

Business Insight


SPECIALIST ADVICE FOR GROWING BUSINESSES

ISSUE 6 2011

How to respond to
a tax investigation

Reduce risks from
long tail liabilities

Explore alternative
financing options



The background image features a magnifying glass held over a financial table. The table contains various stock market data, including indices like FTSE 100, FTSE 250, and FTSE All Share, along with numerical values and percentage changes. Three miniature figures in business attire are standing on the table, appearing to be in a discussion. The magnifying glass is positioned in the lower right, focusing on the figures and the data beneath them.

Close-up on profit

Businesses squeezed between tough
suppliers, rising costs and price-sensitive
customers can magnify their profits

INSIDE Protection against historic risks ■ **When a tax inspector calls** ■ Invoice discounters and factors
■ Perspectives on doing business in Europe ■ Menzies: 100 years of innovative service



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news

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Menzies launches business recovery arm

In the latest step of Menzies' strategy of developing its brand as a specialist service provider to owner-managed businesses, it has launched a new business recovery arm with the acquisition of the London office of insolvency specialist Benedict McQueen, the London representative of Benedict Mackenzie.

Following recent negotiations between the firms, Simon Underwood and Laurence Pagden join the newly established Menzies Business Recovery LLP as partners, bringing with them a support and administrative team. Benedict Mackenzie's other offices remain unaffected by the move.

The support and administrative team will be based at Menzies' London office and will focus on insolvency and recovery work for small and medium-sized businesses,



Menzies' expertise has broadened to include insolvency

as well as forensic investigation and litigation support.

Mike Sands, Menzies' Senior Partner, says: "We are delighted to welcome a team of such experienced practitioners, who will add significantly to the range of services offered under the Menzies brand."

Payroll team achieves top industry award

The payroll bureau at Menzies has been awarded the highest accreditation by the payroll profession's membership association, the Chartered Institute of Payroll Professionals.

The team, which provides a payroll bureau service to more than 1,200 businesses in Surrey and Hampshire, has been accredited as a Payroll Quality Partnership. The award is recognition that an organisation has achieved best practice in the professional development of its payroll staff.

"Employees expect to be paid the right amount, and to be paid on time," says Denise Love, Senior Manager of Menzies' payroll bureau. "PAYE is a headache for most employers, but it's an area that they simply cannot afford to get wrong. We worked hard to earn this award and are delighted as very few payroll providers have managed to achieve this. It shows our commitment to providing our clients with a quality service."

The Payroll Quality Partnership promotes continuous learning and development so that payroll professionals give their customers the highest levels of value and service.

UK taxation ruling

A recent decision by the Upper Tier Tribunal in *Anson v. HMRC* (aka *Swift v. HMRC*) is an important one for UK individuals and companies that are structuring investments into the US. The limited liability company (LLC) can present tax planning opportunities, but with the entity being treated as transparent in the US and as a corporate in the UK, the cross-border tax implications need to be fully appreciated in both territories.

The Upper Tier Tribunal reversed the decision of the First Tier Tribunal and held that the Delaware LLC, of which George Anson was a participant, was not transparent for the purposes of UK foreign tax credits. The decision confirms the UK tax authorities' customary position that a US LLC is to be treated as an opaque entity for UK tax purposes. This accompanies the guidance set out by HMRC and the principle understood by UK tax practitioners.

The US tax authorities taxed Anson's share of the Delaware LLC's profits on the basis that it was a transparent entity. He was non-domiciled in UK, and so was



taxed on remittances, including his income from LLC.

An LLC formed in Delaware is taxed transparently in the US so that its profits are taxed as the income of its members. In the UK an LLC is treated as a company.

The UK tax authorities contended that the LLC was a corporate entity for UK tax purposes and that it had paid the equivalent of a dividend. In the UK, double tax relief on underlying taxes paid on corporate entities' profits is only available to corporate shareholders and therefore no credit was available to Anson.

The Upper Tier Tribunal's judgment held that Anson did not have a proprietary interest in the profits of the Delaware LLC and that the profits belonged to the LLC. The contractual obligation to allocate profits to the members did not mean that the profits belonged to the members themselves.

“This year we have grown by 50% and doubled the number of staff. The business is unrecognisable.”

