a period of growth or development and especially when diversifying into new markets: it is easy to underestimate the barriers to market entry because they have not been sufficiently researched. For example, there may be a big market that seems to be available, but how much of it is tied up in long-term contracts with major competitors whose size and economies of scale enable them to control and manipulate prices to keep out newcomers?

- The Productivity Audit looks at the contributions made by the various products or services offered, their individual profit/cost ratios, and the cost-effectiveness of the various distribution channels and markets. It examines which of the products or services: a) generate the biggest overall contribution towards profit and overheads for the business; b) generate the best profit margins; c) fail to cover their costs. This helps to identify the products or markets on which to focus, and others to avoid or withdraw from in the future.
- The Marketing Functions Audit is a way of reviewing the marketing mix (product, price, promotion and place etc), to investigate its ongoing effectiveness. Are there any factors that have changed the relative significance of any of the components, e.g. an aggressive pricing policy or advertising campaign by a major rival? Has the demand for the product(s) changed at all? Most important of all, to link in with the strategic objectives of the business, what changes in the marketing mix are now needed? This last question will reflect the decisions made about the strategic options faced by the business (cost-leadership, diversification, market focus, etc), as it will reveal how far off the mark the business actually is.

Analysing the External Environment

The external environment focuses on the range of factors and influences that are essentially beyond the control or influence of most businesses and organisations, except perhaps for the larger global corporations that have the size and resources to lobby governments to influence social, political or legislative policies. The external environment not only impacts on individual businesses and their operations, but can potentially change the market environment. It is also the primary source of bureaucracy and regulatory compliance with which businesses must contend, and which creates a disproportionate burden on small firms with limited resources.

Two main tools are used to analyse the external environment: SWOT analysis and PESTLE analysis.

SWOT Analysis

The SWOT analysis is a simple but flexible process that can be used to evaluate a range of different scenarios, including an individual person's skills, capabilities and self-development options, to compare alternative business propositions or courses of action, and for strategic analysis of the external environment. It uses four headings: strengths, weaknesses, opportunities and threats.

For the latter purpose, the strengths and weaknesses of the business are listed (i.e. the internal factors – staff and management skills, position in the marketplace, quality and saleability of the company products, customer loyalty, finance and resources).

Opportunities and threats are the external factors beyond the control of the business, and these are examined to assess the potential value of new opportunities against risks and potential problems that have been identified as threats. The strengths and weaknesses should really reflect the answers to the questions that have been posed in the analysis of the internal environment; and similarly the opportunities and threats will relate to issues that have been identified in the analyses of the market and external environments.

The value of SWOT analysis lies in its speed and simplicity, and the range of analysis it can be used for. As such, it can be a valuable tool. However, its value can also be limited by the knowledge and perceptions, pre-conceived ideas or lack of objectivity of the person who is carrying out the analysis. It is, therefore, always worth getting a second opinion.

PESTLE Analysis

PESTLE analysis is also referred to as PESTEL, and is sometimes abbreviated or changed around to become PEST or STEEP. The six letters relate to the six influences of the external environment as identified in Figure 11.2: political, economic, social, technological, legislative and environmental. Inevitably, there is some overlap between them: for example, political decisions are often based on economic factors and are implemented via the legislative process. However, PESTLE analysis is a useful tool for examining the external environment affecting large and small businesses alike, in order to identify any potential risks or impact on their plans for growth.

- **Political issues.**
These tend to be generated at national government or at international level (in the EU, for example) and may have a direct impact on the day to day operation of the business. Two typical examples are the statutory minimum wage, which guarantees a minimum hourly rate of pay for employees and, therefore, increases the wages costs for employers; and the opening up of national borders across EU countries to enable EU workers to seek employment outside of their own countries, which can have the opposite effect of pushing down labour costs. Political decisions can also influence which parts of countries get assistance to protect or develop their local industries, or where major infrastructure projects such as road building can boost local businesses.
- **Economic factors.**
These can take on many different aspects, and can be hard to forecast in the longer term, as the international economic situation is influenced by a multitude of national policies, changes in demand, and things like recession and inflation. Between 2000 and 2010, there was a rapid growth in the volume of goods manufactured in China using cheap labour costs, against which UK producers could not compete. 2005 also saw rapid rises in oil and gas prices: this had a major impact on the cost of fuel and energy, and pushed up production costs for businesses.

Economic cycles of high growth and prosperity changing to recession and vice versa are largely influenced by factors that are determined at national or international levels – for example, exchange rates between international currencies; the key financial markets in London, Tokyo and New York. The government fiscal policies on inflation use interest rates as the primary control mechanism, but high

interest rates push up currency values, which make imports cheaper and exports dearer and push down profit margins. Again, it is the smaller businesses with fewer resources that are most susceptible to the economic forces beyond their control. The questions, then, are which of these economic influences might be relevant to the particular plans for expansion that a business has, and how might that change over a period of time?

- Social factors.

Over the past 30 or 40 years, there have been major social and demographic changes in the population, including a higher proportion of the population living longer in retirement, a larger proportion of younger people staying in education to a later age, and a social structure that has seen the demise of the old social classes and a major increase in ethnic groups. These include changing social trends and demographic factors such as the growth in single parent families, ethnic minority influences, feminism and human rights. For example, the ageing population and longer life expectancy are impacting on the costs of pension provision, particularly for businesses with company pension schemes; Governments are warning people to expect to have to work for many extra years before they can retire.

Most social changes occur relatively slowly and their impact on businesses is not always obvious at first. In fact, businesses often tend to overlook the changes and just focus on the influences of political and economic change.

- Technological factors.

The fastest changes of all are occurring in technology and no small firm can afford to ignore it or live without it. In 1983 a 1 Mb computer with a basic accounting package would cost well over £5,000, but now a highly sophisticated system with a full range of accounting and office software costs barely 10% of that figure. Technology has also impacted on social factors, but not in the way that was originally forecast. In the 1970s, it was predicted that as technology advanced everyone would still have employment but would have much more leisure time. In reality, technological change has reduced the need for production staff; and not only are more people now unemployed, but those that are still at work have to constantly upgrade their skills to remain employable. Similarly, if businesses do not constantly embrace and engage with new technologies, they risk being left behind by rivals who do so.

- Legislation – current and future.

