

# Chapter 1

## Preparing for Business

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### *In This Chapter*

- ▶ Getting to grips with the basics of business strategy
  - ▶ Working up to opening up
  - ▶ Measuring your business's viability
  - ▶ Growing for success
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**W**hen you're starting a business, particularly your first business, you need to carry out the same level of preparation as you would for crossing the Gobi Desert or exploring the jungles of South America. You're entering hostile territory.

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

This chapter sets the scene to make sure that you're well prepared for the journey ahead.

### *Understanding the Enduring Rules of Business Strategy*

When you're engulfed by enthusiasm for an idea for a new business or engaged in the challenge of getting it off the ground you can easily miss out on the knowledge you can gain by lifting your eyes up and taking the big picture on board too. There isn't much point in taking aim at the wrong target from the outset!

Credit for devising the most succinct and usable way to get a handle on the big picture has to be given to Michael E. Porter, who trained as an economist at Princeton, taking his MBA at Harvard Business School where he's now a professor. Porter's research led him to conclude that two factors above all influence a business's chances of making superior profits – surely an absolute must if you're going to all the pain of working for yourself.

- ✔ **The attractiveness or otherwise of the industry in which it primarily operates.** That's down to your research, a subject I cover in Chapters 2 and 4.
- ✔ **How the business positions itself within the industry in terms of an organisation's sphere of influence.** In that respect a business can only have a cost advantage if it can make products or deliver services for less than others. Or the business may be different in a way that matters to consumers, so that its offers are unique, or at least relatively so.

Porter added a further twist to his prescription. Businesses can follow either a cost advantage path or a differentiation path industry wide, or they can take a third path – they can concentrate on a narrow specific segment either with cost advantage or differentiation. This he termed *focus strategy*, which I discuss in the following sections.

## ***Focus, focus, focus***

Whoa up a minute. Before you can get a handle on focus you need to understand exactly what the good professor means by *cost leadership* and *differentiation*, because the combination of those provides the most fruitful arena for a new business to compete.

### ***Cost leadership***

Don't confuse low cost with low price. A business with low costs may or may not pass those savings on to customers. Alternatively, the business could use low costs alongside tight cost controls and low margins to create an effective barrier to others considering either entering or extending their penetration of that market.

Businesses are most likely to achieve low cost strategies in large markets, requiring large-scale capital investment, where production or service volumes are high and businesses can achieve economies of scale from long runs. If you have deep pockets, or can put together a proposition that convinces the money men to stump up the cash, this could be an avenue to pursue. (I cover everything you need to put together a great business plan in Chapter 6.)

Ryanair and easyJet are examples of fairly recent business start-ups where analysing every component of the business made it possible to strip out major elements of cost – meals, free baggage and allocated seating, for example – while leaving the essential proposition – we will fly you from A to B – intact. Enough of a strategy to give bigger, more established rivals such as British Airways a few sleepless nights.

### ***Differentiation***

The key to *differentiation* (making sure your product or service has a unique element that makes it stand out from the rest) is a deep understanding of what customers really want and need and more importantly what they're prepared to pay more for. Apple's opening strategy was based around a 'fun' operating system based on icons, rather than the dull MS-DOS. This belief was based on Apple's understanding that computer users were mostly young and wanted an intuitive command system and the 'graphical user interface' delivered just that. Apple has continued its differentiation strategy, but added design and fashion to ease of control to the ways in which it delivers extra value. Sony and BMW are also examples of differentiators. Both have distinctive and desirable differences in their products and neither they nor Apple offer the lowest price in their respective industries; customers are willing to pay extra for the idiosyncratic and prized differences embedded in their products.

Consumers can be a pretty fickle bunch. Just dangle something faster, brighter or just plain newer and you can usually grab their attention. Your difference doesn't have to be profound or even high-tech to capture a slice of the market. Book buyers rushed in droves to Waterstone's for no more profound a reason than that its doors remained open in the evenings and on Sundays, when most other established bookshops were firmly closed.

### ***Focus***

Your patience is about to be rewarded. Now I can get to the strategy that Porter reckoned was the most fruitful for new business starters to plunge into.