Andrew Parker, Managing Director of FTI, see page 6. >>

Menzies tax professional wins top award

A member of the Menzies tax team has won an award for achieving the highest mark in the country for her professional tax exams. Lorraine Young, Assistant VAT Manager at Menzies LLP, has been awarded the Victor Durkacz Medal by the Chartered Institute of Taxation for her performance in the institute's Advisory Paper on UK Domestic Transactions.

Lorraine is now a Chartered Tax Adviser, the highest level of tax qualification possible in the UK. She joined Menzies seven years ago and advises owner-managed businesses on VAT and tax.

Richard Godmon, Tax Partner at Menzies, says: "Candidates from the UK's largest accounting firms sit these exams, and so to achieve the highest mark is a truly outstanding accomplishment."

RED TAPE ALERT

Europe backs UK enterprise

The UK tax system must seek EU approval for certain tax breaks deemed state aid. The EU has now allowed investors into Enterprise Investment Schemes (EIS) companies to obtain 30% tax relief on their investment, as well as doubling the annual investor limit to £1 million. The Treasury is hoping EIS will increase investment into small companies and help to kick-start economic growth.

But investors should be wary – some companies offer little else other than tax breaks.

Changes to minimum wage

As of 1 October 2011 the rates and age bands of the national minimum wage have been changed. Employees aged 21 and over now earn an hourly rate of £6.08 (up from £5.93); employees aged 18 to 20 earn £4.98 (£4.92); employees aged 16 to 17 earn £3.68 (£3.64). Apprentices under 19 or in the first year of apprenticeship get £2.60 (£2.50).

New regulations also prevent mandatory tips, gratuities and service charges from counting towards the employer's obligation to pay the minimum wage.

New tax return penalties

HMRC is reminding individuals and businesses about new self-assessment penalties for late returns and late payments, which come into effect this autumn and will affect self-assessment returns for 2010/11, and all future financial years.

Tax return deadlines remain unchanged despite the new penalties for paying late. Taxpayers could inadvertently find themselves on the wrong end of a significant penalty. HMRC should try to ensure it does not ask for a return without good reason, and that it publicises penalties widely.

Respite from 50% tax rate is less likely

The UK's top earners should not expect respite from the 50% income tax rate any time soon, as France has now announced an extra tax as part of a programme to cut its deficit by €2 billion over two years.

But the French top rate is significantly less than the UK's, moving from 41% to 44% on incomes above €500,000. The highest rate of UK income tax applies a 50% rate to income more than £150,000 a year.



Close-up on profit

Companies are being squashed by suppliers, crushed by rising fixed costs and squeezed by customers looking to keep their own expenditure down. Many are seeing their profit margins reduced to a fraction of pre-crunch levels – but there are ways to increase profit, **Sarah Coles** writes.

The first step for businesses looking to restore their profit margins is to put in place proper management reporting to identify the most and least profitable areas of the business. “Business owners often don’t know the products and services which are making the most profit,” says Mark Perrin, a Partner at Menzies. “You need this information to make good quality business decisions.” Hidden costs such as labour input, packaging, management time and distribution costs can cause businesses to overestimate the profitability of key products and services.

Tim Dunn, also a Partner at Menzies, says the process can yield some surprises: “The largest clients can actually prove the least profitable as they can negotiate discounts and absorb the time of senior management, which can make a major difference to profitability.”

Paul Hickson, another Menzies Partner, cites a company that had seen turnover increase in recent years. However, with the right reports, he showed the company had made more profit on a lower turnover three years earlier because it had been selling higher margin services. “It helped focus their attention on the mix of products and services being sold rather than just chasing turnover,” he says.

Golden ratio

The second step is an understanding that profitability can be improved by selling more products and services to existing customers. “We always look for the 80:20 ratio, where 80% of business comes from 20% of customers,” Perrin says. “We want to focus on that segment, because

it’s usually the 80% of customers generating 20% of the business that create the most problems.”

Hickson adds: “Businesses need to take a step back, look at the top 20% of customers and ask how often they are starting a discussion with them about their biggest business issues and how they can help solve them.”

Third, companies can sell existing products and services to new, more suitable customers. Bringing in dedicated sales and marketing expertise may be a steep change, Hickson says, but it can make a dramatic difference to the business. Perrin says that assessing the characteristics of an ideal customer can also help.

A fourth option is to put prices up. Perrin says prices should be as close as possible to the “glass ceiling” where they are deemed too high. “We had one client that started to put day rates up. They got to the point where they had doubled day rates and nobody complained.”