The range of legislation affecting businesses is constantly changing and increasing, particularly for businesses operating in the EU, which face numerous EU regulatory controls in addition to the changes in legislation that are generated in their own countries. In the eyes of the law, ignorance is no defence, so it is the responsibility of the owner-manager to keep abreast of changing legislation and the implications for the business. This applies both to the general legislation that affects all organisations, such as health and safety regulations, pollution control, disability discrimination, and employment law, and to industry-specific regulations such as controls over abattoirs, food storage, processing and handling that have affected the food industry in recent years. Hence, businesses need to be constantly aware of new changes in legislation that might impact on them.

- Environmental issues and controls.

In the past 20 years, people have become much more aware of the need to protect the natural environment from pollution and damage, and to take a more proactive approach to recycling used products and materials and reducing waste. However, environmental protection comes with its own associated costs and has to be paid for.

Since the Control of Pollution Act 1974, there has been a steady stream of environmental legislation to complement the increasing public awareness of environmental issues. Most of it does benefit the environment but inevitably there is a financial impact on businesses, both large and small. One of the most recent positive examples is the regulation requiring that a specific minimum proportion of all packaging should be recycled. Another example is the objective to reduce pollution by imposing high taxes on road fuel; this may seem environmentally friendly (or is it really just an excuse to raise indirect taxation?) but as fuel prices increase, motorists naturally look for the lowest prices. These lower prices are typically found in service stations run by the multi-national oil companies and the major supermarket chains, against which small, local independent suppliers cannot compete. Environmental issues and regulations will not go away, though, so the businesses that will best be able to handle them are those that take a proactive stance and prepare to work with them.

D. DEVELOPING STRATEGIC OPTIONS FOR GROWTH

Having completed the strategic analysis, the second stage of the Johnson and Scholes approach focuses on strategic options: generating potential options from the information produced by the strategic analysis, evaluating the options in terms of suitability, feasibility and acceptability, and then selecting the most appropriate strategy. The model actually differentiates between business strategy (competitive strategy and sustaining competitive advantage) and corporate and international strategy (market diversity, value creation and corporate portfolios); however, the latter relates primarily to multi-national corporate organisations, rather than the growth and development of entrepreneurial SMEs, and for that reason this section will focus on business strategy.

Generic Strategies, Directions and Methods of Development

Johnson and Scholes explain that strategic options need to be examined in three areas: Generic Strategies; directions of potential development; and the methods of development that will be used.

Generic Strategies

Three primary Generic Strategies are identified by Johnson and Scholes; there is also a fourth hybrid of the first three that is often used alongside them.

- **Cost Leadership.** Competitive advantage is gained and maintained by planning and managing the cost structure (comparative price) of the goods or services in relation to those of the competitors. This is essentially a proactive policy of maintaining a leading place in the market by using a keenly competitive pricing policy.

- **Differentiation.** Competitive advantage is created by focusing on the difference or uniqueness of the products (in terms of product choice, quality, options, service, perceived value) in the eyes of the customer, i.e. by emphasising the points of difference and their value to the customers.
- **Focus Strategy.** This is where the organisation concentrates on one or more specific niches in the market that have (typically) been unexploited by competitors. This particular strategy is popular with smaller firms that are competing against much larger rivals for whom the niche markets may not be sufficiently large to be of interest.
- **Best-cost Provider.** This is the hybrid strategy and is offered as a variant of the previous three approaches, for example to gain competitive advantage by combining Cost Leadership and Differentiation to offer a high quality product at a mid-range price.

Potential Directions for Growth and Development

There are a number of directions in which an organisation can potentially move or, in the first instance, choose not to move.

- **Do nothing.** This option keeps the business exactly as it is at present, moving in no specific direction. This would probably be unthinkable in larger organisations, but it is often acceptable or desirable in small firms. It is usually a short-term strategy, but for some businesses it can be for the long term as well. It does not necessarily imply apathy or reluctance to respond to external changes; rather, it is a positive no-growth or no-change decision that the owners of some lifestyle businesses choose to make, as explained in Section C of Chapter 1.
- **Withdrawal.** An option that is often overlooked is the choice to withdraw from the market by a planned exit strategy. This might involve selling the business as a going concern, perhaps to a rival business that regards acquisition as an ideal means of growth.
- **Consolidation.** This is a decision not to move or grow, but to consolidate internal systems and to focus on improving performance and profitability. This is more of a short- to medium-term strategy, but one which can be very appropriate at times of economic uncertainty, or when there may be possible risks involved in aiming for growth.
- **Market penetration.** This is about identifying new sectors or new markets for the existing range of products or services. The market penetration may involve moving into new geographical markets, and engaging in international exports.
- **New product development.** This involves developing new products or innovations to sell in the market in which the company already operates.
- **Related diversification.** This involves expanding the product range beyond the current situation, but remaining in the same market. The expansion could simply be based on variations of existing products that offer different features and benefits to attract a separate group of customers, or it could consist of developing products that are potential substitutes for those of rival companies.
- **Unrelated diversification.** This is about selling different products or services to the same customers. For example, a butcher's shop could start to sell fish, cheese or vegetables; a petrol station could start to sell newspapers and food and drink products; a farming supplies business could start to train farmers in the use of pesticides; or an accountant could start to offer investment advice to clients.

Potential Methods of Achieving Strategic Growth and Development

- Internal development. This involves growing the business from within, using internal or borrowed resources to develop new products, particularly if there are insufficient funds to permit more rapid growth such as by acquisition.
- Growth by acquisition. The business buys or takes over another business in its own market to facilitate expansion and increase its market share or increase its profits by achieving economies of scale.
- Diversification by acquisition. The business takes over another in a different or related market to achieve diversification (particularly if there are barriers that might restrict entry into that market).
- Joint development. This can occur where two or more businesses join together or collaborate in the development of a new product or venture – particularly between large organisations involved in major capital projects such as civil engineering, oil exploration or aircraft design. It can also occur where smaller organisations work together to achieve mutually beneficial expansion, e.g. by the use of franchised business models, or in joint research and development activities, or perhaps where they operate in different but overlapping markets by sharing their respective export or distribution networks.

Evaluating Strategic Options

In order to evaluate the various options that have been identified, it is necessary to ask a range of questions.

