Taking your business to the next level

A BLUEPRINT FOR SME GROWTH

MENZIES
BRIGHTER THINKING

Consultancy Insights Report

Foreword

For many SME business owners, their company, and its success or failure, is the culmination of years of unwavering commitment and hard work. Those looking to transform their operation from stable enterprise to fast-growing SME must be prepared to delegate responsibility and rationally evaluate the best strategic path. However, in the drive to take their business to the next level, the question remains – how can firms ensure they possess sufficient cash reserves, retain talented employees and facilitate the innovation required to do so?

While the personal investment that goes into establishing and growing a business is considerable, entrepreneurs can improve work-life balance and protect their own personal finances by making intelligent decisions, and establishing a network of trusted employees, advisors and suppliers that help to drive the business forwards.

Meet the team

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Cash

Any expansion plan will require a degree of investment, and the fulfilment of new contracts can put pressure on cash flow. While it is easy for business leaders to blindly chase large orders, it is vital that any decisions are made with an understanding of the long-term impact they will have on the financial health of the business. Often seeking additional finance is a must, and detailed forecasting should aid in identifying the timing and magnitude of assistance required.

Debt vs. equity

When evaluating the best route to finance for entrepreneurs and fast-growing businesses – there are two contrasting options, debt or equity. While debt most commonly takes the form of traditional bank loans, asset-based finance or debentures, equity releasing agreements require businesses to exchange a proportion of business ownership in return for investment.

> *While analysing the suitability of available finance options, it is important to remember that one size does not fit all – owners must analyse the individual needs and characteristics of their business.*
>
> **Graham Seddon**

In general, small business owners frequently decide to stretch their debt as far as they can, to avoid any dilution of equity. Debt funding can often prove to be a cost-effective option, especially in the current economic climate, with interest rates at an historic low. Crucially however, business leaders must ensure that this debt provides them with sufficient resources to fulfil growth plans. If this is not the case, then a combination of debt and equity could provide the balance, and financial clout, required to successfully expand business operations or enter new markets.

If business owners are set on bringing a product to market quickly, then the issuing of shares may be the only option. In this case, business owners can vet potential shareholders and relinquish a degree of ownership in return for specific expertise or a strategic business partnership. For example, an investor with previous industry experience and expertise could be granted a stake in the firm in the knowledge that they will provide boardroom expertise and mentoring to the majority owner.

Key considerations

Am I willing to surrender partial ownership of my business?

Should I put my personal finances on the line?

What type of lending is suitable for the nature and characteristics of my business?

How much funding do I need and when?

Individual needs

While analysing the suitability of available finance options, it is important to remember that one size does not fit all – owners must analyse the individual needs and characteristics of their business. For example, a technology start-up is probably able to get up and running with a smaller initial investment and could be better placed to secure debt funding due to existing positive cash flows. However, for those in the B2C arena, hitting the big time may require the injection of a large lump sum to facilitate a high-profile marketing push. Conversely, manufacturing SMEs might need to purchase costly machinery and capital before production can begin – without a proven track record and goods on the shelves, traditional sources of finance may be more difficult to access.

Another key factor to consider in the debt or equity debate is the extent to which business owners are willing to put their personal finances on the line. For some, the securing of a bank loan will require them to guarantee the debt with their own assets, in most cases, the family home. Intertwining affairs in this way presents a risk to the business owner and their dependents, something that can be avoided if a suitable equity partner or investor is selected instead.

Making a business case

Any grant of credit, loan approval or favourable investment decision depends upon the presentation of a solid business case. It's vital that business owners do not get swept away by 'Dragon's Den syndrome'; while a charismatic presentation style and genuine passion for the firm's product or service will capture attention, solid facts, figures and credentials are essential if financial backing is to be secured.

Before meeting with a lender or potential investor, key materials must be gathered including robust financial projections, profit and loss accounts, the balance sheet and the business plan (incorporating carefully evidenced information about market share, demand, logistics and route to market) as well as orders/guarantees from clients and credit terms and/or agreements with suppliers.

External finance checklist

- Financial projections
- Business plan
- Profit and loss account
- Orders/guarantees from customers
- Balance sheet
- Supplier agreements

People & Relationships

Employees

For businesses to achieve sustainable growth and secure increased market share, they must attract and retain talented employees. Often, core team members may hold the key to important client relationships, or possess information about the company's offering, products or intellectual property. However, most SMEs struggle to compete with their larger counterparts' remuneration packages causing staff turnover and massive disruption.

When implementing a growth strategy, business leaders must communicate with key employees to emphasise their role in the firms' future, and ensure that they buy-in to their long-term vision. Here, a willingness to delegate responsibility is essential, and share schemes such as EMI, SIP and CSOP can be utilised to encourage loyalty and increase motivation. However, for many employees, it is a sense of ownership and trust which is the true motivator and businesses may choose to delegate a proportion of employee time into the generation of new ideas or R&D activity, which is then utilised to drive the business forward.

Another measure that small businesses can implement is increased flexibility, allowing individuals greater autonomy over their working patterns and promoting work-life balance. Crucially, what engages one employee may leave another cold, so business owners must invest the time needed to get to know key staff members and create lines of communication which allow any issues or frustrations to be addressed head on.

Suppliers

Growing businesses should audit relationships with key suppliers to evaluate whether the firm is ready to step up its capacity and fulfil new contracts. Having conversations early and discussing potential efficiencies or economies of scale could provide the opportunity to increase margins. However, if current suppliers are unable to meet demand, new relationships must be forged to ensure the timely delivery of a quality product. Too often businesses focus on taking on new customers but neglect to monitor supplier relationships and output; this must be carefully examined to ensure a sustainable and profitable growth strategy.

