

## **Baker Tilly Owner-Managed Business Report 2009**

Unprecedented activity on the global markets has caused chaos and uncertainty for many businesses. However, the downturn has also created opportunities which companies can capitalise on and expand their operations.

Baker Tilly conducted 300 interviews with board directors at private businesses across the UK<sup>1</sup> to gauge opinions on what the current economic climate means for the nation's commercial heartland. Here we analyse the results and consider courses of action companies can take to both survive and thrive in challenging times.

The survey covered firms across all industry sectors located throughout the UK, and found the outlook for the short-term prospects for the UK economy were mixed. Growth has undoubtedly been stifled with sales down and profits waning, which is forcing half of respondents to consider redundancies. However, the economic slowdown has also given businesses an excuse to analyse their processes and systems, implement moves to improve efficiency and streamline operations. There is also a renewed optimism for merger and acquisition deals, and firms have identified growth potential through absorbing new business from defunct competitors.

### **Growth predictions**

Forty-two per cent of respondents predict a drop in sales in the coming 12 months, while 37% expect them to remain static. However, 42% of respondents say they expect gross margins to stay the same, although 45% of businesses did predict falls. Operating profits will be down at 55% of firms, while 25% anticipate that they will stay the same.

With such difficult conditions ahead for many businesses, respondents to the survey said they anticipated making staff cuts and reducing operating costs.

One marketing director at a financial services firm says: *"At the moment the outlook is not good; we are working in a very bleak economic climate. The trend is for companies to shed staff and look to reduce operating costs as much as possible."*

A second marketing director at a larger financial services firm adds: *"With the downturn in economy the trend is for companies to go bust. Companies are looking at their processes, cutting staff, cutting budgets. It will be a struggle for the next couple of years."*

<sup>1</sup> The survey was undertaken during December 2008 and February 2009

### **Regional results**

More than three-fifths of respondents in the North-West responded optimistically to the survey, with just 38% expecting a decrease in sales. Elsewhere the Midlands proved the most pessimistic, with nearly half (48%) of those surveyed in Central-West and 44% in Central-East expecting a decrease in sales.

London and the South-East also anticipated a slowdown in growth with 43% of London firms predicting a decline in sales and 45% remaining static. In the South-East the figures were 41% and 38% respectively.

However, London and the South-East exhibited the most anxiety about the impact of the downturn, with 67% of London firms and 63% of South-Eastern companies labelling the recession a 'major threat'.

Just 43% of respondents in the North-East and 45% in Scotland expressed the same fears.

*"Although the recession is affecting all parts of the country, there are still some geographical oddities. It appears to be hitting different regions at different times and will affect those most dependent on specific sectors such as car manufacturing."* Simon Hart, Partner at Baker Tilly

### **Size matters**

Large businesses were the most optimistic about the future for the UK economy, with 46% of those with a turnover of £50 million or more expecting an increase in sales. The smallest firms (turnover under £10 million) were the second most positive with 23% expecting a growth in sales. However, a further 40% expected a decrease. Firms in the middle (a turnover between £21 million and £30 million) were the most pessimistic with 55% expecting a decrease in sales and just 14% predicting an upturn.

*"Large firms are often better capitalised and are better placed to cope with a slow down. However, on the flipside, smaller firms are more nimble and can adapt to changing economic environments. Those firms in the middle need to consider where they can tighten up processes and improve efficiency."* Rob Donaldson, Head of M&A and Private Equity at Baker Tilly

### **Sector results**

The survey reveals that all sectors of the UK economy are affected, although property, transport, retail and industrial products are feeling it the most. Of all the sectors, property had the greatest chance of a fall in gross margins and operating profits, and the second most likely after retail to see a fall in sales.

*"The most vulnerable sectors saw a fairly significant impact late last year, especially property and anything related to property. We are now seeing the majority of other sectors starting to feel the pinch."* David Blacher, Partner at Baker Tilly specialising in media, entertainment and leisure

However, technology and telecoms fared better than other sectors and proved to be the least likely to see a fall in gross margins and operating profits. The finance director at a technology and telecoms company says: *"There is a decline in retail manufacturing of consumer electronic goods, which creates a surplus. This is good for us as we deal in surplus and we see this as a main opportunity for us."* The MD at a transport firm notes: *"We are involved in the sale of agriculture machinery and have had the best year in 2008. I think the agriculture market will remain relatively strong."*

## Opportunities for growth

Although respondents widely expected a slow down in sales, they also identified opportunities to expand which fell into three broad camps, M&A activity, organic growth and international expansion.

### M&A activity

Appetite for acquisitions and joint ventures proved high among respondents to the survey. More than a third (38%) have plans to engage in transactions in the coming three years as the difficult markets create casualties which strong businesses can snap up.