- Which of the selected options are most compatible with the strengths and weaknesses that were identified in the strategic analysis of the business? Do they build on the strengths? Do they avoid or overcome the weaknesses?
- How do the options relate to the opportunities and threats that have been identified, and do they take full advantage of those opportunities? Are they robust enough to withstand any obvious threats?
- What external factors (changes in government policy, legislation, economic trends etc) could influence the various options, and would the effects of these factors be positive or negative?
- Are the options compatible with the objectives of the owners of the business; and if this is not the case, are the differences minor, substantial or critical?
- Are there any factors within the options that might be regarded as unacceptable by other stakeholders such as suppliers, financiers or bankers?
- What risks are associated with each of the options, and are these regarded as acceptable by the owners and stakeholders involved in the business?
- Is the business capable of accommodating or implementing any changes implicit in the various options?
- What are the current limiting factors that might inhibit the options (e.g. financial resources, borrowing capacity, physical space, management skills, staff availability and skills, market size and accessibility)? How might these limiting factors be overcome?
- Given current resources, which of the proposed options could realistically be achieved by the business in the next three to five years?

- What returns (in terms of increased revenue, cost savings, improved profits etc) might we expect from the respective options, and what levels of investment would be required to achieve those returns?

The choice of appropriate methods of evaluating the strategic options will largely be determined by the nature of the primary strategic objectives of the business, as the chosen tools will need to be relevant to them. There are a range of tools and techniques available to assist in decision-making, including the ever-popular SWOT analysis; a range of financial methods such as cost–benefit analysis, payback periods, liquidity and financial ratios, return-on-capital-employed calculations, net present value, cash flow and profit forecasts; and more complex models that are designed to forecast market share, analyse the sensitivity of the market, and evaluate stakeholder support.

Continuing with the Johnson and Scholes models, they propose a method of evaluation of strategic options that uses a combination of three criteria.

- Suitability: would the option actually work?
- Feasibility: can the option be made to work?
- Acceptability: does it fit with the objectives of the business and its stakeholders?

Suitability, Feasibility and Acceptability

- **Suitability.** To what extent are the strategic options compatible with the strategic analysis of the organisation, its operating environment, and its strengths and weaknesses? Would a particular option make full use of the organisation's strengths whilst also avoiding any adverse impact from its weaknesses or any foreseeable external factors such as changes in legislation or government policy? Suitability examines the rationale and justification of the strategy. It asks the following questions: Does it make economic sense? Would the organisation obtain economies of scale or economies of scope? Would it be suitable in terms of environment and capabilities?
- **Feasibility.** This examines how and whether or not the strategy might work in practice, and its practical potential for implementation within the resource capacity of the business. For example, an option to expand into export markets might not be feasible if the business had no knowledge or experience of exporting and lacked the economies of scale to compete on price against the local suppliers in those markets. Similarly, the option to grow market share by acquiring another business would be totally unrealistic if the business had little or no spare capital and borrowing capacity to finance the acquisition. In the case of the small firm, the feasibility of any option in terms of the firm's capacity and resources will always be the limiting factor. Feasibility is concerned with whether the resources required to implement the strategy are available, or can be developed or obtained. Resources include funding, people, time, information, or cash flow in the market.
- **Acceptability.** This is about how acceptable and compatible the option will be relative to the needs and objectives of the stakeholders in the business. An option that appeals to one stakeholder may be totally unacceptable to another. Acceptability is concerned with the expectations of the identified stakeholders (shareholders, employees and customers) with regard to the expected performance outcomes, which can involve return, risk and stakeholder reactions. **Return** deals with the benefits expected by the stakeholders (financial and non-financial). For example, shareholders would expect to increase their wealth; employees would

expect improvement in their pay and employment conditions; and customers would expect better service or value for money. **Risk** deals with the probability and impact of failure of a strategy (financial and non-financial). **Stakeholder reactions** deals with anticipating the likely reaction of stakeholders to factors that could impact on their personal or financial situations, e.g. dilution of investors' shares, loss of staff jobs, changes in product quality.

E. STRATEGIC IMPLEMENTATION

Having chosen the growth strategy that best fits with the objectives of the business and its key stakeholders, and is both suitable for the markets it operates in and feasible within the resource capabilities of the business, the third stage of strategic planning is to define how the chosen option will be implemented. This involves defining the tactical and operational decisions and activities that will be needed for the company's managers and staff to make it all happen. Strategic implementation looks at the three key areas of planning and allocating the resources, the organisational structure, and the people and systems, and how these factors must be changed and developed to enable the strategic choice (the chosen option) to be implemented successfully.

Strategic implementation can take place in three formats.

- Comprehensive implementation rolls out the strategy across the whole company in a relatively short period of time (relative, that is, to company size and complexity). This is possible when there is a clear-cut strategic direction in place, e.g. when another company is acquired.
- Incremental implementation staggers the process over a period of time, for example when the company has a strategy of growth by planned market penetration, or by planned gradual growth when faced with uncertainty in the external environment.
- Selective implementation applies the strategy to selected parts of the organisation only, leaving other parts unchanged or unaffected by the new strategy. This can occur where parts of the business resources are used for growth by diversification. Alternatively, it occurs where there is no clear strategy for the development of the organisation as a whole; just certain parts of it. Arguably, this is not an example of strategic planning at all; it is really just tactical development of the business.

The original Johnson and Scholes model (1984) split strategic implementation into three main parts: resource planning, organisation structure, and people and systems. These are the processes of getting the business ready and able to support the roll-out of the strategy. Their updated model (2008) replaces strategic implementation with strategy into action, and its three parts entitled organising; enabling; and managing change.

- Organising is essentially about the organisational structure, organisational processes and the management of relationships within the business, and how these three can be configured to benefit organisational performance.
- Enabling is about the planning, integration and management of four key areas of resources (people, information, finance and technology) to facilitate successful delivery of the strategy.
- Managing change is about identifying the factors that block or inhibit change, and designing change programmes and processes that will facilitate the implementation of the growth and development strategy.

Chapters 5 through to 9 examined the staff and physical resource requirements of a potential start-up business, as well as the marketing plans and the financial requirements before the company could be launched. Essentially, the preparation process for implementation of a new growth strategy involves working through the same processes to identify all of the resources needed along with their respective costs and phasing, as well as the administration and support systems that will be required to operate the strategy efficiently, and the monitoring and control processes that will keep it on track. These will be discussed in Chapter 12.

