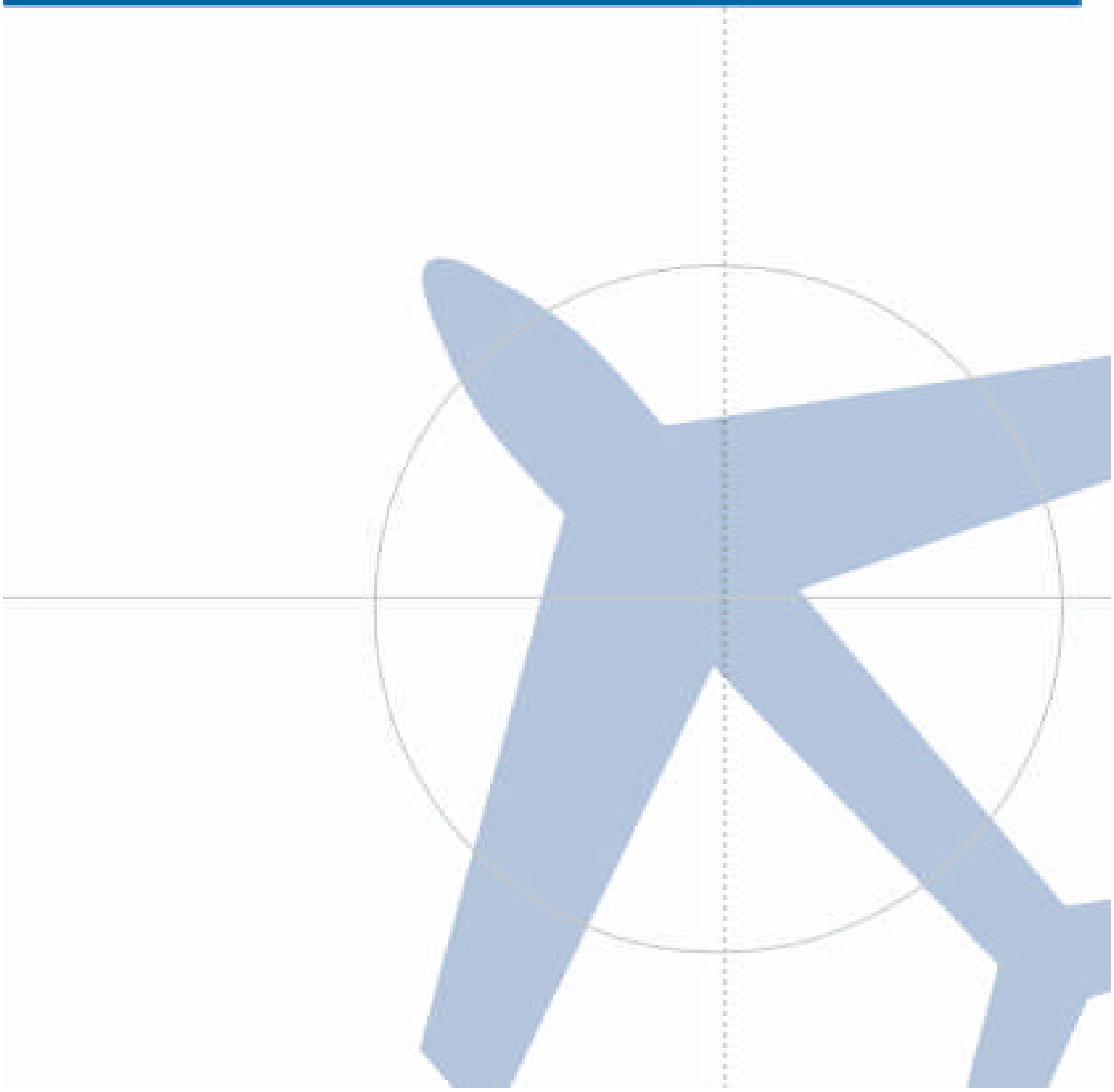
FLIGHTPLAN



Introduction

Flightplan was conceived by AngelNews and its partners in spring 2006 to provide a no-nonsense guide with the answers to all the key questions asked by both entrepreneurs and their investors.

The first two editions of Flightplan, which can be downloaded from www.angelnews.co.uk covered "what is my business worth?" and "how do I deal with my growing pains?" This latter topic has proved so wide in terms of the answers we could provide that, this month, we have addressed the topic in the context of a larger company undergoing high growth. Thus the title of Chapter Three is "how do I deal with my growing pains – as a teenager?". Our partners have addressed various areas where high growth companies are particularly likely to face "growing pain" issues once they are more established. This Chapter starts with David Molian, our guest contributor from Cranfield School of Management's Business Growth Programme, giving 10 lessons on what fast growing businesses do when achieving high growth. Throughout the rest of this Chapter our partners explain; what makes your company valuable, how to understand cost behaviour & breakeven and sales & marketing, and getting your communications strategy right. By popular demand we have also covered two critical employee issues - how to get the right employee incentive schemes in place and how to let people go in the right way. Lastly, we have covered the knotty issue of getting due diligence right when you are making an acquisition. As always, our resident angel investor, Gabriel, has added his own pithy thoughts to introduce the Chapter.

Enjoy this latest chapter of Flightplan and we hope it will be your reference work of choice as you plan, launch, fly and land your business.

Modwena Rees-Mogg

Editor, AngelNews

Contents

Chapter 1 **How do I deal with my growing pains - as a teenager?**

Question

How do I deal with my growing pains - as a teenager?

According to Gabriel

Spots, yes that's the problem with my teenage companies - they are covered in spots. And worse than that I reckon companies don't develop in human years but in dog years so all these spots break-out within 2 years of my investment! Now I know how to invest, I'm pretty good at getting myself a nice clean, fresh baby to adopt on day one. I set out the ground rules – listen to me, do what I say (if not always what I do) and come and cry on my shoulder first. At first everyone is pretty good about it. And then, before I know it, these cheeky management teams seem to think they can do without me and are sucking up to new and more exciting friends, until of course they find that their new friends aren't not quite as selfless as they thought and then they land back on my doorstep wanting support help and inevitably my money – again!

I'm a bit of a mutt of course. I don't drop my poor performers like those aggressive and rather successful VCs in the US. I get fond of the people behind the businesses and anyway my pride is at stake. It's my fault I got the whole show on the road and therefore my responsibility to sort it all out. I'm a man and not a mouse and don't see why I should be pushed aside by anyone. So in I go again, late nights reworking cashflows, meetings with banks, suppliers and customers to instil a sense of support and confidence, always backed up by money of course. It's enough to drive someone to drink – the question is whether it is me or the entrepreneur first!

Worst is when my most beautiful companies attract the attention one of the young turks with wads of cash in his pocket. He wants to invest in my darling and sees no reason for me to be around any longer so tries to squash me out of my equity position. That's why I always have a bit of convertible in there – which converts on the new money terms. What he doesn't know is that I can match the new money pound for pound, so he isn't the only suitor around. My timetable is shorter than Mr Turk's as I need to do the deal before my next holiday in the Caribbean and don't need to worry about due diligence.

In the early days of each of my investments I tend not to become a director or even a titular chairman – I don't invest for ego, but to make money and my lawyer is always banging on about nasty directors' responsibilities and penalties.

Question

How do I deal with my growing pains - as a teenager?

According to Gabriel

Once the companies grow up a bit, I then sneak in and take up my rights to the Chair. It's gleeful when Mr Turk finds out the mutt is part of the core team, has undue influence over events and is essential post his putative investment.

I think the saddest thing I have to do with my teenage beauties is to amputate the rotten bits – to the outside world I call this "cosmetic surgery." It has to be done with finesse – getting the support of other shareholders and management before we remove the people who are not "right". This is usually the second wave of such activity as before I invest I always check out the non-execs and staff as well as the management and make sure the wrong-uns have "gone away" before my money goes in. It sounds harsh, but as I see it – why have two parties who are unhappy with one another, when I can instigate a divorce which will free them to find a new life with more loving friends.