Ideally, businesses should aim to sign service level agreements with suppliers, which stipulate a set of required criteria relating to:

- **Quality**
- **Financial projections**
- **Pricing**
- **Payment terms**
- **Customer care standards**

While in certain instances, SMEs may find these agreements difficult to enforce, especially when the supplier is a large corporate with its own set of standard terms, this framework should act as a guide for firms to monitor key performance indicators or KPIs. Access to this information allows risk factors or dips in performance to be addressed in real time and addressed before they compromise client delivery.

> *When procuring business-critical products, components or services, SMEs should consider implementing a dual-sourcing strategy to guard against disruption and gain the flexibility they need to increase capacity at short notice.*
>
> **Phil Wright**

The reduction of risk is a founding principle of effective supply chain management, and in general, businesses should be wary of simply expanding contracts with current suppliers as their requirement grows – relying too heavily on one vendor means that any break in supply could have catastrophic consequences for the business' ability to fulfil contracts. When procuring business-critical products, components or services, SMEs should consider implementing a dual-sourcing strategy to guard against disruption and gain the flexibility they need to increase capacity at short notice.

Business leaders looking to drive maximum value from supplier relationships should communicate growth plans with vendors and encourage them to share suggestions on how to achieve synergy and increased efficiency. For SMEs, the development of long-term partnerships can provide the most accessible source of finance, once trust has been established suppliers will be inclined to increase payment terms or levels of credit to valued customers.

New market entry vs. diversification

An important consideration for businesses eyeing expansion is the issue of target market, i.e. should the business attempt to roll out more products in the UK, or diversify to service emerging markets overseas? At present, a mere 11 percent of UK businesses export and this is an area that is increasingly flagged as an opportunity for massive revenue growth. However, although such strategies can prove extremely lucrative, any international opportunity requires meticulous planning - business owners must ensure that they understand the legal, logistical and individual challenges this will pose.

Commercial viability

First of all, research must be conducted to assess the levels of demand for the particular product or service in specific geographical locations, and the commercial viability of entering these markets. For example, a company that makes consumer electronics may identify the burgeoning middle classes of China and India as being an ideal area for customer growth, however, further research may reveal that the firm would have to significantly reduce its price point to compete with existing suppliers. Here, the business owner must assess whether the company can streamline its cost base or sufficiently adapt the product specification in order to turn a profit.

As well as this, the level of investment and management required to implement an international growth strategy should be evaluated – how much resource would this involve and could this compromise operations in the business' core market? Here, business owners should decide whether they need to establish an on the ground presence to best negotiate the move, or whether a partner organisation or another senior member of the team should be entrusted with this task. SMEs should make full use of the assistance available to them from UK Trade & Investment (UKTI) as well as business advisors with experience of the marketplace.

> *Many SMEs qualify for full or partial R&D tax allowances, which offer significant financial incentives or tax breaks to encourage innovation. However, businesses must be sure to calculate their eligibility before activity commences.*
>
> **Andy England**

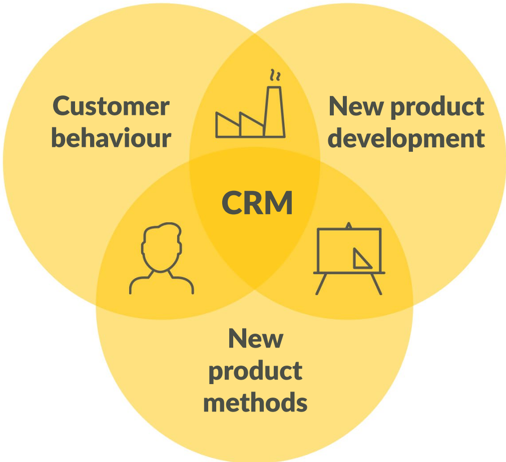
Head or heart

A determination to succeed is often the driving force behind entrepreneurs' transformation into accomplished business people. However, before undertaking an expansion, key goals should be set out – including the point at which the firm potentially withdraws from the project if operations are not going as planned. Recording a limit, either in money invested, or time, where the business should 'cut its losses' reduces the likelihood of business owners making emotionally-charged decisions which could compromise the company's wider financial stability.

Innovation

While the pursuit of rapid business growth can leave resources stretched, research, development and innovation should not be sacrificed, and often hold the key to seizing increased market share. Before implementing expansion plans, business owners must evaluate how they can best manage the firm's resources and drive internal efficiencies which allow outputs and margins to increase.

Areas where innovation should be considered include sales and marketing, through the implementation of customer relationship management (CRM) systems and data capture to analyse customer behaviour, new product development, and in the discovery of new production methods – for example using 3D printing techniques.



Analysing the available options that will have the biggest effect on the company's bottom line informs intelligent decision making and empowers business leaders to keep their firm one step ahead of the competition.

Many SMEs qualify for full or partial R&D tax allowances, which offer significant financial incentives or tax breaks to encourage innovation. However, businesses must be sure to calculate their eligibility before activity commences - how the activity is structured is often crucial. For example, if a third party is involved i.e. the business is commissioned to carry out R&D activities by another, larger company, this is likely to limit or invalidate any tax relief. Understanding the caveats of available tax breaks and ensuring that talented members of staff have the time and resources to devote to R&D activity is essential in promoting innovation.

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