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Chapter 12

Implementing Growth Strategies

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INTRODUCTION

At the end of Chapter 11, we examined the updated Johnson and Scholes model (Johnson, Scholes and Whittington 2008) relating to strategy into action, with its three component parts entitled: organising; enabling; and managing change. This chapter explores the issues of putting together and structuring the strategic business plan, what needs to be in place within the business before it can be implemented (business structure, systems and resources), the importance of effective change management as a catalyst to implementing the development plan, and, finally, some of the broader strategic issues that will influence, and be affected by, that plan.

Some of these issues are actually beyond the scope of the Entrepreneurship and Business Development unit syllabus (and are identified as such) but have been included to highlight their relevance as part of broader business strategy.

A. PRODUCING A STRATEGIC BUSINESS DEVELOPMENT PLAN

Strategic plans typically look three to five years ahead, and map out and prioritise what the business wants to achieve during that period. These plans are normally based on a mission statement or primary objective, which is divided into a series of secondary objectives, usually related to business units or functional areas within the business. The secondary objectives are divided into a series of specific and measurable targets (the tactical implementation of the strategy) with timescales or deadlines attached to them. The specific targets are coordinated using project management techniques (e.g. critical path analysis) to determine the sequence of events and to ensure that the specific strategic developments can run smoothly (e.g. that all of the finance arrangements are in place or phased to coincide with specific development activities).

The final stage of the planning process relates to the monitoring of the strategy and its implementation. This includes:

- monitoring changes and influences in the external and market environments that will impact on the success of the strategies
- within the company at a higher level, monitoring progress and achievement of the strategic objectives against planned targets and timescales
- at a tactical level, monitoring the progress and success of the individual business units or functional areas in the organisation
- evaluating performance, using market research, profitability, budgetary monitoring and control and other performance indicators.

The top-down approach to strategy sets the objectives at senior level and passes them down through the organisation to be implemented. In medium-sized and larger businesses, this can leave lower levels of management with problems in handling impracticalities of the implementation that were not identified at senior level. In contrast, the bottom-up approach to strategy uses inputs and proposals from business unit or functional managers to help define the strategic options and practicalities of implementation; however, this can result in specific projects competing with each other for

limited resources. The reality of strategic planning in small businesses is that the management tends to have much closer contact with and awareness of the business as a whole, and potentially those problems can be avoided because communication between those who make the plans and those who have to implement them is more direct.

Ensuring the Implementation Matches Strategic Objectives

It sounds such an obvious thing to do, but in the same way that the strategic options were selected to meet the resource capabilities and the strategic objectives of the business, and were then evaluated to ensure that they were suitable, feasible and acceptable in the context of those objectives, the implementation process has to be designed and planned with those same objectives in mind.

The primary objective has been identified and established, and from that the secondary objectives, along with their measurable and specific targets, have been defined. The implementation plan must, therefore, specify the actions and activities needed to make them happen in the right place, in the right sequence and at the right point in time; i.e. that:

- the necessary physical resources are in place and ready for use
- the staff that are needed to make everything happen have been recruited and/or fully trained, and understand what is required of them
- external partnerships, distribution networks etc have been established
- marketing plans, advertising and promotional materials and activities have been organised
- support systems have been installed and tested to ensure they are fully operational
- potential risks have been fully evaluated, and contingency plans prepared where necessary
- monitoring and control systems have been set up and tested to ensure that the achievement of the targets associated with the secondary objectives can be accurately measured and evaluated to provide feedback on the progress of the overall growth strategy.

The most critical factor to remember is that throughout the whole process of implementing the business development strategy, it is imperative to keep referring back to the strategic objectives for the business, to ensure that the ongoing development activities are compatible with, and will complement, those objectives. It is very easy to get side-tracked during the implementation stage, perhaps by spotting and pursuing an opportunity that seems like a good idea and might improve short-term profit, but will ultimately detract from your longer-term objectives. The best way of ensuring compliance with the main objectives is to build in progress reviews as a matter of regular practice. Regular evaluation of progress and achievement is an important part of the planning and review cycle; as part of the evaluation, you should automatically check that the information and outcomes derived from the monitoring activities are compatible with the overall business development strategy and/or its component parts.

Structuring the Plan – Marketing, Resource Requirements, Finance

In Chapter 3, we examined the business plan format and structure for a start-up proposal. That was quite broad and lengthy but because there are always so many unknown factors prior to the start-up stage, the forecasts and projections are largely speculative in their

depth and detail and are, therefore, open to challenge. Fortunately, when it comes to producing a business plan for growth and development, the company should have a great deal more accurate and detailed information that can be used to make informed and justifiable predictions and decisions about future market opportunities and revenues.

The structure of the growth and development strategy document does not need to be as complex as that of a start-up plan, and its content will largely be determined by the audience that it is addressing. If it is purely for internal consumption (owners, directors, existing investors, managers) and does not require significant external funding or investment, then it can be structured in a number of quite straightforward sections.

- A summary of the strategic options that were considered, with the chosen strategy explained, justified, and broken down into the primary and secondary objectives.
- A marketing strategy that shows how the growth will be achieved in the target market(s).
- A plan of the staff and physical resources required to make it happen.
- Detailed financial projections showing costs of implementing the strategy and projected revenues, profits, break-even data, capital investment requirements etc. (Some of this data may still actually involve quite sophisticated financial models.)
- An implementation plan, including phasing, risk analysis, etc.

If the growth and development strategy is likely to require any significant amounts of equity investment or loan capital involving external lenders or investors, then a more comprehensive plan will be required, as follows.

- A concise but informative summary of the background of the business and its progress to date.
- A summary of the strategic analysis of the internal, market and external environments.
- A summary of strategic options that were considered and an explanation of the chosen strategy and how it matched the findings of the strategic analysis; plus details of the primary objective (mission statement) and the secondary objectives and associated tactical targets.
- Detailed market research information and market forecasts.
- A marketing strategy that shows how the growth will be achieved in the target market(s) and how that strategy fits with the objectives.
- A plan of the staff and physical resources required to make it happen.
- Detailed financial projections showing costs of implementing the strategy and projected revenues, profits, break-even data, capital investment requirements etc, with quite detailed and sophisticated financial models.
- Detailed financial reports from previous years, including profit and loss accounts, balance sheets, cash flow statements, asset structure, details of directors, investors and their shareholdings, tax liabilities, details of lenders, accountants, etc.
- A detailed implementation plan, including phasing, risk analysis and contingency plans, etc, plus monitoring and control systems.
- Additional due diligence information relating to customers, suppliers, IPR, etc.