Back to those late nights when I am back in the office revising plans et al. This is when I grab the opportunity to teach the management teams to lose their unprofitable customers, ideally by turning them into profitable ones! My favourite technique is to meet the customer and tell them that perhaps they would be better off working with another player in the field who can do the work more cheaply and just as well - almost. You would not believe how sacking a customer, brings them running back to you with an open cheque book – well enough times to make it worthwhile. And after all this is business, not pleasure.

What else is wrong with teenage companies? One of my Managing Directors once told me that he had the wrong shareholders. I think he might have meant me – the cheek of it. He went too!

Babies tend to crawl off in all directions – I always have to rein in my start-ups – VCs call this focus and I suppose they are right. With teenagers, the problem is one day they leap in unprepared – getting out of R&D and into manufacturing before they appoint a manufacturing manager for example – and then the next they are nervous, tearful wrecks with the bravado that got them this far, gone. They get a bit bureaucratic (bad), which they mistake for being process driven (good).

Question How do I deal with my growing pains - as a teenager?

According to Gabriel

This is the time to bring in the professional management that are not particularly entrepreneurial but bring home the bacon in terms of sales and profit growth, international expansion and operational efficiencies. I don't always replace the original entrepreneur just bowler hat him upwards into the company's "Presidency" or send off to "grow the Far East business". "Meet you in Bejing", I say, as I hand over a Trans-Siberian railway ticket and rush off to St Katharine's Dock to check out Hope, my new Feadship.

If you want to contact me, please email: Gabriel@angelnews.co.uk.

Question **How do I deal with my growing pains - as a teenager?**

By knowing how to grow

David Molian, BGP, Cranfield University

Are you ambitious to get more from your business?

Many aspire, few achieve. Over a four-year period we studied the accounts of 15,000 independent UK businesses with turnovers between £1mn and £50 mn. Fewer than 2% consistently grew sales and profits by 25%, and provided a decent return on capital employed. Growing a business isn't easy. For the last two decades we have worked with nearly 1,000 owner-managers and their businesses. Many have gone on to create significant enterprises. Some have sold out for seven-figure sums. They come from all walks of business life, but they have one thing in common. They have managed to confront and overcome the classic obstacles to growth.

How have they managed it? There are ten key lessons that we've learned from observing how successful BGP entrepreneurs like Karan Bilimoria of Cobra Beer create a *great* business out of a good business.

Lesson 1. **You really have to want to grow**. Growth does not happen to the half-hearted. It's the difference between involvement, and commitment. Think back to the last time you had bacon and egg. The chicken was involved, but the pig was definitely committed! The desire to grow has to come from the heart, and it has to be communicated from the top with passion and conviction throughout the organisation.

Lesson 2: **Successful businesses know where they are going and write it down** – and not just on the back of an envelope. They have clear plans and well-articulated goals. That's not to say that a business plan is a guarantor of success. But our own research tells us that around two-thirds of higher-performing businesses operate with an annual plan that covers both strategy and operations.

Lesson 3: **Don't diversify too early**. Most fast-growth SMEs achieve success through selling more of what they currently do to their existing customers and others who are like them. They find a profitable, protected niche, and they establish themselves securely before they move out of it.

Question **How do I deal with my growing pains - as a teenager?**

By knowing how to grow

When they do, it is almost always to adjacent areas where the same successful business formula can be replicated. A good example is BGPer Lara Morgan, founder of Pacific Direct and finalist in Veuve Cliquot's Businesswoman of the Year. Lara built a distinctive niche position in supplying top-end hotel chains with toiletries, before making a similar offer to airlines. The consumer profile and the needs of the customer are essentially the same, and the supply chain capability is very similar. Since 1999, when she took part in BGP, Lara has more than trebled Pacific's turnover and profitability.

Lesson 4: **Be a "profit" in your own land**. Too many businesses think only in terms of growing sales – and do so at the expense of margins. For every ten owner-managers I meet who talk about turnover targets, I encounter one who talks with the same passion about profit – and in my job I get to meet an awful lot of owner-managers! Perhaps this tendency should come as no great surprise. The top line, after all, is the first line we see on the profit and loss statement. Business people define themselves, almost instinctively, by turnover: we have an intuitive sense of what it is to be a £1 million, £10 million, or £100 million business. However, if this is the only way you define the future stages of your business, alarm bells should be ringing.

When Richard Salvage of Shield Medicare attended BGP in 2004 turnover was growing strongly, while profits were stuck at zero. A year later, profits were back to £1.5 million, and have been rising ever since. The key to change was to refocus everyone – and I mean everyone – on the importance of delivering profit.

Lesson 5: **Grow up as an organisation**. Just as people mature, so must organisations. Managing growth means acknowledging the necessary changes to systems, structures and processes. The cycle of business development is well attested by academic research. In the early days, a business grows through the single-minded drive of the founder. But the business is unlikely to progress beyond a certain point unless the boss is able to attract and retain talented people who will want discretion over their roles and responsibilities. Businesses that grow consistently move, inevitably, towards more formalised systems and processes which are anathema to some entrepreneurs.

Question **How do I deal with my growing pains - as a teenager?**

By knowing how to grow

Lesson 6: **Stop solving other people's problems and/or meddling in jobs you pay others to do**. This point is closely related to the previous one. It's really hard to change one's behaviour, but often the boss is the biggest impediment preventing the organisation from moving forward. The behavioural diagnostics we use at Cranfield tell us that most owner-managers display the characteristics of *both* hero *and* meddler. They become enmeshed in day-to-day fire-fighting and find it hard to resist the temptation to interfere in the jobs of their management team. Staff won't develop unless they learn to solve their own routine problems, and talented individuals won't stay if the boss is continually breathing down their necks.

Lesson 7: **And become a strategist**. As the late, great Peter Drucker observed, a business leader has three basic tasks: to run today's business; to make today's business better; and to create a new business for a new tomorrow. Most owner-managers spend nearly all their time running today's business. The top-performers spend most of their time improving today's business and creating the business they aspire to become. That is where a business leader adds most value.

Lesson 8: **Focus on your people**. Your team will deliver the results from you – if you explain to them what you want, allow them to get on with it and invest in their future! When we examine how entrepreneurs who grow successfully spend their time, we consistently see the same pattern: large parts of their week are given over to working closely with their teams in the role of coach or mentor. Their priority is to create an environment in which key people grow and flourish. An important part of that is identifying a path for their career progression in which coaching, mentoring and external development programmes can all play a part.

Lesson 9: **Develop yourself**. Who is the single person in the business who can have the most impact? The owner-manager. Whose development as manager and leader do most owner-mangers never invest in? You've got it. In fact, we find that the single biggest factor that explains why they don't is a sense of guilt: that investing in training their staff is fine, but somehow it's self-indulgent to invest in their own development. Once they overcome that perception, it's a small step to grasping developmental opportunities with both hands.

Question

How do I deal with my growing pains - as a teenager?

By knowing how to grow

BGP participants develop a taste for self-development and after the programme do more of it, both at Cranfield and elsewhere.

Lesson 10: **Work smarter**. Working longer and longer hours is most owner-managers' recipe for success. It's actually a pretty good recipe for working yourself into the ground. If anything, our top-performers work fewer hours than the average. They take more time off and get more fun out of their businesses. If that seems counter-intuitive at first sight, it's actually the logical consequence of less fire-fighting and meddling. They have more time to think and plan – which is the only way they're likely to grow and develop their businesses.

For more information on BGP and Cranfield's other programmes for owner-managers,
visit
http://www.som.cranfield.ac.uk/som/groups/enterprise/credo/index.asp.

Question — How do I deal with my growing pains - as a teenager?

By understanding what makes you valuable

Tim Davies, Marketing Director
Charles Stanley Securities

Let's be frank: we go into business to be successful, to build something real and to make money, for ourselves and for other shareholders. However it doesn't automatically follow that the path from dream to realising value will run smoothly, or that the value management has in mind will materialise.

