trowers & hamlins

thinking Business

ISSUE SIX

Contents

Welcome to the latest of Thinking Business, in which we share our latest insights and thinking with a view to supporting growth and sustainability in our clients' businesses.

In this edition, we have chosen to focus on the theme of 'Driving Change', considering some of the many ways in which UK businesses – currently faced with a great deal of uncertainty on a number of fronts – can capitalise on the opportunities presented by technological, social and political transformation. With a lack of clarity continuing to surround the Brexit process and the threat of an economic slowdown now concerning many in the UK, companies find themselves in a period of unprecedented change. Personal computers, smartphones and the internet have created and destroyed entire industries in the past two decades and artificial intelligence and robotics will do the same in the years ahead.

This issue looks at just a few ways in which this accelerating pace of change is impacting UK businesses and considers opportunities that arise from the transformations that impact our clients most, such as:

- Adapting to the changing face of work – How can employers adapt to the changing work patterns, attitudes and demands of the new generation of employees?

- Making a business investable – How can owner-managed businesses prepare for the next step in their own evolution, and shape up for investment from growth capital or private equity?

- Keeping ahead in information technology – What are the latest trends and developments in the world of IT and how can users make sure they continue to get the best deal from IT suppliers?

- Unlocking regional growth in the UK – Given the prosperity gaps that exist across the UK, particularly between London and the regions, what is the latest government policy and how can businesses support efforts to unlock regional growth?

- Supporting an environmentally sustainable future – As the environment becomes a high-priority issue for consumers and employees, how can businesses demonstrate that they are taking the issue seriously?

We hope you'll enjoy reading this and that you'll find some interesting food for thought over the course of the following pages.

We would love to hear your thoughts on these topics, so please do get in touch with your usual Trowers & Hamlins contact on thinkingbusiness@trowers.com. You can also follow us on Twitter @Trowers.

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Adapting to the changing face of work

The world of work is transforming at a rapid pace, with the next generation of employees demanding a wholly different set of policies, procedures and relationships to those that went before. Millennials are embracing not only agile working but zero-hour contracts and other atypical working arrangements. The expectation of a job for life is now but a distant memory, replaced by new demands of employers much more likely to be focused around culture, ethics and responsibilities.


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The Employment and Pensions team has developed a new Future of Work blueprint to support clients. This includes a multi-generational workforce and issues ranging from the shift in real estate investment towards more co-working and flexible workspaces to challenges associated with employment status for casual workers in the gig economy.

Emma Burrows, head of the Employment and Pensions team, says: "With the rising number of employment tribunals (doubling last year) and a focus of many on #metoo allegations, some of the biggest risks we see our clients facing at the moment are discrimination risks. People are much more likely to come forward with these types of complaints now and demand action. Claims of whistle-blowing and discrimination by one employee against another are increasing, and those can be high-value and demand a huge amount of management time to reach a satisfactory resolution."

In the new climate, there is a growing onus on employers to be proactive and look after the well-being of staff, and that includes physical, mental and financial well-being. Starting with physical well-being, employers need to make sure procedures and practices are understood to ensure employees take regular breaks, have time to visit the doctors when they are unwell and work in a healthy environment, which emcompasses the state of the buildings. Such measures can lead not only to happier employees but also to reduced absence as a result of sick leave.

"When it comes to mental well-being," says Burrows, "we increasingly see companies putting in place mental health first-aiders, and giving people training on understanding mental health, to provide support in instances of stress at work"

Rebecca McKay, a pensions partner says: "There is a lot that employers can do to support employees with their financial well-being. Financial stress causes a huge cost to UK plc as a result of lost work-time and it really is something that employers should take seriously.

"Today's employees are less interested in perks like table tennis tables and much more focused on the support that employers can offer in demystifying pensions or offering savings tools"

She adds, "Historically, employers have tended to steer away from some of these products for fear of falling foul of legislation and being perceived to be giving financial advice. But that is, in fact, a very manageable risk and there is lots that they can do, which really supports employee recruitment, retention and well-being."

In addition to well-being, the changing face of the labour market is placing new demands on employers from a legal and compliance perspective. Employment contracts change much more today than they ever used to and must now take account of much broader definitions of employment status. They must also adapt to agile working by changing performance targets to be based more on outputs and deliverables rather than inputs, or hours spent behind the desk.

"Flexible working creates a lot of new challenges for employers that people are only beginning to understand."