Fifth, businesses can look at the other side of the profit equation and rationalise costs. “It’s not an opportunity to beat people down on fees because the easy savings have been made; it means challenging the fundamentals of the process to make it more efficient,” Hickson says.

Richard Godmon, a Tax Partner at Menzies, says tax incentives are another aspect. “A business should make

It’s usually the 80% of customers generating 20% of the business that create the most problems.



Examination of a
business's books
can boost profits

sure they maximise their research and development tax credits and capital allowances: they need to be tested at all times." One client, Gordon Murray Design, has received a substantial payout through R&D credits (see box, page 6).

Extract profits efficiently

Profit, once made, should be extracted in the most efficient manner possible. "I am always asked whether salary or dividends are the best approach, but the answer depends on the circumstances," Godmon says. "It starts with understanding objectives for the next year, three years, five years or ten years. It leads on to how the business should be structured and owned. That flows through into how you extract profit." There are five common considerations.

The first is salary. In many instances it may be appropriate for salary to be kept low, as income tax and national insurance burdens are so hefty. However, where there is a contract in place, salary must not be lower than the national

minimum wage. Godmon advises that it may be appropriate to pay a higher level of salary, for example, for mortgage or pension purposes.

Dividends are a popular alternative because they are not liable to any form of national insurance contributions and are tax-free where they fall within the basic rate band of the shareholder. However, rules must be followed regarding the level of dividends in comparison to the level of profits made, and dividends are subject to tax where they come above the basic rate upper threshold.

Third, pensions provide more options since the introduction of the Self-Invested Personal Pension (SIPP), which allows a personal pension to invest in commercial property. Godmon says buying premises or a warehouse opens up new possibilities. "They can contribute to a SIPP tax-efficiently then use the SIPP to buy the property. The business will then rent the property from the pension scheme. It's an incredibly tax-efficient way to extract cash." >

> A share ownership plan is the fourth option. This can be highly effective but shares must be used in a way that suits all shareholders. Perrin says: "When you have three or four director/shareholders you need to understand everyone's personal position and find the line of best fit." For example, shares held by directors can be given to family members to enable dividends to be paid to a spouse or an adult child.

The Enterprise Management Incentive (EMI) is a popular share option scheme. Although this is highly tax efficient, Godmon warns that it must be properly explained to staff. "The worst type of EMI is when the paperwork is just presented to staff and they think the company is about to be sold and that they are about to lose their jobs."

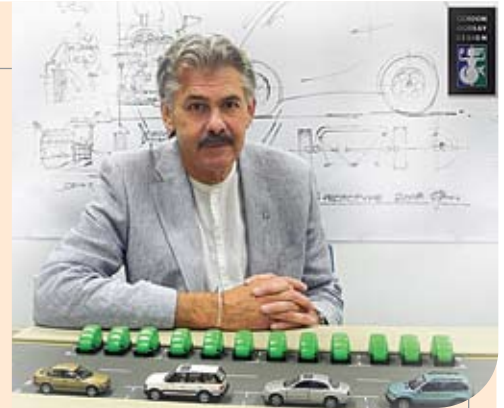
The fifth consideration is some kind of more advanced planning, using employer financed retirement benefit schemes or employee benefit trusts, for example. However, Godmon cautions that more aggressive schemes are not for the fainthearted. "They don't come with any guarantees. HMRC is continually changing the rules and they can

CASE STUDY

Gordon Murray Design

Gordon Murray Design Limited obtained payments of just under £1 million from the Government for the first two years of its project – a new car manufacturing process to cut production and running costs, lighten vehicles, improve space utilisation and boost fuel economy.

Gordon Murray designed Formula 1 racing cars for Brabham and McLaren, before going on to design the McLaren F1 sports car. His latest project is a new small car that seats three people, weighs only 575 kilograms, delivers around 96 miles per gallon and is built using a unique, holistic manufacturing process known as iStream.



Cashflow is crucial for the design stage – there are no sales revenues and usually the only source of cash is from investments in equity or loans. Menzies proposed an R&D tax credit claim, designed to maximise the cash recovered from HMRC at this critical time, culminating in a six-figure payment.

apply retrospectively, so you may receive no benefit."

Leaving the cash

Alternatively, business owners can choose not to extract the cash from the business at all. "Leaving the cash in the business is a perfectly valid remuneration plan," Hickson says.