At a simple level, like houses, a business is worth what the market will pay for it. Uncontrollable macro-economic influences can also affect value. Valuations will also vary according to a wide range of factors including, but not limited to, the overall size of the business, general financial health, profitability, liabilities, business mix, how long it has been established, trading record, forecasts, perceived ability of management, reason for sale or fund raising and so on.

Whilst management rightly focus on doing everything possible to grow the business (and the 1001 other jobs that entrepreneurs do as part of the daily challenge), sometimes – understandably – they don't always take time out to stand back from the business and to consider how other people may see it. Whilst important in trading and business development terms, this is also vital in terms of helping to establish exactly what the true value of a business is.

But there is a range of measures – irrespective of whether your business is publicly quoted or privately owned - that can be taken to help maximise its value. Although some may seem like normal practise or even common sense, read on…

Question

How do I deal with my growing pains - as a teenager?

By understanding what makes you valuable

Know the competition

At what prices do seemingly comparable businesses change hands for? Remember that because a business *looks* comparable, it doesn't necessarily follow that yours will be worth the same.

It will be time well spent to familiarise yourself with the perceived competition and to benchmark your business against them. With the onwards march of the internet, so much information is now available on-line, be it as a simple level (what they do), through to more detailed information such as Companies House and credit rating agency reports. Easier said than done is to understand on what bases the competition value themselves: published equity research reports on public companies, annual accounts and memorandums on businesses for sale can tell you quite a lot.

Knowledge of the competition also allows you to present your company accordingly, be it to differentiate your business offering, or to create a more flattering, higher quality perception.

The business itself

But it's not all about available information. We believe that businesses should punch above their weight. By this we mean that the company should to all intents and purposes be a bigger business struggling to get out of a smaller one – and at all times behave and present as a larger company.

Starting with the board, all core skills should be represented around the boardroom table (including non-executive directors), with the operating board structured accordingly. Individual responsibilities and reporting lines should be clear.

A business with a strategy that makes sense (and that is proven to deliver) will be preferable to one that makes occasional and unexpected strategic deviations – which can prove costly – or one that simply has not really delivered. We prefer businesses that stick to their core disciplines – what they know best, are good at and have a track record in making money on.

Question: How do I deal with my growing pains - as a teenager?

By understanding what makes you valuable

Equally companies that have publicly stated strategies which are supported by financial goals being met, and measured and proactive communication serving to reinforce this value, tend to be well received.

Similarly, companies should not feel compelled to make acquisitions unless there are good reasons for so doing: the rationale and price need to be right and the incoming business must lend itself to quick integration and contribution.

The stories are legion of acquisitions that have not worked and often, it will make more sense to invest in further organic growth.

Know your shareholders

It is likely there will be significant shareholdings by management. But what about external investors? Management teams do not always know what information needs shareholders have, or how they may like to present information so that it is not only accurate, but reflects all of the good and value-enhancing aspects of the business.

Larger shareholders (often by virtue of how they came to be invested in the first place, such as venture capitalists) may well have a close relationship with management. But there may be smaller shareholders whose buy-in can be very important – especially when it comes to selling the business or raising new funds.

As part of the punching-above-your-weight theme, treat all shareholders to regular information updates. Invite them to an annual facility visit, or even the AGM.

Most of all, listen to what shareholders have to say. They may have a perspective on the business which could be very useful, or have knowledge of comparable organisations.

Advisers

As a business grows, so will its advisery needs. It is essential that advisers of the right calibre – auditors, lawyers and corporate finance advisers, to name but some – are in place. Management should not be afraid of 'trading up' from a local firm to a regional or national player.

Question How do I deal with my growing pains - as a teenager?

By understanding what makes you valuable

Fees may not be that different and the larger firm is likely to have a much wider range of services under one roof and greater geographic reach. Employing known and respected advisery firms is also important in perception terms.

Whoever you use, ensure that all advisers are at one: diarise regular review / update meetings with them and listen - they usually know better and are there to add value and to help plan the way forward.

Communication

Reputation management is important. It is surprising how many companies have overly brief or uninformative websites. Tired or out-of-date corporate brochures and sales material also say a lot about an organisation.

PR has become more important, not just in terms of targeted information updates for shareholders but also for other trading partners and stakeholders. Specialist agencies that can help build profile with the media abound: some call it smoke and mirrors, but a solid media profile and visibility is part and parcel of a business punching above its weight and in so doing, helping to create value.

Finally, we like companies that not only deliver, but also have reputations for being consistent and reliable performers and communicators. In the stockmarket, there is one golden rule: always just exceed market forecasts, but never, ever disappoint.

Charles Stanley Securities specialises in smaller and growing UK-listed companies. It also works closely with companies moving towards IPO. Contact Tim on 020 7149 6412 or via email at tim.davis@csysecurities.com

Question How do I deal with my growing pains - as a teenager?

By understanding cost behaviour and breakdown

Mark Dowding, Vantis plc

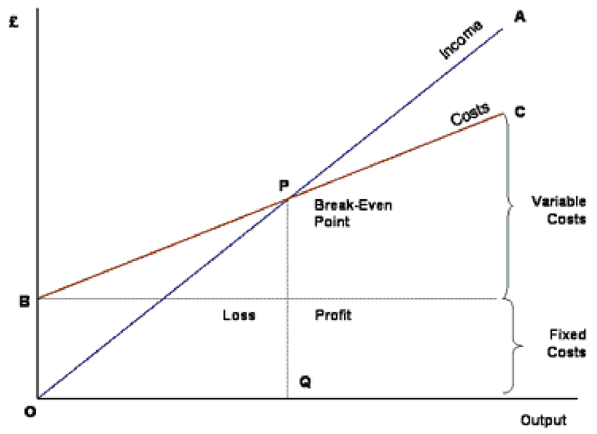
Whether you are planning to start a business or are already in business, understanding how your costs vary as a consequence of a business process is vital in order to maximise profitability and therefore cash flow. It is something you must get to grips with in order to forecast your break even point. Your break even point is the level of sales you need to achieve so that you have enough contribution (profit) to cover your fixed costs.

Fixed costs; these are costs that you will incur regardless of your production level or the amount of services you provide. Examples are rent and rates, marketing, administration, and depreciation on fixed assets.

Variable costs; typically vary in direct proportion to your level of activity or output. They may include the direct cost of buying or building your product (depending on what your business does) and things like sales commission.

The level of contribution you make on each unit of output is estimated by subtracting variable cost from your selling price.

Diagrammatically this kind of analysis can be illustrated as follows:



Question: How do I deal with my growing pains - as a teenager?

By understanding cost behaviour and breakdown

The line OA represents the level of income at various different levels of activity, OB is the total level of fixed costs; this is the starting point for total costs because variable costs only occur with the commencement of output. At P, the point of intersection or break even, neither a profit nor a loss is made.

In practice of course there are complications, for instance costs may be semi variable, selling prices fluctuate, abnormal costs arise, and some costs may reduce over time by virtue of the learning curve effect or economies of scale.
Costs are sometimes referred to as direct or indirect; the distinction here is whether they can be directly attributable to the cost of output or not; direct costs tend to be variable whilst most indirect costs may be fixed. Do take care with things like production wages; these may be direct but fixed. Costs may also be controllable, that is to say that outcomes can be influenced from within the business or uncontrollable; business rates are a good example of an uncontrollable cost.

Break even analysis can prove useful in the formulation of sales pricing policies, financial forecasting and will help you stay in control generally. Your investors will expect you to understand these concepts and how they apply to your business.

Growing pains 2

Using budgets as part of a control process

The purpose of a budgetary control system is to assist in planning and controlling the activities within a business. Most organisations will employ some form of budgeting system, this may be on an informal basis for instance in the mind of an entrepreneur or by means of a sophisticated process for a mature business.