First are the risks associated with people working at home, when employers have a responsibility to set them up to be working from home. Some people fudge that, but it does create legal risks. Secondly, you have got to make sure you can manage the work that is done in an agile space, which is a new challenge to many employers. That can be very difficult and can create real issues of trust within the workforce." says Burrows.

She adds: "Lastly, it's very difficult to overestimate the lack of control that you have as a result of people not being in the office when it comes to your data, intellectual property and so on. You have to really focus on data security and protecting corporate wealth, because it is frankly a lot easier for people to behave irresponsibly with confidential information when they are not working alongside a colleague."

One solution is to invest heavily in tools that facilitate people working together, organising regular check-ins and focusing on building the team ethos by new means in the absence of workplace camaraderie.

MAKING A BUSINESS INVESTABLE

Two-thirds of UK businesses are currently family owned (accounting for a quarter of UK GDP and employing over 12 million people between them). There are potentially a significant number of companies at any one time working towards securing either private equity funds or growth capital from investors to assist in the next stage of their development. But in the run-up to such a transformation, what should business owners focus on, if they want to be attractive to a new equity backer?

The truth is that mid-market private equity investors look at a wide array of factors when considering making an investment, some of them financial, and some much broader. Tim Nye, a partner in the corporate department at Towers & Hamlins, says: “From a financial perspective, an investor will look for predictability of earnings, with recurring revenue streams being very attractive, and the solidity of the underlying customer base. Statutory or needs-based revenue streams in areas such as health and social care, whether from local authorities or NHS trusts, give a defensive element to the revenue stream that is always attractive to investors.”

As well as drilling into revenues, investors will also be keen to understand the history behind the current numbers, seeking to identify an enduring growth story over time as opposed to a recent boom that may be followed by bust.

“Aligned to that are some non-financial characteristics,” says Nye. “The key one being the management team and whether that is strong and cohesive.

“The financials are a snapshot of where the business is and where it has come from, but it is the future that an investor is focused on and that is represented by the management team.”

Potential backers will seek assurances that the management team has the talent, market knowledge and foresight to remain at the forefront of developments and that they are all pulling in the same direction with the commitment and motivation to drive growth.

Another factor that routinely features on an investor’s shopping list of must-haves is a diversified customer base, to avoid any over-reliance on either a single client or a single industry sector. More defensively, most will focus during due diligence on the possibility of regulatory or legislative change that might impact the business, because such developments have the potential to cause significant harm. In recent years we have seen valuations in certain sectors impacted considerably simply by politicians threatening, for example, caps on the rates of interest that can be charged by payday lenders, caps on the prices that health and social care suppliers can charge the NHS and caps on prices chargeable by energy and utility providers.

Turning to the bigger picture, there will be considerable focus given to the potential for the business to expand, whether into new markets, geographies or products and services, and also to the exit strategy. Nye says: “Typically these investors see themselves as custodians who, after a period of time, will want to realise their investment and move on. They will look for the existence of aggregators or large strategic buyers, and the prospects for an initial public offering, by considering recent exits by competitors and what returns those have generated.”

Outside of the private equity space, where investors are usually looking at businesses that have proved a concept and are now looking to build that out, there is a whole other set of owner-managed entities that are at a much earlier stage in development. These start-up businesses are typically yet to build a convincing track record and so represent a bigger risk, making them attractive to a different set of investors, including high net worth individuals, private offices and smaller venture funds.

Adrian Jones, a Trowers corporate partner, says: “These types of investors are focused on predictions of growth, because the business probably has limited or no turnover today, which means the business owner has to convince an investor of his or her vision and how that is going to be achievable.”

In this space, the challenge is much more around articulating an ambition, explaining how the idea differs from current offerings available in the market and producing a robust business plan showing the value creation on offer to an investor.

“Investors are looking at the potential for growth and the timescale to realise a return on their investments,” says Jones.

“They are looking to the founder and the managers to see if they have the capability to deliver a transition from a start-up into a fully-fledged business.”

One fundamental skillset that investors are seeking at this stage of a business lifecycle is the ability of management to lead change. “There comes a point at which achieving the growth that everyone wants requires bringing in outside help,” says Jones. “The more successful businesses that we see clients investing in are those that can smoothly manage that transition and bring in professional management and non-executives where needed.”

Investors may be keen to inject their own strategic boardroom expertise and support the professionalisation of key functions with enhanced financial analysis, digital capabilities or marketing skills. Owners seeking investment need to be ready to welcome and embrace that new level of sophistication.