Dunn notes that this option can also mean less taxation. "You would

need advice if you planned to sell the business and bring it into the capital gains tax regime, but even that is a lower rate of tax. Quite often we will ask how much money the owners actually need from the business because there's no point in taking more than you need and then paying tax on it. The client may feel that they have earned this money, but in some cases it's about thinking as a shareholder rather than as an employee."

In such a difficult economic environment, where HMRC is challenging every attempt to pay less tax, owners should be open-minded to change. "A lot of business owners make decisions on a gut feel of how the business is performing," Perrin says. "You have to respect that because it is their business and no one knows it better than them, but when you go through the detail of the whole picture it can enable them to be more objective and it can often lead them to better decision making."

Sarah Coles is a past winner of the Watson Wyatt media award for excellence in journalism.

CASE STUDY

FTI profits from New Horizons

Andrew Parker, Managing Director of FTI, a supplier and manufacturer of instrumentation products, has been working with Menzies on a 'New Horizons' project. The process – breaking the business down into 12 areas then challenging what is done and how – has made a massive difference. "This year we have grown turnover by 50% and doubled the number of staff. The business is unrecognisable."

The first step was to put in place a new management accounting system, which enabled scrutiny of individual product lines and customers to see what each customer buys and what profit has been derived.

Parker says: "It meant we could spend more time marketing to more profitable areas and reduce our exposure to large suppliers. The following year we increased our margins by 4-5% and decreased our exposure to our largest supplier from 45% to 35%."

The company has also set up new methods of profit extraction, including an EMI scheme. "The scheme has allowed us to establish a tax-efficient reward mechanism for a newly employed director," Parker explains. "We are also contributing into a SIPP which in the longer term we will use to fund purchasing a commercial property, an extremely tax-efficient strategy for us."

More information

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Historic risks

HWM is a successful motor dealership with an interesting past: in the 1940s and 1950s the company built and raced its own sports and Grand Prix cars, and was one of first British teams to compete in Formula One. But, without assistance from Menzies, its history might have cost HWM dearly, finds **Paul Gosling**.

The family business, today the Surrey agency for Aston Martin and Alfa Romeo, was unprepared for attempted legal action when an employee from the post-war period died from asbestosis. Despite having only worked for HWM for a short time, lawyers acting for the ex-employee's family took legal action alleging that his illness dated from his spell in HWM's employment and sought a payment of £400,000 in compensation.

"This particular claim was highly speculative as the person had only been there for a year and it became clear that they had little evidence to support their claim," explains Menzies' Partner Salvador Amico. "My client sought legal advice and, rightfully, everyone realised there was no case to answer."

Historic liability

However, the experience persuaded HWM and Menzies to look again at the company's structure. If this happened once, could something similar happen again? They decided it was sensible to

protect against other potential liabilities emerging from history that could threaten the existence of the business.

"No one had expected the claim, or could have predicted it," says Amico. "HWM's Managing Director is a lawyer and he understood the risks. At one of our regular meetings we discussed the possibility of restructuring the group."

While we have a responsibility to former employees, we also have a responsibility to our current employees and the people we transact with.

Managing Director Andrew Harting explains that some of the company's potential liabilities had a long tail, particularly under certain types of public employment liability legislation, where there is no time limit. "While we have a responsibility to former employees, we also have a responsibility to our current employees and to the people we transact with on a day-to-day basis to

ensure there is some certainty about our liabilities and to ensure there are no non-time limited liabilities that threaten the future health of business," he says.

"We have put a lot of time and effort into making sure our business is robust and that we can deal with the economic climate, and manage the business's current liabilities. But liabilities that date back 60 years can disrupt all the planning that we have done."

Insulated

Harting says Menzies helped him to create a corporate structure with a separate holding company and trading company that would be insulated from potential historic liabilities. "It is important to stress that the objective is not to escape liabilities," he adds. "The liabilities faced by the trading company are the current trading liabilities, rather than historic environmental liabilities."

Moves towards restructuring are under way but take time to complete, says Harting. It is essential, he adds, that restructuring is conducted to maximise tax and organisational efficiency. "One of the advantages was that it allowed





HWM's motor racing legacy also had the potential to turn into a business liability



Small firm, big risk

While corporations typically employ risk managers to mitigate and prepare for risks, most SMEs are unable to devote comparable levels of resources to the role. Yet SMEs often face similar risks to large corporates.