The type of information required for the marketing, resource requirements, and finance sections is largely covered in Chapters 4 and 5 (marketing), Chapters 6 and 7 (resource requirements) and Chapter 8 (finance). However, for the marketing section, it would be appropriate to include analyses or explanations of the marketing strategy, using one or more appropriate models to evaluate competitive advantage. The resources section is primarily a detailed description of the additional staff resources (skills and numbers) and

physical resources (premises, transport, capital or production equipment, ICT facilities, etc) required to provide the capacity to deliver increased production or output. For the financial information, the focus is on the costs of delivering the growth strategy and the projected revenues, cash flow and profits that will accrue from the growth over the period of implementation.

B. PREPARING FOR THE IMPLEMENTATION PROCESS

Any significant growth or expansion within a business will put pressure on the firm's staff, systems and resources. If cash is extremely tight, the tendency is to take a reactive approach and to delay buying in what is needed until it becomes really necessary. Whilst this approach may be pragmatic from the cash management perspective (which is easily measurable), it can have substantial (but less quantifiable) negative impacts on the running of the business. These impacts might include: pressure and stress on staff; having customers' orders delayed whilst waiting for materials or because of production backlogs; and administration or order processing errors when systems become overloaded. So it makes much more sense, when planning for the expansion, to take a proactive approach to systems and resources, and to put them in place in advance of when they are needed. This is the first stage of the tactical implementation of the growth strategy.

Ensuring Resources Are in Place

If the analysis of the internal environment was comprehensive, it should have highlighted aspects of resources that could potentially inhibit the firm's ability to grow. However, the overall implications for resources will not become clear until the direction of the proposed growth is finalised, so it is necessary to revisit each of the main types of resources with a series of questions to explore and define exactly what the company needs.

- **Staff.** The obvious starting point here is the skills gap analysis (see Chapter 7), which the company should be carrying out on a regular basis to ensure that it has the right numbers of staff and a balance of appropriate skills to operate efficiently. What areas of the business will need additional staff (e.g. sales, production, administration, customer service, installation) and what numbers of extra staff will be required in each area? Are they all needed at once or can they be recruited as the business grows? What specific skills will each role require? Can the staff be recruited locally? What will be the lead time for recruiting and training them to full efficiency? What will be the cost of recruiting and employing them? Has that cost been allocated in the company budgets?
- **Premises.** Are the existing premises adequate to facilitate growth? If not, at what point will extra space be needed? What will the extra space be needed for? Is there space available to expand the current premises or will relocation or an additional site be required? What special facilities are required (e.g. broadband access, cold storage, high security, humidity controls, access for delivery and distribution vehicles)? What is the likely lead time for finding and preparing additional premises for use? What are the options for acquiring them (rent, lease, buy) and what are the cost implications?
- **Plant and equipment.** Will extra capital equipment be required (e.g. for production or handling of goods)? Is this equipment readily available or will it need to be specially commissioned and built? What is the lead time for installation? Does the production equipment necessitate special modifications to the premises (e.g. reinforced floors,

or special power supplies)? What are the likely costs and options for purchase (e.g. lease or buy)?

- Furniture, fixtures and fittings and ICT equipment. What extra furniture, fittings and ICT equipment will be required for extra staff? What equipment will be needed for remote workers (e.g. mobile phones and laptops for sales or technical installation staff)? When will the equipment be needed and can it be phased?
- Raw materials and/or stock. How much raw materials or bought-in stock will need to be held to satisfy the forecast demand from customers? Does it require special storage or materials handling facilities? Will the suppliers be able to meet this demand on a reliable basis? What are the lead times for deliveries of any imported stock? Can it be obtained from supplies on a just-in-time basis? What extra working capital will be needed to fund the cost of holding the extra stock?
- Transport. What additional transport is required (e.g. cars for sales staff, vans for technical support staff, larger delivery vehicles)? What is the most cost-effective and tax-effective way of acquiring these (lease or buy)? What are the likely purchase and operating costs?
- Distribution networks. Are the existing distribution networks adequate to cope with the increased demand that is forecast? What extra geographical coverage (including export markets) will be needed? How long will it take to set up the new distribution network coverage? What will it cost? Are there any options for outsourcing?
- Intellectual property. Is there any additional intellectual property that needs to be registered to enable the growth strategy to go ahead? Is the company's existing intellectual property audited and maintained regularly? Are there any patent licences that need to be renewed?

Implementing Systems to Support the Growth Strategy

The administration and support systems that the company relies on to support its trading activities, process customer orders, ensure legal compliance, and maintain financial and personnel records are as follows.

- ICT and administration systems. Are the ICT systems fit for purpose and working efficiently? Will they be adequate to handle the extra data that will be generated by a substantial growth in business activities? Are the sales order processing and accounting systems robust and capable of expansion, or have they evolved over time as the business has grown? Do they need to be upgraded? Are the IT security systems up to date?
- Legal compliance. Have all the necessary legal registrations been completed (e.g. data protection, VAT)? Are all of the necessary policies and procedures up to date (fire risk analysis, health and safety, induction training, discipline and grievance, etc)? Are there any quality accreditations that are due to be renewed and may need updating (ISO 9002, Investors in People)?
- Credit control. Does the business have an effective credit control system to ensure that invoices are paid on time? Will this need to be expanded to accommodate increased business?
- Customer service and support. Will extra staff be required to deal with an increase in customers? Have the company's quality and customer service policies and standards been updated? Have any changes been communicated to staff and customers?

- Security. Are the company's physical security systems adequate? Have they been tested recently to ensure they are robust and are working effectively? Do they comply with the requirements of the company's insurers? Are any improvements needed?
- Insurance. Do insurance policies need to be reviewed and updated to cover additional premises, additional staff numbers, additional vehicles, greater volumes of stock and/or goods in transit, increased value of plant and equipment, etc?
- Business continuity plans (see Section D of this chapter). Does the business have a business continuity plan in place? Has it been updated in readiness for the expansion programme? Have any changes been communicated to the staff?

Scheduling the Implementation

The planning and scheduling of the implementation of a start-up business plan is described in Section B of Chapter 10. Gantt charts are used to plan the timetable and to identify critical activities and those activities that must be completed before others can start.