Budgets are by definition prepared in advance of business activity and can thus be thought of as being part of a feed forward system; they look at the implications and expected outcomes of business activity. The preparation and setting stage is the first aspect of attempting to operate a budgetary control system.

Question | **How do I deal with my growing pains - as a teenager?**

By understanding cost behaviour and breakdown

A budget is a plan expressed in quantitative terms; the inputs and outputs can be either monetary or non monetary. Typically budgets will cover different functional areas of a business on either a departmental or an activity basis or both. For instance there may be an overall sales budget sub divided between different products/services by department.

Budgetary control is essentially the process of establishing budgets relating the responsibilities of budget holders to pre defined measures of expected performance; measuring actual performance against plans and then taking corrective action where necessary. It should be seen as a continuous process and it often involves revising the original plans.

Setting budgets

At an early stage in the process you will need to determine the budget period and a suitable timetable; ideally you should be looking to complete the planning phase well in advance of the commencement of the budget period (usually the forthcoming financial year).

Organisations can be split up into budget centres; these can be based on function; for instance research & development, sales or administration or on a business unit location basis. At this stage of the planning process you should determine how budget responsibility is best represented. A common approach is to classify budget centres as "Cost", "Revenue" or "Profit centres".

These budget centres will then need to forecast the inputs and outputs relevant to their part of the business.

In most cases budgets will be interlinked; for instance a purchase or stock budget may be connected with a sales budget, in turn the outputs of these budgets will determine the inputs to a cash budget. For this reason the model you use should be robust enough to generate different scenarios and iterations just by varying the input data or assumptions. In practice there are pre packaged software packages available to do this, alternatively you could build your own spreadsheet models or have a model developed for you.

Question How do I deal with my growing pains - as a teenager?

By understanding cost behaviour and breakdown

Using budgets as targets

Amongst other things the budgeting process can be used to formulate and communicate financial and non financial targets. Psychological studies have concluded that when demanding targets are set, performance tends to be better. Care does however need to be taken to ensure that targets are not unattainable as this can be counterproductive. In the right circumstances budgets can prove useful as a motivational tool.

Where managers are empowered to fix their own targets, they will quite often build in some level of slack. This is achieved by underestimating anticipated sales revenue or overestimating costs or by shifting profits and losses between different financial reporting periods. In practice the budget setting process should involve representatives from all of the key areas within the business. This should help ensure as far as possible that realistic targets are set, resource requirements are agreed across the different functional areas, and that self interest is not prominent in the control process.

Using budgets for performance evaluation

Setting performance levels can also form the basis for individual reward systems; the payment of bonuses or granting promotions is often linked to the attainment of predefined budget criteria. As with the setting of targets, care needs to be taken to ensure that individual needs are not put before those of the business and that the goals of departments are congruent.

Monitoring performance and revising plans

During the budget period you will now be able to monitor actual performance against the targets you set yourself as part of the budgeting process. This is often achieved through the preparation of management accounts on a monthly basis. The accounts are then compared to budget and explanations are sought for any variances. Such variances may be either adverse or favourable; what they will give you is valuable intelligence about the efficiency of your business. Consequently the results may be fed back into the budgetary control process so that the budget inputs can be refined for future periods.

Question

How do I deal with my growing pains - as a teenager?

By understanding cost behaviour and breakdown

In summary

Good financial control will help maximise the value of your business. If your systems are robust and produce reliable information on a real time basis, this will allow the principals and or senior managers to concentrate on what they do best; this may be in developing improved products or sales for instance. Critically you will have a better idea of what your profitability and therefore cash flow is likely to be in the future; if all does not go to plan you will know about it as quickly as possible, thus giving you time to take any necessary corrective action.

To learn more about the financial aspects of controlling your business, please contact Mark Dowding at Vantis plc, by e-mail at mark.dowding@vantisplc.com or by telephone on 020 7549 2430.

Question

How do I deal with my growing pains - as a teenager?

By understanding sales and marketing

Emma Vigus, Head of ShareMark

Following on from the first half of this article which appeared in the last edition of Flight Plan, covering various aspects of marketing including product, price and place, this month's installment will cover 'promotion'.

Before proceeding it's worth remembering what American business man William Bernbach said, 'advertising doesn't create a product advantage, it can only convey it.' Increasing awareness of a product or service should be one of the key objectives of a promotional campaign but the product or service must be deliverable. I can think of several firms who've built significant awareness without having a service to sell, and many other firms who've spent thousands on advertising in the hope that it will make up for a terrible product – it doesn't!

Promotion

There's no need for a complex introduction here, promotion is 'what it says on the tin' – the promotion of your company's product or service. It's a large subject , the intent of this article is to give a brief overview of some of the key components.

•**Network**, network and then do some more networking. Talking to people is great market research, it's the best way to raise awareness and is often free. Talking on a one to one basis can be worth far more than putting a one off advert in a magazine that goes out to an audience of thousands. If you meet someone, follow the contact up even if you simply send them an email saying it was nice to meet (you must do this on the next working day). If you think it's a good contact, try to arrange a meeting and if it's a good meeting, keep following up every month. Share contacts, thoughts and advice with people – most people are decent enough to re-pay that sort of help with some help of their own. Networking can be daunting and if you walk into a room and you just can't face it – hide for 10 minutes, gather your thoughts and walk back into the room smiling, and somebody will talk to you.

Question **How do I deal with my growing pains - as a teenager?**

By understanding sales and marketing

•**Sales Database** - developing a sales database is crucial, even if it's done in Excel or Outlook. Every single business card you receive should go into your database, even if you don't think you'll receive any business from that person. Don't just put the data in the database and forget about it, make regular contact updates and review the entire database every 6 months to ensure you keep in touch with good contacts.

•Be wary of designing an overly complex database – I've used databases with millions of fields that never get used. Yes information is power, but do be realistic and make sure your staff are trained to use it. If you outsource the design, make sure the providers can support you on an ongoing basis. During the design stage, you must also consider scalability, for example if you are planning to employ remote sales staff, the database needs to accommodate remote access and updates.

•**Staying in Touch** - Once you've got a database, look at cost effective ways of staying in touch with it. An electronic newsletter is a good option, but ensure you are up to date with data protection legislation. There are some cost effective outsourcing solutions that can help with the delivery of a newsletter, but it's surprising what you can do with Outlook, if finances are tight. Keep news relevant to your target audience and avoid long complex articles. Newsletters are ideal for headlining new product launches, new clients and contracts but not for discussing your views on world politics. Remember that most people will only read the first 20 words so that's where your key message needs to be.

•**Direct Mail** is an excellent marketing method however to be truly effective it relies on being well written, good research, an up to date database and good follow up. It's pointless writing to 200 leads, if you can't follow the letter up with a phone call (probably about 5 phone calls in reality). Equally don't waste time writing to leads, just to broaden awareness of your product or service if those leads don't fit your target audience. Also think about how you want people to respond to your letter – do you want them to arrange a meeting with you or visit your website, if the latter is your website up to date and easy to use. Again, bear in mind that most sales letters are thrown in the bin after about 20 seconds so you're opening paragraph has to be really strong – all it needs to say is what you can do for the person you're writing to. Use plain English and keep it down to one page.

Question **How do I deal with my growing pains - as a teenager?**

By understanding sales and marketing

•**Sales Presentations and Meetings** nobody enjoys them, but we all have to do them. Firstly find out what presentation facilities you'll have access to, not everyone will provide a projector. Research the target thoroughly before you go to the meeting, and don't just look at their company website. Be punctual, so obvious, but so many people aren't. Be honest, friendly and concise – all they want to know is what the product does for them. Ask about their business as well, you might not be able to sell to them now but there could be another opportunity further down the line. Finally be human, if people are going to do regular business with you, you have to develop a relationship with them and that won't happen if they don't like you. If you can't achieve all of the above, then send someone else to the meeting. That sounds very harsh, but it can take days to get a meeting with a good contact, so you must send the right person to meeting, otherwise all the hard work is wasted.