John Hurrell, Chief Executive of the Association of Insurance and Risk Managers, says that more small firms should consider the "emerging risks" of liability and business interruption linked to increased reliance on IT and sometimes termed 'cyber risks'.

"Many corporations are more dependent on IT now than they were a couple of years ago",

Hurrell points out. Hardware failures or cyber attack can cause severe difficulty, as can data loss and breach of data protection regulations.

Globalisation presents another emerging risk. SMEs extending their range of suppliers need to be aware of partner companies' business practices and security. Risks can include political instability, reputational risk where working and environmental practices are poor, and intellectual property theft through counterfeiting. "Many large organisations have been caught out by these problems," warns Hurrell.

us to create a company with a modern constitution, giving us an opportunity to clean up our balance sheet and get rid of some old classes of deferred shares that no longer had any relevance." Restructuring also brings the possibility of creating an employee share scheme.

Harting says that Menzies was an important partner, because it understood

both the business and, as accountants, the future and current trading position. Menzies' tax expertise also means that the reorganisation is tax-efficient and will take into account future tax planning, he adds.

While most companies are not exposed to comparable historic risks, there are many other threats to be considered. One of the most common,

says Amico, is where a proprietor is expecting to take value from a company's property, but the viability of the firm is undermined by current trading conditions.

"Freehold property might be seen by the proprietor as their retirement fund," continues Amico, so restructuring to separate property ownership from a trading operation may be the best way to protect value. There are downsides to reorganisation – group structures create administrative complexities and greater expense. "A decision needs to be taken about whether that is worthwhile," he says.

Businesses and proprietors certainly have a greater need to prepare and protect assets today than they did in the past, Amico advises. "We are seeing more claims being made against companies. We are becoming a more litigious society, partly as a result of the recession."

More information

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How to respond to an HMRC investigation

If an HM Revenue & Customs inspector turns up unannounced, don't panic, explains **Sarah Perrin**. Seeking out expert advisers straight away and letting them take control of the situation can save stress.



The taxman is on the warpath, with taskforces and campaigns under way aiming to collect an additional £7 billion in tax revenue each year by 2012/13. Intensive "bursts of compliance activity" are targeting business sectors that are considered to be high risk for HMRC, such as restaurants and fast food outlets, plumbers, medical practitioners and private tutors.

According to Mike Eland, HMRC's Director General Enforcement and Compliance, "Only those who choose to break the rules or deliberately evade the tax they should be paying will be targeted. Honest businesses have absolutely nothing to worry about."

Is there a need for business owners to continue to worry? "The Revenue does have the power just to turn up," notes Menzies Tax Partner Simon Massey. "This power is very rarely used, however, and HMRC doesn't want to abuse it, so clients should not be worrying unduly."

Nevertheless, the HMRC's inspectors are on a campaign to reach their targets and more inspections are on the horizon. "We anticipate more clients will be asked to justify their income and lifestyle in the future," says Menzies Tax Partner Richard Godmon. "HMRC are planning to increase their inspection visits and become firmer with business owners."

Apart from cases where fraud is suspected, HMRC generally gives at least

seven days' notice of an inspection visit. "Clients should then contact us straight away," says Godmon. "We try to deal with any issues by correspondence, which is less stressful for clients."

If an inspector calls...

If you do find an HMRC inspector on your doorstep, the first rule is: do not invite them in. "If an inspector turns up unexpectedly, you don't have to admit them," Massey says. "You don't need to let them cross the threshold, and certainly not beyond your reception area."

Business owners should not feel awkward about this. "You wouldn't allow anybody else access to your premises without checking their identity," says

A calm, unified front
is the best way to deal
with HMRC inspectors

Massey confirms the importance of professional support. "Unfortunately for the taxpayer, HMRC more often than not makes a presumption of guilt," he says. "If inspectors turn up unexpectedly, business owners are inevitably unprepared, both mentally and in terms of documentation. In opening meetings HMRC inspectors will ask questions that support

Companies selected for checks and inquiries are almost always consistently late in filing their tax returns. To keep under the parapet, you should always try to file on time.

conclusions they have already reached so you need sufficient clarity of mind to handle that." Professional tax advisers can apply that clarity and control the situation.