The planning and phasing of a growth and development plan involves the same process. The primary difference is that in a start-up business situation, the timescale is typically between 3 and 12 months, whereas a growth and development strategy may involve several phases that can be spread over several years. This is particularly true if those phases involve geographical expansion into international markets, where each market may need to be targeted, penetrated and consolidated before moving on to the next. The limiting factor for geographical expansion is normally finance, and SMEs rarely have the financial resources to target several new markets simultaneously. They tend instead to prioritise their target markets by ease of access and potential profitability; as the first becomes established and starts to generate a profit, they will use the profit and cash flow from that to move on to another. The one main exception to that process is where high-growth, high-tech firms are able to license out production and sales of their innovations using patent licences.

Risk Analysis and Contingency Plans

Risk analysis and contingency plans for start-up businesses are covered in Section C of Chapter 10. The principles and processes that apply to assessing risks (evaluating the probability and potential impact of the risks occurring) and preparing contingency plans for growth and development strategies are exactly the same as those used in the business start-up situation – the only difference is likely to be in the number of risks that need to be assessed and evaluated.

Scaling-up a business operation to achieve growth involves the coordination of a lot more activities, much larger resources and finances, and more people. The risks, therefore, become more numerous and complex – and carrying out a proper detailed risk analysis becomes that much more important. It becomes more critical still when the business is proposing to engage in export markets, where distances and communications difficulties can impede the processes of risk management, turning risks into crises.

Monitoring and Control Systems

Monitoring and control systems for start-up businesses are covered in Section D of Chapter 10, and once again the monitoring and control systems that are needed to support a growth and development strategy are not significantly different. The primary differences are the scale and depth of information.

As the business grows and becomes more complex, the range of monitoring it carries out will need to become more sophisticated. Consider a few examples.

- A larger customer base and a correspondingly larger sales turnover will require greater monitoring of revenues and cash flow, in particular credit control, changing costs, and profitability.
- Budgets forecasts and outcomes will be much larger and will, therefore, need careful and frequent monitoring to ensure that problems are quickly identified and corrected before they cause harm to the company's profitability, liquidity or solvency. Changing raw materials, stock or operational costs can have a major impact on profit margins in a relatively short period of time.
- Sales volumes and revenues may need to be analysed against targets by product, by customer, by sales person, and possibly by country or geographical region.
- An enlarged sales force will need monitoring to ensure that sales costs are proportionate to the results they generate, and that travel and motoring costs are maintained within expected parameters.
- Increased staff numbers will require more careful management and monitoring for sickness, attendance, absenteeism, compliance with working hours regulations etc, for purposes of ensuring correct salary payments, legal compliance, and monitoring staff attitudes and motivation levels.
- Investors or lenders will expect regular (often monthly) financial and progress reports that can influence the availability of staged funding for growth.
- Achievement of growth will not go unnoticed by competitors, so it becomes increasingly important to keep a reciprocal eye on their activities and responses.
- Product and service quality needs to be monitored because of its potential impact on complaints, returned goods, warranty claims, and ultimately customer retention.

The increased scale of operations means that the potential impact on the company and its profitability when problems occur is also increased. As the firm grows and its trading activities spread geographically perhaps across a number of foreign countries, any delays in identifying problems will increase that impact further; so it is imperative to have robust and efficient monitoring and control systems in place.

C. CHANGE MANAGEMENT

Invariably, any proposals to develop and grow a business will generate the need to change the way the business operates, to change its systems and processes to handle increased volumes of activity, to change the responsibilities and workloads of members of staff, and the skills they need to do their work. It can also involve significant physical change, especially if substantial expansion of facilities or relocation of premises is needed. This is where the problems can start: the prospect of change creates uncertainty; people dislike uncertainty and fear what is unknown; and that fear creates resistance to the change. If

this resistance is not properly managed, it can prompt potentially stronger negative reactions to the changes.

Barriers to Change

The implementation of strategic objectives is usually a difficult process because it almost certainly requires significant changes to occur in the business, and any form of change is a potential source of problems or conflict. Fortunately in smaller organisations, any changes are likely to be less extensive, or have less impact, than would be the case in a big company. Furthermore, the change process is often easier within smaller businesses because of the more open and direct lines of communication that normally exist between the staff and management. Similarly, in small firms, the critical but often routine functions or systems that are important to the running of the business tend to be under the close or direct control of the owners or directors. This can be important to the implementation of the new strategies, as any problems that arise within these systems during the change process tend to be noticed more quickly. On the other hand, if the owner of a small firm gets distracted by operational issues and fails to monitor progress, there may be no other person around to spot the problems that are occurring or that are likely to arise.

Before the owners can think about implementing any proposals for expansion or diversification, they need to consider the impact of those proposals on the other people involved in the business, and to gain a perception of their perspectives. For most people, change provokes feelings of uncertainty, uncertainty creates fear and apprehension, fear incites negative attitudes and dissension and, before you know it, the whole workforce has become totally demotivated and uncooperative. Why did this happen? Because the owners probably didn't take enough time right from the start to tell the stakeholders what was going on, and how it would or would not affect them! The attitude of small business owners towards the sharing of information with staff varies widely: some are totally open about their plans; some share just what they feel is needed at any point in time; and some believe that the management of their own business is their prerogative alone and is not to be shared with anyone. It is the latter example of "mushroom management" that tends to create the most fear when change occurs, and clearly the point when the business is preparing to grow is a time when the owner needs the full support and cooperation of staff, so cannot afford to keep them in the dark.

The fears and negative reactions that are spawned by often unjustified fear or uncertainty are referred to as barriers to organisational change; and these might include the following.

- Fear or dislike of what is unknown or unpredictable (although not typically an issue for the entrepreneurs themselves).
- The association of change with threats to job security or downsizing – even when the change process results from planned growth.
- Clinging to tradition/habit/complacency/comfort – it is too easy and comfortable to stay with the status quo, and implementing changes requires effort.
- The natural hostility that people tend to have to new ideas that are cascaded from above/not generated by themselves/not directly involving themselves.
- Perceived threats resulting from not understanding the implications of the change.
- Threats or challenges to established/ingrained attitudes/cultures.
- Feelings of personal inadequacy and/or stress that may be aggravated by poor communication about the nature of the changes.