Once the meeting is over, make sure you follow it up. Even if it's abundantly clear that they weren't interested, send them an email thanking them for their time. If they were interested, then keep contacting them until you get the sale or you're told to go away.

Existing Customers – Don't forget to look after your existing customers. They may be one of your best sources of new business and they are a great marketing tool. Produce case studies on them, make them feel valued, call them regularly, use and act on their feedback – they will help you develop and improve your product. It's also worth asking existing customers for referrals, you could even consider offering them a discount on future purchases in return for new leads.

Referring back to William Bernbach's quote, don't focus so much on winning new business that you loose sight of the promises you make to customers. Hoover learnt this lesson, when they offered free air tickets to the US to customers. The offer was massively ooversubscribed and led to a lot of negative media coverage of a company that seemed unable to cope with a fairly basic issue that had nothing to do with its fundamental business.

•**Branding** - Do you need to spend thousands of pounds developing a 'brand' and 'what is a 'brand'? A brand is more than just your company's identity; it is every aspect of your company.

Question

How do I deal with my growing pains - as a teenager?

By understanding sales and marketing

If you do create a brand (and it will take time) you need to ensure that your brand characteristics are present in every aspect of your business – the behavior of your staff, the way the phones are answered, your documentation, even the way you distribute your product.

If you can't ensure this, then your brand simply becomes your firm's visible identity and you will have wasted a lot of money and at worst you will damage your company's reputation. As an example British Airways has spent many years developing its brand values of customer service, strong communication and good relationships. Unfortunately these values weren't present in the way BA handled its Human Resources and this resulted in a series of strikes that very publicly damaged the airline's reputation for looking after its customers, as well as its staff.

However a well managed brand will help differentiate your business from your competitors and given that a lot of brand values are intangible, a strong brand can be very hard to duplicate, thus forming a significant barrier to entry. Finally brands can be much easier to successfully adopt when a company is still small because it's easier to get buy in and it's easier to add the essence of the brand into everything a company does. Once you've got 60 staff and a set of established procedures you might find it harder to ensure that all the procedures live and breathe your brand as opposed to counteracting it.

•**Corporate Logo and Look** - If you choose to simply create a company image in preference to a complete brand, then you should still employ a design agency. Again make sure that the 'image' fits with your marketing strategy, ensure that it's consistently portrayed and that it can be easily transferred across media i.e. on a website and on print media. Also remember that different colors and images will have different impacts in different countries. What's acceptable in the liberal West, may be totally unacceptable in the more conservative countries of the Middle East.

Once you've chosen a suitable identity, ask you agency to help you develop a corporate identity manual, which should list fonts, font sizes, pantone references for corporate colors, standard imagers etc. This should be available to all staff along with standard templates for letters and other key documents such as service level agreements. This is all pretty basic stuff, but it's so easy to overlook when you're in the middle of chasing your next client, trying to raise money and recruit a new member of staff.

Question **How do I deal with my growing pains - as a teenager?**

By understanding sales and marketing

•**Advertising** is expensive and the results can be very difficult to measure. Randomly placed adverts rarely work so unless you can afford to run a campaign across a range of relevant media, it's not worth it.

Even if you can afford it, you need to ensure that you are placing well designed ads. Remember AIDA, a classic formula used by advertisers, which is also useful for direct mail campaigns. AIDA stands for:

Attention – use a powerful headline that clearly and simply states what you are offering. This is the most important part of your communication.

Interest - create an interest in your product, try using a powerful statistic such as '50% of your competitors are using our product'.

Desire – There is a big difference between being interested in a product and desiring it. This is a good place to mention a special offer or new product development.

Action - Even if you have a good ad, you still need to tell people precisely what to do - how to take action and then you need to ensure that you can deal with that action. For example if you're placing an advert that appears on a Saturday, will there be anybody in your office to take calls on a Saturday? If you point people in the direction of your website, can they use your site to request further information?

•**Exhibitions and Conferences** offer great networking opportunities, but the former can be an expensive way to market your product. In my experiences, most conferencesin all but the fastest moving sectors have a useful life span of about 3 years. After that exhibiting is a waste of time, unless you have a new product or service to launch, because you will just see the same faces over and over again. Don't exhibit at a conference unless you have attended as a delegate first, there are hundreds of new conferences launched every year and many turn out to be a waste of time. Securing a speaking slot or being a 'case study' at a conference is far more valuable and your PR agency should be able to help you secure these slots. If you don't have a PR agency then develop a short introduction to your business and yourself (including details of any past speaking roles) and send it round to the conference organisers.

Question **How do I deal with my growing pains - as a teenager?**

By understanding sales and marketing

•PR - Hiring a PR agency can be expensive, but running an efficient PR campaign is time consuming and because the results of PR are hard to quantify any PR related activities often get pushed to the bottom of the pile…. I know!

However if you are going to hire an agency, don't expect to put your feet up. You need to be just as committed to the relationship as they are and you will need to be proactive and willing to follow up on their ideas. Keep them in on the loop on everything you do, even if you can't spot an opportunity a PR agency might be able to. Keep measuring their results and if they aren't performing tell them, don't just sulk. Don't forget that PR is more than just getting column inches – your PR agency should be able to help with leads, case studies, media training, new ideas, securing speaker slots and sponsorship deals. Finally, they should understand your business as well as you do.

•Website – Probably the greatest revolution in marketing in the last 20 years. I have no doubt that this will be covered in far more detail in a separate edition. Personally I think that every business should have a website (25% of AIM companies don't!). That website should be simple, concise, visually appealing and functional. Do your research before you start the design process, what have your competitors got, what do your target audience want, and how are you going to market your site. Consider what you're website is supposed to do, is it an online brochure, is it a sales site or is it an enquiry site, does it include complex functionality and how can it be designed to enhance your sales and marketing activities, i.e. could you build a back end Customer Relationship Management system into the website to capture any enquiries. Finally market you website efficiently and don't forget to review it and update it.

Summary

-Networking is crucial and cheap

-Your contact database is valuable, put time and though into establishing, managing and maintaining it.

Question	How do I deal with my growing pains - as a teenager?

By understanding sales and marketing

Research any planned marketing activity thoroughly before committing expenditure;

-Ensure you have the resource to make a marketing idea work.

This article has only touched on the key aspects of marketing which encompasses such a broad range of activities that it would be impossible to cover them all here. What I hope I've conveyed is that marketing can be simple and cheap and you don't need a degree to do it. However you do need to be focused and co-coordinated. As a general rule, don't spend more than £100 or 5 hours on any marketing project, without going back to your business plan and asking: will it help achieve an objective, is the target audience right, can we afford it and can we follow it up. If the answer to all 4 is yes, go for it.

Emma Vigus has worked in Sales and Marketing for the last 10 years, with roles at a broad range of companies including Rover and Morgan Stanley Quilter. Emma is now Head of ShareMark, a stock market for smaller companies.

To contact her, please email emmavigus@share.co.uk

Question

How do I deal with my growing pains - as a teenager?

By getting your communications strategy right

Peter Curtain, Director, Capital MS&L.

They used to say about banks that the best time to start one was 20 years ago – the point being, lenders make so much money, think what you've missed in the meantime. In rather the same way, I often advise companies to start effective communications as soon as they can – think what you can achieve when people understand your business.

Yet on those occasions when a company announces something big, say plans to raise money in public markets, it's often the first time anyone has heard of it, perhaps outside a small circle of customers, staff, suppliers and investors. The risk is that some will interpret your message as: 'You know nothing about us, but we'd like your money.'

Information is the lifeblood of business and it's important that ambitious, growing firms generate their fair share. Nobody is recommending that companies make noise for the sake of it – as in social situations, no one likes a boastful bigmouth.

But it's important that people know you are there, active and able to serve a need, whether it's making widgets or providing consultancy services. Corporate communications is not about finding a spouse by getting your picture in the paper. It's about making cold leads hot, winning orders, flushing out better, more efficient suppliers – or obtaining better terms from your current ones, reassuring staff and prompting the best applicants to send in their CVs. It's also about getting on the radar of potential investors – both individual and institutional.