Reasonable obstruction

If the inspector has not arranged the visit in advance and has no search warrant or official notice, Menzies can ask them to withdraw, on the basis that the client is being advised not to grant access to any business premises, assets or information.

HMRC officers may argue that their visit is being obstructed, but this is not a criminal offence. A civil penalty of £300 could be imposed in certain circumstances. "We advise clients not to be phased by the threat of an obstruction penalty charge," Godmon says. "The consequences can be more serious if they just let the inspector in."

If an HMRC inspector does enter your premises, they should be accompanied at all times – by you or your adviser. Remember that they cannot open cupboards or enter rooms unless invited to do so.

Inspecting books and records

If made available to them, HMRC officers may inspect and copy business records, including statutory books, business books and papers, documents relating to PAYE, VAT and

other business matters. Private records may also be inspected if they contain business transactions, as can assets in the form of stock.

"Inspectors can also interrogate computer records," says Godmon. "They will, therefore, try to remove computers. You can verbally refuse their removal, but not physically." Always obtain a formal receipt for computers, stock and any other records that are removed.

Note that while obstruction is a reasonable action, concealment of tax-related documents is not. Deliberately hiding or destroying documents can amount to a criminal offence, as well as attracting a penalty.

Keeping out of the spotlight

HMRC inspections and investigations are stressful, so are to be avoided if at all possible. "Companies selected for checks and inquiries are almost always consistently late in filing their tax returns," says Godmon. "So to keep yourself under the parapet, you should always try to file on time."

Including estimates and round-sum numbers could attract attention so should also be avoided. "It's important to keep books and records up to date," Massey adds. This includes all accounting and business records, details of income and expenditure, assets and liabilities, paying-in slips, purchases and sales information, VAT and PAYE details.

Finally, make good use of professional expertise. "Menzies has a good reputation with the Revenue – not for being a pushover, but for being an organisation that's straightforward and reasonable to deal with," Massey says. "That's helpful for our clients, for whom we always aim to provide calm reassurance."

Sarah Perrin is a qualified chartered accountant and a professional freelance journalist and writer.

More information

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Massey. "As long as you are courteous, the inspectors should respect that you are taking a diligent approach to protecting your premises."

The next step is to find out some key details. "Ask for identification, the inspector's name and office, and try to find out why they are there," Godmon advises. "Then call us and we will speak to the visiting officer by phone. We will ask about the reason for the visit and see if it is practical for us to attend. We will then ask the officer to wait for us."

Professional support is vital. "Tax inspectors are highly trained," Godmon says. "If we are involved early on, it can be the difference between a successful outcome and a very large tax bill."

Alternative finance



Business owners who are struggling to get a bank loan or overdraft extension could find invoice discounting or factoring a worthwhile solution, as **Mark Williams** discovers.

As the spectre of recession once more stalks the UK economy, the threat of falling consumption and declining orders means many companies are seeking a restructuring of their finances to ensure they are protectively positioned. In these testing times, businesses that can draw on alternative sources of finance could gain the upper hand.

Jeremy Rayment, Menzies' Corporate Finance Director, says bank lending is not always the best option. "Some businesses are still struggling to get a bank loan, while others are put off by lending rates and having to provide security," he says. "Whether it's to ease short-term cashflow problems or even grow your business, there are other options, including invoice discounting and factoring."

Asset-based lending

Invoice discounting and factoring, forms of asset-based lending, have become more common in the UK. Invoice discounting enables businesses to draw against their unpaid invoices. "Importantly, the business retains control over its sales ledger," Rayment says. "However,

factoring involves selling your invoices to a 'debt factor', who takes over collecting debts and managing your ledger. Factoring involves conceding debtor collection control."

Typically, invoice discounting and factoring give up to 80% of the invoice's value and receive the balance once paid – minus interest and transaction fee. "But, if you have to pay £7,500 during a year to avert a serious cashflow crisis or free up cash to make £150,000 of additional sales, it's worthwhile," Rayment says.

Some businesses are still struggling to get a bank loan. Whether it's to ease short-term cashflow problems or grow your business, there are other options – including invoice discounting and factoring.

Specialist arms of banks usually provide invoice discounting and debt factoring services. Such finance mirrors your business cycle. "The more sales you make, the bigger the facility and because the sum advanced is based on sales, it lessens risk. Invoice discounting and factoring can be more expensive, but all you're doing is sacrificing some profitability for less risk."