*"It's a once in a generation opportunity for businesses to grow through acquisition. If you are in the fortunate enough position of having cash or access to finance there are some fantastic bargains out there. You have to be careful as some of the businesses are very cheap for good reason but there are some great deals and we are certainly doing transactions where the pricing has dropped considerably from where it was."* Rob Donaldson

Businesses considering M&A activity need to advertise they are in the market for a sale, and contact advisers to see what's in the market. Purchasers need to plan for the deal and be ready to act quickly by using an adviser to speed up the process.

*"If you think there's a good opportunity, don't waste time, talk about the structure of the deal and see if there is a fit straightaway."* Rob Donaldson

Businesses can also consider opportunities outside of straight acquisitions either through joint ventures, buying in new teams of people and via franchises.

### Organic growth

Respondents to the survey recognised that as businesses fall victim to the current economic climate, surviving firms would be able to absorb their competitors' businesses. One finance director at a small property firm says: *"The more companies that go bankrupt, the more work there is for us."*

A general 'shift to thrift' from consumers has also led businesses to rethink their product ranges and renegotiate service arrangements with clients. One MD at a transport firm says he has experienced a noticeable demand for cheaper products and the company has responded to that.

Other companies have rewritten deals with clients to streamline services which have reduced costs for both provider and customer. Firms are also capitalising on new technology and moving online to harness new markets and create opportunities.

The finance director at a small financial services firm says: *"The future lies in the digital world; it is our biggest opportunity."*

*"While your competitors fall away you will be there to pick up the business. I have one or two clients that are very lean with few costs and they are taking advantage of less competition."* David Blacher

### **International expansion**

More businesses are recognising the need to take their offerings across borders and capitalise on the burgeoning opportunities overseas. One quarter of respondents expanded abroad in the past three years, while 21% plan to continue that trend in the next three years, a move which has been accelerated by the depreciation in sterling.

The operations director at a technology and telecoms company, says his firm is branching out into Eastern Europe, adding: *"We need to look at emerging markets and focus on increasing sales in those countries as there is limited scope for domestic growth at the moment."*

*"Over a quarter of our clients are expanding globally. More and more businesses will shackle themselves if they are not prepared to look abroad for business opportunities."* David Blacher

Companies considering a move overseas need to be prepared for differences in tax and regulatory regimes in different countries. By using an adviser in your home country, who has experience of dealing with global expansion, you can ensure your international framework is set up effectively.

## Sharpening up management

A large proportion of respondents to the survey admit their businesses were not set up to cope with such severe economic conditions. However, many directors see this realisation as an opportunity to improve management and sharpen up business processes.

The finance director at an entertainment and media company says: *"We need to review our current strategies as a consequence of the current economic climate. The landscape has changed quite markedly in the last six to 12 months and so we must adapt our strategies accordingly."*

To improve business function, focus should be on the 'four Ps': planning; performance indicators; people; and processes.

### Planning

While 80% of respondents say they have an up-to-date business plan, only two thirds (67%) say this is effective in giving them a competitive advantage, suggesting they need to tighten up their focus. Businesses need to have a clear plan, show discipline when executing it, and still be able to react quickly to changes in circumstance.

*"Businesses need to think towards the long-term and ensure they are prepared for an upturn in fortunes. There needs to be a balance between the here and now and a focus on the future."*  
Simon Hart

### Performance indicators

Eighty-three per cent of OMBs have key performance indicators (KPIs) in place with more than half (53%) believing this to be beneficial. However, this suggests a large proportion of firms could get more out of their KPIs.

To get the best out of performance indicators, businesses need to keep them relevant and succinct, and subject them to regular review. The KPIs also need to be communicated to the relevant people across the business.

*"Are businesses using the right KPIs for the prevailing conditions and are they being communicated to the right people? They need to be relevant to the current conditions so could include a focus on reducing debtor days, or regularly contacting clients, and then communicating that to the rest of the business."* Simon Hart

### People

More than half of the businesses surveyed said they planned to make redundancies in the next 12 months. Retail was the most likely sector to make cuts to its staffing levels, followed by industrial products, financial services, transport and property. Technology and telecoms businesses were least likely to scale back their workforces.

In spite of the planned cuts in manpower, firms still see people as their most important resource and consider staff loyalty a key strength. The CEO of a transport firm says: *"I think people have to be our strength. We have had people who have worked here for over 20 years. Whole families work here. Loyalty from our staff is really our main strength."*

However, the survey showed businesses needed to do more when it came to motivating and incentivising employees. Just 59% of businesses said they had a succession plan and only 56% communicate the business plan to their workforce. Just over half (51%) provided flexible benefits while less than a quarter (23%) offered a share scheme.

*“Soft people skills are now invaluable in these times; businesses must make sure they are keeping the workforce up-to-date and communicating with them properly. They need to feel included and part of the team.”* David Blacher

*“People respond to positive leadership and if they see that management have made hard decisions to protect the majority of jobs, employees will react to that. It’s about communication and, within reason, giving the remaining staff the good grace of letting them know the situation.”* Simon Hart

There are also opportunities to improve numbers of skilled staff in the workforce as the job market is flooded with talented people who were previously unavailable before the recession took hold. More than one in 10 (11%) of respondents said they had plans to increase headcount in the next 12 months, with 36% keeping numbers static.