We often advise growing companies, even those seemingly destined to stay private, to act like they're already publicly quoted so they get used to the idea of keeping their various audiences informed. (Increasingly, investors believe, no news is bad news.) But there are equally valid reasons for starting this process even if you're undecided on an eventual IPO. One, circumstances change and a float may become the best strategy. Two, if and when the time comes when your shares go on sale in the market, the investment community – institutions and equity analysts – will be much more inclined to open their doors if they know a bit about you, or can find out through a quick media search.

Question: How do I deal with my growing pains - as a teenager?

By getting your communications strategy right

Analysts in particular don't like surprises. They are relied upon by traders for their judgment, and won't roll out the carpet for companies that appear from nowhere. Financiers will be looking for the 'back story'.

So how to go about developing a communications strategy? First, get a plan – plot out all the news your company is likely to generate in the coming 12 months – orders, fundraising, a sale or acquisition, a big hire, an office opening, hitting a new market or introducing new technology or application. Don't worry that you can't predict these things with certainty – it's a working document, a moveable feast. Getting used to updating it is a good exercise in itself.

Second – work out whom you want to get your messages across to – these could be any and all of the following – potential customers and others in your supply chain, present and potential private-equity investors, current and prospective staff, and industry regulators.

Third – look at what communications channels you have already – brochures and other collateral, your website, electronic newsletters, your professional association, direct mail, the trade shows you attend, contact with referrers – and ensure the way you talk about your company and its progress is aligned. Making the most of all these valuable information sources and establishing procedures that guard against miscommunication will enable you to get the good news across.

Fourth – use the media. We are fortunate living in a democracy where, despite the style of some popular publications, we enjoy an active, independent press. The business and financial press plays its part better in the UK than just about anywhere, reporting good news and bad, protecting and balancing the interests of investors, entrepreneurs, customers, fighting their readers' corner, often battling needless bureaucracy and over-regulation on your behalf.

A good media relations strategy will not only minimise the risk of inaccuracy, it will also build milestones, an independently reported account of your company's progress – and could even lead to your being projected as an authority on your industry or profession. A journalist will often look for specialists to comment on developments in their industry.

Question

How do I deal with my growing pains - as a teenager?

By getting your communications strategy right

Make a point of understanding the media you rely on and examining fresh ways to get your message across. Familiarise yourself with the media in general and the output of certain journalists in particular – whether financial, local, trade and technical, web-based, broadcast or paper. But make sure you and your advisers understand the nature of 'news' – not, as one corporate lawyer told me, his firm's sponsorship of the flower beds on a ring-road roundabout. PR is highly valuable but should not be viewed as a substitute for advertising. Journalists tend to know the difference, especially since the latter pays their salary.

Many companies engage PR firms to help them, whether by providing strategic advice, arranging media training, or designing and implementing a communications programme. A key part of your advisers' work will be assembling a body of information such as the key messages that will be agreed and 'signed off'. This will make the process of drafting documents easier and ensure all the management team, and its advisers, have the same answers to major questions. In choosing a PR firm, consider what you require, write a brief (helpful to PR firms in understanding needs but not always provided) and invite a couple to pitch. Focus on what they can commit to delivering – ongoing strategy sessions may not help you achieve your objectives. The right agency will recognise this and work with you on concrete deliverables.

As in all your dealings, reputation is hard won and easily lost. But this should not stop your business adopting a higher profile. Be open and honest – about bad news as well as good. Companies that are realistic and open enough to share their news build support among key audiences such as customers, investors and staff. An ability to demonstrate that management is equipped to deal with a crisis and point to a way out of it will instill confidence. As in all other elements of your business, it is important to manage expectations.

You don't need me to tell you that business is about vision, strategy, hard work, resourcefulness, creativity and common cause. Doing all that, without making sure people know about it, simply doesn't make sense. A sound communications strategy, well worked out and professionally implemented, will underpin your accomplishments and lay a firm foundation for the future.

Peter Curtain is a director of financial communications consultancy, Capital MS&L. To contact him please email: peter.curtain@capitalmsl.com

Question: How do I deal with my growing pains - as a teenager?

By having the right employee incentive scheme

Chris Page, Vantis Corporate Finance

The War for Talent

Mounting research, including a year long study by McKinsey & Company, has highlighted that a company's most important resource over the next 20 years will be talent. It is also the resource in hortest supply.

Research shows that over the past decade, talent has become more important than capital, strategy and R&D. In reviewing the sources of competitive advantages that companies have:

(i) capital is accessible today for good ideas and good projects;
(ii) strategies are transparent (as even smart strategies can simply be copied by others); and
(iii) the half-life of technology is growing shorter all the time.

This means that for many companies, especially SMEs, people are the prime source of competitive advantage. Talented people, in the right kind of culture, have better ideas, execute those ideas better – and even develop other people better.

So the question is, what can SMEs, competing with larger corporates for high calibre employees, do to best arm themselves to fight for their fair share of talent?

The answer - implement an effective employee incentive strategy

Employee incentivisation

Attracting, retaining and incentivising the right people to drive the business forward, is now accepted as being fundamental to the success of the business. Effective remuneration is no longer just about competitive salary levels, which can prove difficult to match for the SME sector.

Question How do I deal with my growing pains - as a teenager?

By having the right employee incentive scheme

As a result, an increasing number of successful SMEs are turning to employee incentive arrangements (predominately share based) to ensure that, by linking employee and shareholder interests, they are best placed to achieve their business and human resource objectives.

What type of employee incentive arrangements are best suited to SMEs

There are a number of tax approved share based employee incentive arrangements, which are capable of delivering shares to employees' tax efficiently. However, the Enterprise Management Incentive Scheme (the "EMI") was specifically bought in by the government in July 2000, to address the needs of the SME market place.
The EMI is based on the granting of share options. A share option is the right to acquire a share at a pre-determined price (the exercise price) at some time in the future.

No income tax or National Insurance contributions to pay when shares acquired

Broadly, as long as the EMI option is granted with an exercise price equal to the market value of the underlying share on the date of grant, **NO** income tax or National Insurance contributions are payable on the value of any "gain" made (i.e. the difference between the exercise price the employee pays to exercise the option and market value of the shares acquired on the date of exercise), when the option is exercised and the shares are acquired.

Capital Gains Tax charged at 10% on the sale of shares

Business Assets Taper Relief ("BATR") reduces the effective rate of CGT payable on the sale of any business asset held by an individuals for 2 years or more to just 10% (40% being the CGT rate for higher rate tax payers).

Question — How do I deal with my growing pains - as a teenager?

By having the right employee incentive scheme

Shares under an EMI option, not only qualify for BATR, but more importantly they qualify from the time the option is granted, **NOT** when the shares are acquired. EMI option holders could therefore, have a CGT liability on the subsequent sale of any EMI option related shares as low as 10%, within just 2 years from the date of their EMI option grant. Further more with annual CGT exemptions, loss relief and other CGT tax planning opportunities available, it may even be possible to reduce even this 10% CGT liability.

No other tax approved share based employee incentive arrangement delivers such beneficial tax treatment. As a share based incentive arrangement, the EMI should be the first employee incentive scheme of choice, for any SME that meets the qualifying criteria.

Qualifying for an EMI Scheme

The EMI is predominately aimed at SMEs and although not exhaustive, the main features needing to be satisfied to implement an EMI are as follows:

●a company must be an independent trading company trading in the UK (although some types of businesses will represent excluded activities, e.g. certain types of financial activity) and have gross assets not exceeding £30 million. With group companies the shares used in the EMI must be the parent's shares and all subsidiaries must be at least 51% owned by the parent

●the company can be quoted or unquoted

●a company can grant EMI options up to a maximum of £3million, with an employee being able to hold an option over shares worth up to £100,000 (valued on the date of grant)

●employees are eligible for an EMI option grant if they are employed by the company for a minimum of 25 hours per week, or if less devotes at least 75% of their working time to the company

Question

How do I deal with my growing pains - as a teenager?