Management buy out

When Ben Sangster and Debbie Berrie wanted to stage a management buy out of southwest London-based recruitment agency Rearden Cord, invoice discounting provided the solution.

"The discounter we used was Lloyds TSB – our bank. Discounting provided most of the money, with the rest from a bank loan," Sangster says.

The buy out took seven months. "Setting up the invoice discounting arrangement was complicated at first," Sangster admits. "We still use it. Our credit term with most customers is 30 days but discounting gives us about 90% of money we're owed almost immediately."

Would Sangster recommend invoice discounting? "With advice from your accountant to prove it's suited to your needs, I would," he replies.



Funding using family investments requires a co-operative approach

Alternative finance

- **Invoice discounting** – borrowers typically get up to 80% of the invoice's value up front and receive the balance once paid – minus interest and transaction fees.
- **Factoring** – borrowers sell invoices to a 'debt factor', who takes over collecting debts. Factoring is better suited to high-volume transactional businesses not reliant on relationship goodwill to drive sales.

A family affair

Many smaller businesses choose a funding source closer to home: family investment is popular among business owners who are cautious about potentially ceding control of aspects of their firm.

Investment from a family member can cut red tape and waiting times. While family investments presuppose a certain level of affluence, as investors must have access to savings, the small amounts involved – typically a few hundred to the low thousands of pounds – make it more of a 'real world' option.

Christina Greenhalgh is the Managing Director of the London-based glass design brand Spaceform. She tapped her family's resources in August 2009 to help her buy out her previous business partner.

Approaches to banks were of little help. "I needed money upfront but the banks were offering funding staggered over three years."

Greenhalgh's parents stumped up the cash. "We are a really close family so we wanted absolute clarity on both sides from the

beginning as regards control of the business aspects, potential share buy back evaluation principles and so on."

All parties should know where they stand, advises Greenhalgh. "Happy beginnings come with clarity. I now love being able to talk to my parents as investors as well as parents."

Involving experts like Menzies can provide clarity on expected returns or repayments, responsibilities and other issues. "As well as legal considerations, there are tax implications too," says Menzies' Corporate Finance Director Jeremy Rayment. "An investor might expect to have a big say in how the business is run or need to get their money back immediately because their circumstances have changed," he says.

"Things can get more complicated when money is involved. Proper preparation protects the business and ensures that relationships remain amicable. Even if the business does well, you need to detail how and when investors get their money back."

Disadvantages

Choosing between factoring and invoice discounting needs careful consideration, Rayment advises. "Factoring is better suited to high-volume transactional businesses that don't rely on relationship goodwill to drive sales. Invoice discounting is more discreet – your customers need never know you've sold the invoice."

Getting advances against a small number of debtors, or overseas customers, can be more difficult, Rayment explains, as the risk is higher. If an invoice goes unpaid the risk of default remains with you, the supplier, but credit risk insurance can provide a solution, he says.

Rayment stresses the importance of doing your homework. "Be clear why you need the finance, how much you need and which option is best suited to your needs and circumstances."

Mark Williams is a freelance business writer and editor who specialises in SMEs. He is the Editor of Start Up Donut, a website for new businesses.

More information

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Doing business in Europe

Europe represents an opportunity for UK SMEs but there are also many hurdles. We asked five experts for their views on the challenges to look out for.



Simon Drakeford
CEO at Eurooffice

"A good example of how countries require different approaches is Italy's attitude to adopting technology. Trust issues mean credit card penetration is low. This culture meant we couldn't use the payment system we use elsewhere and had to develop a 'cash on delivery' option where buyers pay the delivery driver in cash.

"It is also very expensive to get broadband in Italy – a connection in Milan costs around ten times as much as in London, so access to applications in the cloud can be slow or expensive."



Nick Farmer
Partner at Menzies

"From a tax perspective, Europe isn't coordinated; it is 27 different tax regimes. Countries are very protective of how they raise taxes so it can be challenging to understand the nuances of local tax obligations, whether related to compliance, planning or administration.

"Companies trading between countries need to identify where their profits are arising so they can work out which territory has the right to tax those profits."



From a tax perspective, Europe isn't coordinated; it is 27 different tax regimes. It can be challenging to understand the nuances.



Sarah Barron
VAT Manager at Menzies

"Changes to VAT across Europe since 2010 have simplified the process to some extent. However, companies are often not fully compliant with reporting requirements – EC sales lists are now required when selling services, in addition to goods sales.