*Focused strategy* involves concentrating on serving a particular market or a defined geographic region. IKEA, for example, targets young, white collar workers as its prime customer segment, selling through 235 stores in more than 30 countries. Ingvar Kamprad, an entrepreneur from the Småland province in southern Sweden, who founded the business in the late 1940s, offers home furnishing products of good function and design at prices young people can afford. He achieves this by using simple cost-cutting solutions that don't affect the quality of products. (You can read more about Kamprad in the nearby sidebar 'Less is more'.)

Warren Buffett, the world's richest man, knows a thing or two about focus. His investment company combined with Mars to buy US chewing gum manufacturer Wrigley for \$23 billion (£11.6 billion) in May 2008. Chicago-based Wrigley, which launched its Spearmint and Juicy Fruit gums in the 1890s, has specialised in chewing gum ever since and consistently outperformed its more diversified competitors. Wrigley is the only major consumer products company to grow comfortably faster than the population in its markets and above the rate of inflation. Over the past decade or so, for example, other consumer products companies have diversified. Gillette moved into batteries used to drive many of its products by acquiring Duracell. Nestlé bought Ralston Purina, Dreyer's, Ice Cream Partners and Chef America. Both have trailed Wrigley's performance.

Businesses often lose their focus over time and periodically have to rediscover their core strategic purpose. Procter & Gamble is an example of a business that had to refocus to cure weak growth. In 2000 the company was losing share in seven of its top nine categories, and had lowered earnings expectations four times in two quarters. This prompted the company to restructure and refocus on its core business, big brands, big customers and big countries. Procter & Gamble sold off non-core businesses, establishing five global business units with a closely focused product portfolio.

## *Appreciating the forces at work in your sector*

Aside from articulating the generic approach to business strategy, Porter's other major contribution to the field was what has become known as the Five Forces Theory of Industry Structure. Porter postulated that you have to understand the five forces that drive competition in an industry as part of process of choosing which of the three generic strategies (cost leadership, differentiation or focus) to pursue. The forces he identified are:

- ✓ **Threat of substitution:** Can customers buy something else instead of your product? For example, Apple and to a lesser extent Sony have laptop computers that are distinctive enough to make substitution difficult. Dell, on the other hand, faces intense competition from dozens of other suppliers with near identical products competing mostly on price alone.
- ✓ **Threat of new entrants:** If it's easy to enter your market, start-up costs are low and no barriers to entry, such as intellectual property protection, exist then the threat is high.

- ✔ **Supplier power:** Usually, the fewer the suppliers, the more powerful they are. Oil is a classic example where less than a dozen countries supply the whole market and consequently can set prices.
- ✔ **Buyer power:** In the food market, for example, just a few, powerful supermarket buyers are supplied by thousands of much smaller businesses, so the buyers are often able to dictate terms.
- ✔ **Industry competition:** The number and capability of competitors is one determinant of a business's power. Few competitors with relatively less attractive products or services lower the intensity of rivalry in a sector. Often these sectors slip into *oligopolistic behaviour*, preferring to collude rather than compete. You can see a video clip of Professor Porter discussing the five force model on the Harvard Business School website (<http://hbr.org/2008/01/the-five-competitive-forces-that-shape-strategy/ar/1>).

## Recognising the first-to-market fallacy

People use the words 'first mover advantage' like a mantra to justify a head-long rush into starting a business without doing enough basic research. That won't happen to you – after all, you're reading this book and by the end of this section you'll be glad you paused for thought.

The idea that you have the best chance of being successful if you get in first is one of the most enduring in business theory and practice. Entrepreneurs and established giants are always in a race to be first. Research from the 1980s claimed to show that market pioneers have enduring advantages in distribution, product-line breadth, product quality and, especially, market share.



### Less is more

Furniture company IKEA was founded by Ingvar Kamprad when he was just 17, having cut his teeth on selling matches to his nearby neighbours at the age of 5, followed by spells selling flower seeds, greeting cards, Christmas decorations and eventually furniture. Worth £16 billion, Kamprad is the world's seventh richest man, but lives frugally, in keeping with the functional nature of the IKEA brand. He

lives in a bungalow, flies easyJet and drives an 18-year-old Volvo. When he arrived at a gala dinner recently to collect a business award, the security guard turned him away because he saw Kamprad getting off a bus. He and his wife Margaretha are often seen dining in cheap restaurants. He does his food shopping in the afternoon when prices are lower and even then haggles prices down.