By having the right employee incentive scheme

•unlike other types of tax approved share schemes, for added flexibility, the company can limit voting rights, provide pre-emption or set other conditions in respect of the shares that will be acquired on the exercise of the EMI option

•the company can deduct the setting up and certain administrative costs relating to the EMI scheme. In addition, the employing company should qualify for a statutory corporation tax deduction for the provision of share benefits to its employees. The deduction will be equivalent to the value of the gain the employee makes on exercise i.e. the difference between the exercise price and the market value of the shares on the date of exercise

•certain disqualifying events can remove the EMI tax benefits (e.g. the employee ceasing to meet the working time requirements, or the issuing company ceasing to be a trading company). However, a forty day period of grace is allowed in which to exercise the option before tax relief is removed

•prior approval before grant is not required from the tax authorities, although a notice of a grant of an EMI option has to be submitted to them within 90 days of the EMI option grant.

Chris Page is a Director of Vantis Tax. If you would like to contact him about employee incentivisation, please email: chris.page@vantisplc.com
.

Question **How do I deal with my growing pains - as a teenager?**

By letting people go in the right way

Andy Moseby, Kemp Little LLP

There is a story, which may be apocryphal, that during Kelvin MacKenzie's reign as editor of The Sun newspaper, he once sacked the resident astrologer (who had been reusing old predictions) by letter which began: "As you will have no doubt foreseen…" This approach to firing staff is, unsurprisingly, not one which should be recommended. In this article, **Andy Moseby**, associate at **Kemp Little LLP**, identifies key points for businesses to consider before terminating the employment of any member of staff as well as practical advice on how to avoid potential claims.

Wrongful Dismissal

An employer must give employees the appropriate period of notice specified in their contract of employment or make a payment in lieu of notice; otherwise they could find themselves being the subject of a wrongful dismissal claim. The only defences available to the employer are either: (i) that proper notice of termination (or payment in lieu) has been given; or (ii) that the employer was entitled to dismiss the employee without notice. The circumstances in which staff members can, in principle, be dismissed without notice are often found in the contract of employment. In practice, if the employment contract is silent, it will be necessary to show that the employee was guilty of gross misconduct or gross negligence.

If an employee is successful in a wrongful dismissal claim, he will be entitled to compensation equal to the net value of the salary and benefits which he would have received had he been given his full period of notice. However, the employee must take reasonable steps to look for alternate employment (and give credit to his former employee for any earnings received during the period which would have been his notice period). Failure to take reasonable steps to mitigate his loss could lead to a reduction in compensation.

In addition, an employee may be entitled to claim additional compensation if the employer fails to follow a contractual disciplinary procedure before dismissing for misconduct or poor performance.

Question **How do I deal with my growing pains - as a teenager?**

By letting people go in the right way

They employee will need to establish, though, that the disciplinary procedure forms part of his contractual terms. It is currently possible, therefore, to avoid liability for claims of this type by including a statement in the disciplinary procedure to the effect that it is not contractually binding.

As an alternative to dismissing an employee without notice, an employer may want to put the employee on garden leave. However, unless there is an express clause in the employment contract, an employer may not be able to force the employee to not attend work but remain "on call". Recent case law has suggested that in the absence of an express general power to suspend the employee, an employer may be under an implied duty to provide the staff member with work (if there is work to do and the employee is willing to do it), especially if there is a need for the employee to practise his skills in order to maintain them.

Unfair Dismissal

In most circumstances, only employees with one or more years' continuous employment with the same or an associated employer and who are under "normal retirement age" (with reference to other workers in the same position) are entitled to bring claims for unfair dismissal. Employees who have been dismissed may bring a claim for unfair dismissal, but if an employee resigns in response to a fundamental breach of their contract of employment (and did not waive the breach by waiting too long before resigning), he may bring a claim of constructive dismissal.

To defend such a claim successfully, an employer will need to show not only that it had a fair reason for the dismissal but that it followed a fair procedure in carrying it out.

If an unfair dismissal claim is successful, the employer can be ordered to reinstate the employee to their old position or re-engage them in a comparable position and pay any lost earnings. However, in practice, such orders are rarely made. The most common remedy is an award of compensation. The employee will be granted a basic award calculated as a multiple of a week's gross pay for each complete year of service up to a statutory maximum, which is currently £8,400.

Question **How do I deal with my growing pains - as a teenager?**

By letting people go in the right way

In addition, the employee will be awarded such additional compensatory amount as the Tribunal deem "just and equitable" having regard to the loss suffered as a consequence of the dismissal. In practice, this equates to loss of earnings. The current maximum compensatory award that can be made for most unfair dismissal cases is £56,800. These awards can be reduced if, for example, it can be shown that the employee was partly to blame for his dismissal. In certain circumstances, the reduction can be as much as 100%.

Redundancy

If the dismissal is due to the employer closing the business at the location where the employee works, or if it is because the employer requires fewer employees to carry out work of a particular nature then there will be deemed to have been a redundancy. An employee who is made redundant is entitled to receive the notice period set out in their contract of employment or payment in lieu of notice. If a worker has more than two complete years' service at the date of dismissal, they will also be entitled to a statutory redundancy payment calculated in the same manner as the basic award referred to in respect of unfair dismissal (although some employers operate enhanced redundancy schemes).

Compromise Agreements

If an employee is offered a payment which is more than their statutory or contractual entitlement on termination, it is advisable for the employer to make the offer conditional on the employee waiving all claims in connection with the employment and its termination. Whilst contractual claims can be waived simply by an employee confirming that they are accepting the payment in full and final settlement of any claims, it is not possible to waive statutory claims (such as unfair dismissal) in this manner. This is usually achieved by way of a compromise agreement.

The form and content of a compromise agreement must comply with statutory requirements to be effective (the most important being that the employee must be advised on the terms and effect of the agreement from an independent legal adviser). The employer may wish to include other protections into a compromise agreement, such as provisions prohibiting the employee from making derogatory statements about the employer or imposing restrictions on the activities the employee could pursue after termination.

Question **How do I deal with my growing pains - as a teenager?**

By letting people go in the right way

Employee Shareholders

Unless expressly stated otherwise in the constitutional documents of the company or agreed contractually with the employee, if the employee holds shares in the employer at the date of his dismissal, he will retain the shares and continue to be able to vote on company business as well as benefit from any increase in value of his shareholding. Depending upon the circumstances surrounding the departure of such an employee, it may be preferable for the company to insist that the ex-employee's shares are transferred upon departure. There are numerous permutations of compulsory transfer ("good leaver / bad leaver") provisions which look to determine the circumstances (if any) in which a departing shareholder could retain his shareholding and the value at which his shareholding (or part) would be transferred, and legal advice should be sought before attempting to impose any such provisions on employees.

For advice on dealing with employee shareholders and minority shareholders generally, please see the article "*When Good Shareholders Turn Bad*" in this edition of FlightPlan.

Post-Termination Restrictions

Most businesses would want to ensure that their employees do not, immediately after being dismissed, commence working for a competitor or conduct themselves in a manner which could damage the reputation of the former employer. Many companies therefore look to include post-termination restrictions in employees' contracts of employment.

Generally, restrictive covenants are only enforceable if they are no wider than necessary to protect legitimate business interests. The only recognised business interests are trade secrets and trade connections (which would include an employer's relationship with its workforce). Restrictions must be drafted carefully and reflect the exact circumstances of the employee's position and the employer's business. They should also be regularly reviewed to ensure enforceability.

It is important to note that where an employee id dismissed in breach of contract, the restrictive covenants will cease to be enforceable in any event. It is therefore often advisable to include a payment in lieu of notice clause in senior employees' contracts.

Question

How do I deal with my growing pains - as a teenager?

By letting people go in the right way

This will allow the employer to dismiss the employee by paying them in lieu of notice and still, in principle, enforce the restrictive covenants.