*“There are good people out there so it’s an opportunity for firms to acquire talent which they couldn’t have got a year ago when people were in very short supply. Now there are lots of them around so businesses can set themselves up for when things pick up.”* David Blacher

### **Process**

Underpinning the other ‘Ps’ is an overall robust process that channels the business towards its goals. A coherent process should run across the business and employees should understand what the company is trying to achieve. Directors must be ready to support changes in processes and ensure key messages are communicated across the firm. Where necessary, call on advisers to provide an independent view on where efficiencies can be achieved.

The director of a small financial services firm says: *“We need to have more efficient processes particularly in HR. We also need to have more help from senior management to roll this out across the company.”*

## Exit strategies

Forty per cent of respondents to the Baker Tilly survey said they planned to exit their businesses within the next decade, with more than one-fifth expecting to do so within five years.

Planning is a key element of a successful exit and firms need to start thinking about this long before the actual date of sale. Get succession plans in place early and make arrangements to incentivise management for the exit. Start getting the business ready for sale by getting contracts in order, planning your P&L and generally tidying up the firm's appearance.

It is imperative you have experienced advisers that can push the deal from both sides. Ask them for references and make sure they appoint senior people to your team.

*"It often amazes me how little preparation some people do for an exit. Ideally the business needs to get itself in shape for a transaction a couple of years ahead, so although nobody in their right mind would try and sell a business today unless they have to, it is a good time to be getting ready."*  
Rob Donaldson

## The four threats

There are numerous issues facing UK businesses in the current climate, but the survey identified four key threats to the future growth and security of OMBs.

### Slowing demand

Nearly nine out of 10 (88%) businesses surveyed said they saw slowing demand as a threat to growth and profitability in the next two years. However, nimble businesses should be able to survive by reacting quickly to the changing consumer demand. Firms also need to be more creative in the way they generate business and offer services. The MD of a transport firm says: *"We have diversified, we are more widespread and we have more products to sell."*

*"Businesses have to be quick to trim their cost base to fit the sales they generate. Those who are slow to respond and realign their businesses are at best going to suffer and at worst go out of business."*

*"Everyone has the responsibility to be more proactive about how they win work. They need to be entrepreneurial and innovative which could be as simple as changing the way they sell and giving incentives to customers for paying early, looking to do bulk discounts or delivering services differently." David Blacher*

### Access to capital

Nearly three-quarters (72%) of OMBs see access to capital – or the lack of it – as a threat to business in the next two years.

One managing director of a technology and telecoms firm says: *"We have the capacity to grow our business even during these lean times, but sourcing funds is a problem."*

Respondents to the survey expressed a preference for raising debt over equity, with 19% planning to increase debt over the next three years and just 10% looking at equity. However, debt may not be the most effective way to finance a business in uncertain times and businesses should reconsider the benefits of private equity which gives greater flexibility.

There are numerous private equity firms who are willing to invest but there are rules of engagement and businesses must be aware of the risks. Firms need to choose investors carefully and use an independent firm to introduce them to reputable players.

*"Probably not as many businesses are considering private equity as much as they should. They need to understand that the whole environment for raising money has changed and almost everything you have learnt over the last 10-12 years needs to be reconsidered."*

*"There is still a preference to raise debt as it avoids any dilution but there is a lack of appreciation of the downside of debt which is how inflexible it is when you get to an environment like this. There are lots of private equity firms out there who still have plenty of money to invest and who are looking for the opportunity to fund businesses through the downturn." Rob Donaldson*

## **Government burden**

Government efforts to reduce the impact of the financial downturn through fiscal stimulus packages, has done little to alleviate pressure on the OMBs responding to the survey. Seventy-four per cent say increasing regulation is a major problem, while two-thirds say the tax burden is a threat to the financial security of their business.

However, there are ways to cope with the regulatory and tax system in the UK, firstly by hiring a competent accountant and adviser, and secondly by communicating with the authorities.

*“The main thing is not to bury your head in the sand; keep talking to advisers and maintain lines of communication.”* Simon Hart

*“HMRC is becoming far more flexible in arrangements for you to pay your taxes. The key point is to talk to HMRC; don’t wait until you default and can’t make your payment.”* David Blacher

## **Counter-party and supplier risk**

As more businesses fall victim to the recession, respondents to the survey see counter-party and supplier risk as a major threat to their firms. If creditors go bust owing businesses money, or suppliers are unable to deliver, OMBs are left in precarious position. Business need to keep a close eye on suppliers and conduct proper checks on clients before taking them on.

*“Stay close to your suppliers and key clients. If you are taking on clients do proper credit checks on them, don’t give them automatic credit terms that you would have a year ago.”* David Blacher

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