- Inadequate organisational structures or flexibility of those structures to accommodate the proposed changes without major problems occurring.
- Lack of confidence from staff in the competences of management.

These are some of the symptoms of resistance to change that arise from those barriers.

- Increased rates of sickness and/or absence from work.
- Increased complaints from customers/reports of product or service quality problems.
- Circulation of unfounded rumours within the organisation, e.g. threat of redundancy.
- Aggression/indifference shown towards managers or staff in authority.
- A fall in rates of output or productivity.
- In extreme cases, damage/vandalism/sabotage of equipment.

Managing the Change Process to Overcome Potential Problems

For the owners or business managers, the first step in avoiding these problems is to carry out a stakeholder analysis. This identifies how the changes resulting from the growth and development strategy might impact on the various stakeholder groups, in particular staff, customers and suppliers. This process is outlined in Section A of Chapter 11, and it enables the owners to identify everyone with a concern or interest who needs to be positively engaged during the change process.

The effective management of change is a skill most people learn by default or in retrospect, and it is something that small business owners tend to be insensitive about and poor at handling. This is usually because the sole focus of their attention is on what they want the business to achieve, and not on how to get the other stakeholders around them to help them in the process.

Effective management of change requires good, clear communication that informs stakeholders of exactly what is being proposed and how they can expect it to affect them right from the start of any new project. It is essential to communicate proposals to customers, staff and other stakeholders so that they understand the need for change, and the purpose and importance of the changes being made. It is also imperative to gain staff commitment and “buy-in” to the change process, to generate cooperation and support from them from the outset. Involve them, perhaps, in planning the change process, consult them at regular intervals, and then keep them informed of progress and issues to minimise potential doubt or fear of what might (or might not) happen. The key steps in this process are as follows.

- Decide when the change will be announced and try to minimise rumours and false information before that date. If negative news leaks before it is announced, don't lie or drop hints – give a definite date for a full announcement.
- Decide exactly how you will communicate information about the change to your staff and ensure that they are all told at the same time to avoid them being made to feel that they are getting the news second hand.
- Keep the staff informed of what is happening right from the start. It is not necessary to tell them every single graphic detail of what will be happening, but by outlining the main changes that will occur you can avoid the sort of speculation and rumour that creates fear and demotivation.
- Sell the benefits and advantages of the changes to staff (where possible) and relate the changes to the long-term objectives of the organisation. Play down disruption as

an issue of short-term inconvenience, and promote the prospects of secure employment and development opportunities that the long-term profitability of the business will confer.

- Consult with appropriate parties at each stage – staff representatives, line managers, etc – and don't allow lack of information to breed opposition to the change. Be prepared to commit time for full discussions with staff and stakeholders so they don't feel that their concerns are being ignored or brushed off.
- Ensure they understand the need for change, and try to gain their commitment at all stages – don't ignore problems or uncertainties. Listen carefully to their concerns and objections to get an insight into their perceptions of the change, and respond positively to them. Give them regular opportunities to air their views and specific channels to do so, perhaps a short weekly feedback meeting with representatives or supervisors. This again contributes towards the ownership of the changes, and to breaking down any barriers that might stand between them and what you want to achieve.
- Review the process at each stage – set new targets, deadlines, etc – and keep staff fully apprised of project progress. Consult them about details of the implementation: not only does this help with the ownership of change, it will almost certainly throw up some useful or practical ideas that you have overlooked and which could make the implementation easier.
- At the end of the process, thank them for their cooperation; if it has been a success, perhaps make a special occasion out of doing so. You might need their cooperation again in the future.
- Finally, critically evaluate the whole process at the end, and learn from any mistakes in preparation for the next time.

There are a number of theoretical models for the effective management of change. One of the most frequently used is Lewin's (1947) three phases.

- Unfreeze. Determine what needs to change/Ensure there is strong support from upper management/Create the need for change/Manage and understand the doubts and concerns.
- Change or Transition. Communicate often/Dispel rumours/Empower action/Involve people in the process.
- Refreeze. Anchor the changes into the culture/Develop ways to sustain the change/Provide support and training/Celebrate success!

D. PLANNING FOR THE LONGER TERM

There are three key areas of strategic planning that fall outside of the development of growth strategies for a business, but which still need to be considered because of the impact they can have on plans for growth and development. Although these do not form part of the Enterprise and Business Development syllabus, they are worth briefly mentioning.

Succession planning, the development of exit strategies, and the preparation of business continuity plans are each parts of the strategic planning process that need to be put in place at senior level, as they can all have an impact on the future direction of the company or its survival.

Succession Planning and Exit Strategies

It is estimated that 76% of all UK firms, and 85% of EU firms, are family-owned sole trader or partnership businesses. Of the remaining 24%, many are small private limited companies under family ownership or control. Only 30% of family firms survive in that form to the second generation, and only 10% survive to the third generation (Coulter 2003).

Ownership and succession problems can arise when the principal owner (or a partner in the business) dies, becomes sick over the long term or disabled, decides to retire or sell up and transfer or offer ownership and control to other family members or company directors. Problems also arise when the principal owner decides to sell the business, potentially leaving other family members under new management; or when a partner decides to cash in the value of his or her share of the business. Similarly, if there are no potential partners, directors or inheritors of the business, or if there are but none wish to actually take control, then the person or persons wishing to leave are faced with a decision about whether to sell the business or to employ managers to continue to operate it. Where there is no obvious route for succession of business ownership, then the business owners will need to consider alternative exit strategies.

It is important, therefore, for entrepreneurs to consider their exit strategies on an ongoing basis throughout their involvement in the business. This is not only because they need to be able to plan how and when they will leave or sell the business, but because the decisions they make about investment and growth (or otherwise) may impact on the potential exit point, or vice versa. Serial entrepreneurs and those planning high-growth and high-tech start-ups tend to integrate their exit strategy with the business plan, so they know at approximately which stage of development they will sell. For example, it is quite common for entrepreneurs involved in biotech start-ups to develop the technology to a point where it is proven and tested and has IPR protection, so that the business has grown substantially in value but will require considerably greater external investment to grow it further. The exit route in this case would typically be a trade sale to a larger rival company, which would buy the company and its IPR, or to a specialist biotech venture capital firm, which would invest in the next stage of growth before realising its profit through another exit route.