Beguiling though the theory of first mover advantage is, it's probably wrong. Gerard Tellis, of the University of Southern California, and Peter Golder, of New York University's Stern Business School, argue in their research that previous studies on the subject were deeply flawed. In the first instance earlier studies were based on surveys of surviving companies and brands, excluding all the pioneers that failed. This helps some companies to look as though they were first to market even when they weren't. Procter & Gamble boasts that it created America's disposable-nappy (diaper) business. In fact a company called Chux launched its product a quarter of a century before Procter & Gamble entered the market in 1961.

Also, the questions used to gather much of the data in earlier research were at best ambiguous and perhaps dangerously so. For example, researchers had used the term 'one of the pioneers in first developing such products or services' as a proxy for 'first to market'. The authors emphasise their point by listing popular misconceptions of who the real pioneers were across the 66 markets they analysed:

- ✓ **Online book sales:** Amazon (wrong), Books.com (right).
- ✓ **Copiers:** Xerox (wrong); IBM (right).
- ✓ **PCs:** IBM/Apple (both wrong); Micro Instrumentation Telemetry Systems (right) – it introduced its PC, the Altair, a \$400 kit, in 1974 followed by Tandy Corporation (Radio Shack) in 1977.

In fact the most compelling evidence from all the research is that nearly half of all firms pursuing a first to market strategy are fated to fail, but those following fairly close behind are three times as likely to succeed. Tellis and Golder claim the best strategy is to enter the market a few years after pioneers, learn from their mistakes, benefit from their product and market development and be more certain about customer preferences.

## *Getting in Shape to Start Up*

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

The following sections help you through a pre-opening check-up so that you can be absolutely certain that your abilities and interests are closely aligned to those that the business you have in mind requires. The sections also help you to check that a profitable market exists for your products or services.

You can use these sections as a vehicle for sifting through your business ideas to see whether they're worth the devotion of time and energy that you need to start up a business.



You may well not have all the expertise you need to do everything yourself. Chapter 7 introduces you to the zillions of agencies and advisers who can fill in the gaps in your expertise.

## *Assessing your abilities*

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

- ✔ **Nature:** If one of your parents or siblings runs their own business, successfully or otherwise, you're highly likely to start up your own business. No big surprise here, as the rules and experiences of business are being discussed every day and some of it's bound to rub off. It also helps if you're a risk taker who's comfortable with uncertainty.
- ✔ **Nurture:** For every entrepreneur whose parents or siblings have a business there are two who don't. If you can find a business idea that excites you and has the prospect of providing personal satisfaction and wealth, then you can assemble all the skills and resources needed to succeed in your own business. You need to acquire good planning and organizational skills (Chapter 6 covers all aspects of writing a business plan) and either develop a well-rounded knowledge of basic finance, people management, operational systems, business law, marketing and selling, or get help and advice from people who have that knowledge.
- ✔ **Risk taker:** If you crave certainty in everything you do, then running your own business may be something of a culture shock. By the time the demand for a product or service is an absolutely sure-fire thing, there may already be too many other businesses in the market to leave much room for you. Don't confuse risk taking with a pure gamble. You need to be able to weigh matters up and make your risk a calculated one.
- ✔ **Jack-of-all-trades:** You need to be prepared to do any business task at any time. The buck definitely stops with you when you run your own business. You can't tell a customer that his delivery is late just because a driver fails to show up. You just have to put in a few more hours and do the job yourself.

## Discovering a real need

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



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

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



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

- ✓ **Cost reduction and economy:** Anything that saves customers money is always an attractive proposition. Lastminute.com's appeal is that it acts as a 'warehouse' for unsold hotel rooms and airline tickets that you can have at a heavy discount.
- ✓ **Fear and security:** Products that protect customers from any danger, however obscure, are enduringly appealing. When Long-Term Capital Management (LTCM), one of America's largest hedge funds, collapsed and had to be rescued by the Federal Reserve at a cost of \$2 billion, it nearly brought down the American financial system single-handedly. Two months later Ian and Susan Jenkins launched the first issue of their magazine, *EuroHedge*. At the time 35 hedge funds existed in Europe, but investors knew little about them and were rightly fearful for their investments. *EuroHedge* provided information and protection to a nervous market and five years after its launch the Jenkinsons sold the magazine for £16.5 million.
- ✓ **Greed:** Anything that offers the prospect of making exceptional returns is always a winner. *Competitors' Companion*, a magazine aimed at helping anyone become a regular competition winner, was an immediate success. The proposition was simple: subscribe and you get your money back if you don't win a competition prize worth at least your subscription. The

magazine provided details of every competition being run that week, details of how to enter, the factual answers to all the questions and pointers on how to answer any tie breakers. It also provided the inspiration to ensure success with this sentence: you have to enter competitions in order to have a chance of winning them.