Five Steps to Avoiding Costly Disputes

- *Consider including in any employment agreement express circumstances in which an employee can be dismissed without notice, provisions for garden leave, payment in lieu of notice and any post-termination restrictions.*

- *Operate a fair disciplinary process; this includes inviting the employee to a disciplinary interview and giving him an opportunity to answer the allegations made against him.*

- *Provide written reasons for dismissal where requested (or where necessary – for example, if dismissing a female employee on maternity leave).*

- *Agree good leaver / bad leaver provisions with employees at the start of their employment.*

- *Get the psychology right: when dismissing staff, be rational and professional; do not attempt to apportion blame or make promises which the business cannot keep.*

To learn more about compliance and how you can protect your business, email **Andy Moseby** at Kemp Little LLP at andy.moseby@kemplittle.com.

Question **How do I deal with my growing pains - as a teenager?**

By not making a mistake when you due diligence an acquisition

Matthew Gorman, Associate, Corporate Stephenson Harwood

Introduction

It is an oft recited fact that the majority of M&A deals fail to deliver on the bountiful blessings that they promise. Indeed, in a recent survey by KPMG *The Morning After, Driving for post deal success,* it was found that 69% of M&A deals were regarded as value neutral or worse by respondents.

For many SMEs, an acquisition can represent one of the quickest and easiest means of growth: identify a smaller/underperforming synergistic target and mop it up to gain critical mass, increased market share or a wider product range. However, M&A prices are currently riding high as a result of increased levels of activity fuelled by various factors including relatively low interest rates and the seemingly insatiable appetite of the private equity market. As a result of these higher prices the margins to be derived from M&A deals are tighter and against this backdrop it is critical that those with acquisition plans have a clear understanding of the value that can be extracted from the targets they are eyeing.

This is where the due diligence process comes in.

What is due diligence?

In simple terms, due diligence is the investigatory process by which the buyer forms an understanding and appreciation of the target, its business and the actual and potential risks and rewards of owning and operating that business. Due diligence is founded on a number of concepts including:

•**Buyer beware**: If you don't do the due diligence then (subject to the nature and extent of the warranties) you have no protection.

•**Forewarned is forearmed:** If you discover something unfavourable which the seller has not revealed you can plan for it even if it is adverse.

Question

How do I deal with my growing pains - as a teenager?

By not making a mistake when you due diligence an acquisition

Knowledge is power: Matters discovered via due diligence can be used to adjust the price/obtain other concessions.

It is generally accepted that due diligence can be divided into 3 categories:

•**Legal:** Does the target own its assets, have enforceable contracts or a pensions black hole?

•**Financial:** Are the target's financial systems sufficiently robust, do the numbers stack up and are the accounting practices followed by the target appropriate?

•**Commercial:** Where does the target sit in the industry, how did it get there and can it maintain / grow its position?

What are the pitfalls?

Due diligence is not without its disadvantages:

•**Reliance on warranties:** Warranties serve an important function in the M&A process and, subject to disclosures, enable the buyer to claim against the seller in the event of a breach. However, buyers should be aware of over-reliance on warranties as a substitute for due diligence. Not only can suing on a warranty be expensive and the outcome uncertain but the buyer may prefer to walk away if it discovers the full facts during negotiation. Few buyers do sue on warranties in practice.

•**Unwanted information:** Care should be taken to avoid too much due diligence in areas where the warranty cover is regarded as adequate protection. It may be preferable to rely on a wide warranty rather than undermining it with heavy due diligence, particularly if more expenditure would be required to understand the results!

•**Areas of responsibility:** Be sure to establish clearly which advisor is responsible for which aspect of the due diligence process. This should prevent both overlap and gaps (e.g. on tax).

Question

How do I deal with my growing pains - as a teenager?

By not making a mistake when you due diligence an acquisition

•**Management time:** For a smaller buyer with a lean management team time is a precious commodity. A protracted due diligence process can deflect from the day to day operations of the buyer's existing business so it is important to ensure that any due diligence that is undertaken has real value.

•**Cost:** Lawyers, accountants and other professionals required for a due diligence exercise can be expensive.

•**Lack of focus**: Identify the scope of the due diligence exercise at the outset so as not to waste resources on areas which are not material to the business.

•**Seller fatigue**: Sellers regularly complain that a buyer's due diligence team is pursuing lines of enquiry that are of no intrinsic value to an understanding of the business. Often this is bluster on the part of a nervous seller with a wardrobe full of skeletons. However, where it is true, this can alienate the seller who forms the perception that the buyer is uncommercial and that this will manifest itself on the documentation phase of the transaction too. In a competitive situation this situation needs to be managed to ensure that it doesn't result in the seller favouring a competitive bid.

•**Seller ignorance:** Even the most honest seller can be oblivious to problems within its business. It is therefore unwise to assume that a seller's responses to due diligence questions constitute a complete and accurate picture of the target and its business and assets.

•**Future plans:** Buyers commonly fail to adequately plan the post-acquisition phase of the transaction. Where a proper strategic plan is put in place in advance it should inform the due diligence process enabling the buyer and its advisers to better understand those areas of the target's business that are likely to be important to the buyer going forward. The results of a well-planned due diligence exercise may also provide a useful reference point particularly if considering an IPO in the future.

Question **How do I deal with my growing pains - as a teenager?**

By not making a mistake when you due diligence an acquisition

•**Panacea factor:** Buyers often wrongly assume that a detailed due diligence exercise is the solution to all their problems and that close attention to technical risks will deliver a harmonious and profitable union. However, the majority of businesses are about people and the buyer needs to understand that it is likely to be the quality, attitude and commitment of the target's staff that will determine whether an acquisition is successful.

•**Cultural issues:** Part of commercial due diligence, these are often overlooked. Two businesses in the same geographical and product market can have completely disparate corporate cultures which may prove to be highly incompatible.

Why bother?

As stated, a full scope due diligence process can be expensive and time consuming. However, a sensible and focussed due diligence exercise can deliver important advantages:

•**Negotiating tool:** Issues unearthed through the due diligence process can be used to negotiate the price down or to obtain other strategic concessions.

•**Unchallenged problems:** Internal audits and reviews will rarely, if ever, be as rigorous as a third party due diligence exercise. Accordingly, it is often the case that a seller is unaware of certain problems in its own business.

•**Technical areas:** Even very commercial operators can fail to appreciate some of the risks associated with their business or the assets it owns. This is particularly the case with more complex organisations. In an ever more technical world, voluminous and detailed legislation has given rise to many areas (such as pensions and environment) where only a specialist can hope to understand all the issues.

•**Spring clean:** In the process of integrating a newly acquired target, due diligence reports produced at the time of the acquisition can be invaluable tools for the buyer's management. Problems which were identified but which were not critical in the context of the acquisition can be prioritised; as can areas where the integration effort is likely to be most intense.

Question How do I deal with my growing pains - as a teenager?

By not making a mistake when you due diligence an acquisition

Summary

For a buyer, due diligence is a critical aspect of the M&A process and, if undertaken properly, can deliver a variety of valuable benefits ranging from a better understanding of the target's business to the decision to abandon the transaction. However, due diligence can be time consuming and costly and can have adverse strategic consequences particularly if it appears to the seller lack focus or relevance. Accordingly, for SMEs and, in particular, small, fast growing business with lean management teams and limited resources, the due diligence process needs to be tailored to the wider strategic plan. It should be formulated in conjunction with the buyer's advisory team and should be informed by a clear understanding of how the target will be integrated into the buyer's business post-acquisition.

Matthew Gorman is an associate in the Corporate Department of Stephenson Harwood. To contact him, please email: matthew.gorman@shlegal.com.

Notes

Published by TMRM Ltd
Swallows Lodge
Knowle Hill
Chew Magna
Somerset
BS40 8TE
Tel: +44 (0) 1275 333 443
Fax: +44 (0) 1275 333 443

First edition: September 2006