Here are some examples of exit strategies.

- Family succession plans.
- Sale of the business as a going concern (trade sale).
- Merger with another firm in the same market.
- Sale to staff or managers (a management buyout).
- Sale to a venture capital investor or investment institution.
- Sale by a venture capital investor back to the original entrepreneur(s), to its staff, or to a rival company.
- IPO (stock market flotation).
- Sale of business assets (including IPR) and closure.
- Liquidation.

Good practice in succession planning follows a number of basic principles.

- It should be commenced years ahead of when it is needed, and ideally at the outset of the business.

- The options should also be examined in the context of the overall skills, abilities and personal objectives of the owners – not just whether or not they have the necessary skills to operate and grow the business in the longer term, but whether or not they have the interest or inclination to do so.
- If the inclination to continue the business is present but the skills are lacking, then actions can be defined to get the necessary skills in place for when they are needed, and transfer of control can be staggered over a period of time.
- A risk analysis must be an integral part of any succession planning process to identify potential risks and to formulate the necessary contingency plans to deal with them should they arise.
- It is in the best interests of the business and all of its stakeholders that succession plans should be published to stakeholders to remove any possible confusion and to give time for any objections to be addressed. The confidence of banks, key customers and suppliers in the future of the firm will be sustained if they are aware in advance of the proposed changes and their implications.
- Long-term planning for succession is also essential for the long-term planning of potential tax liabilities, both for owners or directors wishing to exit the company and for those that will remain or replace them. Careful planning to minimise tax liabilities for the inheritors, and the financial impact of that on the cash reserves of the business, should be started as early as possible.

When most entrepreneurs talk about exit strategies, they are usually referring to their own exit from the business – either selling it to a third party for profit, passing it on to a relative as part of planning for retirement, or installing a manager to run it for them. In the context of venture capital funding, it is the venture capitalists that are planning their own exit from the business. For an entrepreneur who wants to raise capital to expand, venture capital is an attractive proposition as it offers interest-free equity, usually accompanied by supportive business expertise from the venture capital firm. In return for the risks that they take, venture capital companies expect to make their profit primarily from capital growth as opposed to dividends from profits. The investigative process of “due diligence” by the venture capital investor is quite rigorous but once it is completed, an agreement is formulated wherein, after a specified period of time, the venture capital company “exits” the business by a pre-agreed process so that the capital growth can be realised. This specified period of time is usually three to five years but can sometimes be as much as ten.

The method of exit varies, but typically it would involve one of three options.

- Flotation of the company shares on the Alternative Investment Market or similar, known as an Initial Public Offering. This gives the entrepreneur the option of realising his or her share of the growth at the same time, by selling all or part of the shareholding, if desired.
- The sale of the business to another firm in the same market, known as a trade sale. This usually requires the exit of both the venture capital company and the entrepreneur, unless the entrepreneur makes a private arrangement with the purchasing business to stay on.
- Receivership, if the company fails, or liquidation, if the venture capital company decides that the investment is no longer viable and wants to sell the assets to realise some cash.

Business Continuity Plans

When a disaster occurs, irrespective of the cause, it is impossible to keep all functions within the business operating normally, and it would be totally unrealistic to even try. The purpose of business continuity planning is to identify and prioritise the critical functions to keep the business operating – most typically the service provision to customers, organisation of staff, sales operations, IT systems, and a functional operating base. Things like other day to day administration and accounts can usually be postponed for a few days until the immediate crisis settles down and order starts to be restored.

A great example of this process in practice was the House of Reeves furniture store in Croydon, England, which was totally destroyed by fire in the summer riots of 2011 after over 100 years of operation on the same site. The owners just calmly opened up their storage warehouse opposite, arranged for temporary signage to direct customers: the company was open for business again within 24 hours, albeit operating on a reduced basis in less than auspicious premises. That was not actually a planned example of business continuity planning but it still worked in practice and because of the swift action to make the best of a bad situation, the company survived. Interestingly, in contrast, it is reckoned that 50% of businesses that experience a major disruption do not survive beyond two years.

Business continuity management is defined by the Business Continuity Institute (www.thebci.org) as: *“an holistic management process that identifies potential impacts that threaten an organisation and provides a framework for building resilience with the capability for an effective response that safeguards the interests of its key stakeholders, reputation and value creating activities”*.

The British Standards Institute (www.standardsuk.com) defines business continuity planning as: *“[a] strategic and tactical capability, pre-approved by management of an organisation, to plan for and respond to incidents and business disruptions in order to continue business operations at an acceptable pre-defined level”*.

The primary objective of the business continuity management process is: *“to allow the Strategic Management of an organisation to continue to manage their business under adverse conditions, by the introduction of appropriate resilience strategies, recovery objectives, business continuity and crisis management plans in collaboration with, or as a key component of, an integrated risk management initiative”* (Business Continuity Institute).

Business continuity is about the strategic and tactical capability of the organisation to plan for and respond to incidents and service disruptions, in order to continue critical functions and operations at an acceptable pre-defined level and in compliance with relevant legislation, standards and corporate governance – i.e. to maintain service provision to customers whilst ensuring normal legal and regulatory compliance. Maintenance of service provision is of particular importance where the services provided by the company are statutory requirements or are part of a legal contract to deliver statutory services (e.g. fire and rescue services, security, social welfare).

A business continuity plan (or strategy) will typically include the following.

- Disaster recovery plans, specifying the short-term actions to be put into place immediately after the disaster, and then the subsequent, medium-term actions to re-establish more normal levels of operations.
- ICT systems back-up facilities/data security systems – most companies that are reliant on ICT for their business activities have some sort of back-up or secondary system: not just a daily back-up of data files, but perhaps a remote server location or back-up server in case one fails.
- Arrangements for temporary relocation for part/all of business – perhaps via a reciprocal arrangement with another local small business, although preferably not a rival or one operating in the same market.
- Staff awareness and training about the firm's business continuity plan and how it relates to each area of business activity, with regular updates and ideally periodic (annual) testing of parts or all of the process.
- Allocation of specific roles and responsibilities to staff in readiness for any disruption, with duplicate instruction to ensure coverage for staff who are absent due to the disruption.
- Allocation of secondary staff contacts for customers, ideally with personal introductions so that customer contact is maintained during any disruption of business.
- The final stage is to embed the process of business continuity management into the structure and culture of the business.

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