- ✓ **Niche markets:** Big markets are usually the habitat of big business – encroach on their territory at your peril. New businesses thrive in markets that are too small even to be an appetite whetter to established firms. These market niches are often easy prey to new entrants because businesses have usually neglected, ignored or served them badly in the past.

## *Checking the fit of the business*

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

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

## *Confirming Viability*

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

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

## *Researching the market*

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



## Inflated numbers on the Internet

If you plan to advertise on an Internet site it makes sense to check out the different sites you're considering. Be aware that some sites publish a fair amount of gobbledygook about the high number of 'hits' (often millions) they receive. Millions of hits don't mean that the site has millions of visitors. Some Internet sites increase their hit rate by the simple expedient of leading each viewer through a number of pages, each of which adds to the number of hits. Another mildly meaningless measure of the advertising value of a site is the notion of a *subscriber*. In Internet parlance anyone visiting a website and giving over their email address becomes part of that company's share price! Compare that to the suggestion that anyone

passing a shop and glancing in the window turns into hard cash the following day.

Any real analysis of website use starts with *page impression*, which is a measure of how many times an individual page has been viewed. The Audit Bureau of Circulations, which started its life measuring newspaper response, has now turned its attention to auditing websites ([www.abc.org.uk](http://www.abc.org.uk)). Also check out the World Internet Usage website ([www.internetworldstats.com/stats.htm](http://www.internetworldstats.com/stats.htm)) for the latest statistics on Internet penetration by continent and country. That gives you a realistic measure of the maximum traffic and relative importance of each market you're interested in.

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

The areas to research include:

- ✓ **Your customers:** Who may buy more of your existing goods and services and who may buy your new goods and services? How many such customers exist? What particular customer needs do you meet?
- ✓ **Your competitors:** Who are you competing with in your product/market areas? What are those firms' strengths and weaknesses?

- ✔ **Your product or service:** How can you tailor your product or service to meet customer needs and give you an edge in the market?
- ✔ **The price:** What do customers see as giving value for money, so encouraging both loyalty and referral?
- ✔ **The advertising and promotional material:** What newspapers, journals and so forth do your potential customers read and what websites do they visit? Unglamorous as it is, analysing data on what messages actually influence people to buy, rather than just to click, holds the key to identifying where and how to promote your products and service.
- ✔ **Channels of distribution:** How can you get to your customers and who do you need to distribute your products or services? You may need to use retailers, wholesalers, mail order or the Internet. These methods all have different costs and if you use one or more, each wants a slice of your margin.
- ✔ **Your location:** Where do you need to be to reach your customers most easily at minimum cost? Sometimes you don't actually need to be anywhere near your market, particularly if you anticipate most of your sales coming from the Internet. If this is the case you need to have a strategy to make sure that potential customers can find your website.



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

## *Doing the numbers*

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

You absolutely must establish the financial viability of your idea before you invest money in it or approach outsiders for backing. You need to carry out a thorough appraisal of the business's financial requirements. If the numbers come out as unworkable, you can then rethink your business proposition without losing anything. If the figures look good, then you can go ahead and prepare cash flow projections, a profit and loss account and a balance sheet, and put together the all-important business plan. (Chapters 6 and 13 cover these procedures.)



You need to establish for your business:

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

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

## Raising the money

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



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

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

Alternative financing methods include raising money from family and friends, applying for grants and awards, and entering business competitions. Check out Chapter 8 for a review of all these sources of financing.



The Financial Services Authority, a City watchdog, ordered all banks to publish statistics on complaints on their website from 31 August 2010. Lloyds had received 288,717 complaints in the first six months of the year, Santander 244,978, Barclays 195,956 and HSBC had just 65,236. If your bank is high on this name and shame list get straight on to Chapter 8 where I cover all aspects of raising money.