"Companies selling over the internet may need to register for VAT in any country where they sell to the general public.

"The little differences catch people out. A company registered in different countries has different deadlines for filing returns. Whether or not a local representative must be appointed varies between countries and there are different requirements for invoice wording.

"We work closely with our HLB contacts across Europe to assist clients with their overseas compliance."



James O'Callaghan
Founding Director at Eckersley O'Callaghan structural design

"Of the EU countries we have worked in, we encountered most difficulties in France. In order to do the work we do – structural engineering – we were legally required to carry a certain sort of insurance. We were forced to form a French company as no insurers would offer the ten-year policy to a non-French entity. This means paying French taxes and VAT."



Andrew Denley Managing Partner at Menzies

"Most SMEs are nervous of expansion because, notwithstanding much standardisation across the EU, there are always local laws and regulations that differ from the UK and SMEs are stepping into the unknown.

"It's important to find strong local firms experienced in handling inward investment that are the right size and fit for a start-up in a

new territory, rather than larger national firms. Menzies is a member of HLB International, an international network of accountancy firms, so can offer UK companies access to the right advice.

"HLB members produce *Doing Business In ...* guides so clients have an easy-to-follow booklet on local issues, and these have proved very valuable as a quick and easy source for finding out about expansion into any particular new country."

More information
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“ To last 100 years in business

you have to do more than provide a good service – you have to remain relevant, says Julie Adams.”



This year we mark our centenary. Menzies is undoubtedly a very different practice from the one that set up in St James's Street, London in 1912. Our celebrations will acknowledge both change and continuity of service throughout that period. But perhaps most importantly, we celebrate our success in retaining the long-term trust and support of our clients.

That goodwill and reputation is one of the most valuable assets in any business. It adds measurable value and, in today's service-driven economy, we know the importance of protecting it by providing the best possible service at all times.

However, I would argue that this only tells half the story. Yes, it is essential to demonstrate value by providing a high-quality service. But remember too that many much-loved brands failed in the past 100 years for no reason other than that the world moved on and they became irrelevant.

Innovate to stay relevant

The challenge for all businesses is how to innovate and remain relevant over the long term. The harsh reality is that a business delivering a popular service inadequately has a brighter future than one whose 'quality service' is in terminal decline. As business owners, we all need to take some time away from day-to-day matters and think about who our

customers will be and what they will want in ten or 20 years' time.

Accountancy firms faced such change several years ago when accountants were allowed to market their services and the audit threshold increased. Until then the marketing mantra had been do a good job and let your reputation do the rest. Suddenly accountants had to think competitively – they had to stop thinking about the services they provided and start thinking about how clients might benefit from those services.

Change on this scale inevitably brought casualties but overall it was good for us and our clients. Accountants, forced to think beyond providing technical services, had to innovate and discover new ways of adding real value to their clients' businesses. Many of us now play a more strategic advisory role, helping clients achieve their business goals. In fact, a recent survey ranked accountants among the most trusted of the professional practitioners, coming second only to doctors.

This is a common phenomenon. Businesses that embrace change and innovate do far more than simply find new revenue streams. They move up the value chain, form deeper relationships and consequently become more trusted by clients.

In our own business, as our role shifted from that of service provider to problem solver, demand grew for additional services such as outsourcing, corporate finance and wealth management. Having more strategic conversations with clients has revealed new ways to help them.

Recruitment services

One such area is HR consultancy. Employee costs are usually the biggest element in any business, so we recently spoke to some clients about how our HR professionals might help them. We are now helping them cut costs and increase output by recruiting people with the right skills, at the right salary, to do the right job.

In the past century, technology and globalisation have driven down costs bringing the realisation to businesses that, somewhere, there is always a cheaper supplier. Focus on service quality alone is not enough – there comes a point when it no longer compensates for a higher price. The only option is to innovate, adapt and offer ever-greater value to clients.

Julie Adams is a Managing Partner at Menzies, specialising in advising privately owned businesses and professional partnerships.



More information

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Thinking long term?

As leading advisers to family owned businesses, we can help you to build and grow your business. By working together, we can help you formulate your long-term strategy and bring you peace of mind.

Our services:

- **Succession planning**
- **Estate planning**
- **Family employment into the firm**
- **Share transfers**
- **Family strategy**

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