## *Writing up the business plan*

A *business plan* is a selling document that conveys the excitement and promise of your business to potential backers and stakeholders. These potential backers can include bankers, venture capital firms, family, friends and others who may help you launch your business if they only know what you want to do. (Chapter 8 considers how to find and approach sources of finance.)

Getting money is expensive, time consuming and hard work. Having said that, you can get a quick decision. One recent start-up succeeded in raising £3 million in eight days, after the founder turned down an earlier offer of £1 million made just 40 minutes after he presented his business plan. Your business plan should cover what you expect to achieve over the next three years. (Chapter 6 gives full details on how to write a winning business plan.)



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

- ✓ **Hit them with the benefits:** You need to spell out exactly what you do, for whom and why that matters. One such statement that has the ring of practical authority is: 'Our website makes ordering gardening products simple. It saves the average customer two hours a week browsing catalogues and £250 a year through discounts not otherwise available from garden centres. We have surveyed 200 home gardeners, who rate efficient purchasing as a key priority.'
- ✓ **Make your projections believable.** Sales projections always look like a hockey stick – a straight line curving rapidly upwards towards the end. You have to explain exactly what drives growth, how you capture sales and what the link between activity and results is. The profit margins are key numbers in your projections, alongside sales forecasts. Financiers tend to probe these figures in depth, so show the build-up in detail.
- ✓ **Say how big the market is.** Financiers feel safer backing people in big markets. Capturing a fraction of a percentage of a massive market may be hard to achieve – but if you get it at least the effort is worth it. Going for 10 per cent of a market measured in millions rather than billions may come to the same number, but the result isn't as interesting.

- ✓ **Introduce yourself and your team.** You need to sound like winners with a track record of great accomplishments.
- ✓ **Include non-executive directors.** Sometimes a heavyweight outsider can lend extra credibility to a business proposition. If you know or have access to someone with a successful track record in your area of business who has time on his hands, you can invite him to help. If you plan to trade as a limited company (Chapter 5 has details on legal structures) you can ask him to be a director, without specific executive responsibilities beyond being on hand to offer advice. But non-executive directors do need to have relevant experience or be able to open doors and do deals. Check out organisations such as Venture Investment Partners ([www.ventureip.co.uk](http://www.ventureip.co.uk)) and First Flight Placement's non-exec search site ([www.nonexecutivedirector.co.uk](http://www.nonexecutivedirector.co.uk)) for information on tracking down the right non-executive director for your business.
- ✓ **Provide financial forecasts.** You need projected cash flows, profit and loss accounts and balance sheets for at least three years ahead. No one believes them after Year 1, but the thinking behind them is what's important.
- ✓ **Demonstrate the product or service.** Financiers need to see what the customer is going to get. A mock-up is okay or, failing that, a picture or diagram. For a service, show how customers can gain from using it – that it can help with improved production scheduling and so reduce stock holding, for example.
- ✓ **Spell out the benefits to your potential investors.** Tell them that you can repay their money within  $x$  years, even on your most cautious projections. Or if you're speaking to an equity investor, tell him what return he may get on his investment when you sell the business in three or five years' time.

## Going for Growth

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

Businesses follow a similar formula: most successful new businesses, those that survive that is, reach a plateau within five to seven years. At that stage the business employs 5 to 20 people and has annual sales of between £250,000 and £1 million. Of the 4.4 million private businesses operating in the United Kingdom, fewer than 120,000 have a turnover in excess of £1 million

a year. That doesn't represent a bad result. Viewed from the position of a one-man-band start-up, having a couple of hundred thousand pounds in sales each year is an admirable (and unusual) success.

The following sections demonstrate the great benefits of growth (Chapters 15, 16, 17 and 18 contain more advice on how to make your business grow).

## ***Gaining economies of scale***

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

## ***Securing a competitive advantage***

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

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

## ***Retaining key staff***

The surest way to ensure that a business fails is to have a continual churn of employees coming and going. You have to invest valuable time and money in every new employee before he becomes productive, so the more staff you lose the more growth you sacrifice. Most employers believe that their staff work for money and their key staff work for more money. The facts don't really support this hypothesis. All the evidence is that employees want to have an interesting job and recognition and praise for their achievements. In Chapter 18 you can find out how to get the best out of your staff.

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

## *Gaining critical business mass*

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

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

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