Whilst many investors may expect to professionalise practices and procedures, good corporate practice is important to potential investors, who will typically scrutinise a company’s corporate governance arrangements as part of due diligence. They may not necessarily walk away from a deal because policies and procedures need improvement.

Nye says: “There’s a level of due diligence that is always done on an investment and a level of expectation as to how a business should be run. A mid-market investor is going to look at whether there are regular board meetings, are recommendations implemented, are there protective practices in place such as an anti-corruption policy, what do the employment policies look like and are they adhered to, and so on. But they are not looking because they won’t invest if those things are not right. Rather, it is about understanding how much may need to be changed and understanding what the impact of that change is going to be, particularly on the culture of the business.”

That said, any owner-manager seeking external equity would be well-advised to consider what investors might be focused on ahead of time,

“Every business should go through a bit of pre-sale grooming – a kind of pre-investment audit,”

Jones says. “The intention is to ensure that the sort of things that an investor will want to see, such as customer contracts, employment terms, details of IP ownership are present and correct. This is an opportunity to fill in any gaps and prepare answers to inevitable questions. It gives people a warmer feeling that if they ask questions, proper answers will be forthcoming and can avoid scrabbling around trying to ‘fix’ things in front of an investor.”

At the end of the day, most investment decisions rest on the strength of the relationships built up between management teams and those looking to inject capital, so putting time into preparations is rarely wasted.

KEEPING AHEAD IN INFORMATION TECHNOLOGY

As more and more businesses continue to migrate to cloud technology to reduce costs and drive efficiencies across their IT operations, there is a growing appreciation of the challenges associated not only with transition, but also with ongoing management. While business objectives may be met through cloud adoption, with access improved and security tightened, the aftermath of migration can present a raft of new issues for business owners to consider.

Riccardo Abbate, a partner in the corporate department at Trowers & Hamlins, says: “One consequence of moving to the cloud is that you have to be a lot more thoughtful as a client about how you monitor the output you are getting. This is about good contract management, which requires monitoring the service you are receiving and making sure it is consistently fit for purpose.”

A company may be used to a level of forgiveness around IT glitches or failings while its own staff were managing servers on the premises, but once a third-party provider takes over responsibility, there should be an expectation of higher standards.

“Once you are outsourcing,” says Abbate, “then the onus is on you to include key performance indicators in the contract and measure whether the service is what it should be, not just in terms of functionality, but also in terms of service quality.”

Vigilance can be required around the future-proofing terms included in a contract, which will often require software vendors to update their offering to meet new legislation. Abbate says many providers now challenge this and push the boundaries. This includes attempting to charge extra money for new products designed to better facilitate developments like compliance with the new General Data Protection Regulation, when these updates should have been provided under the terms of the original arrangement.

Amardeep Gill is a partner in the commercial department at the firm and is often involved in outsourcing projects for purchasers looking to access the latest developments in 5G, automation or artificial intelligence. He says that while companies may not immediately understand how such technologies actually work, there is still an obligation on the part of the buyer to really get to grips with what might be on offer.

“There is a need to kick the tyres and scrutinise what you have at the moment and what you might like in the future,” says Gill. “You need to challenge yourself as a customer before you go out into the marketplace, and have at least a reasonable understanding of what you want from an output point of view and what your requirements are.”

Abbate says: “If you start the process on the right foot, having done your homework properly, that gives bidders the ability to provide a more meaningful response to a tender and the result is a much more positive process.”

One of the biggest challenges during the course of IT purchasing is the need to identify and articulate what is really needed, and then to develop the evaluation criteria against which to judge providers when they respond.

There are many ways in which a business owner can build up the necessary level of understanding, with IT consultants typically able to add some real value. Also of great use are the company’s employees, who may be encouraged to enter into a dialogue with management about IT through the introduction of user groups. “You can really get some great insights into what is going to make a difference to users and what might not,” says Abbate about the establishment of user groups. “You have to make sure that you educate yourself and avail the organisation of the right expertise.”

“Many IT contracts are signed by businesses looking to facilitate new ways of working or public sector entities looking to employ technology to improve the services they provide. Both want to deliver something slightly differently or more effectively and a good specification at the outset is at the heart of making that achievable.

“Technology is moving at such a pace that it is very hard to keep up, but some understanding of what it can offer is essential in order to make astute purchasing decisions.” says Gill.

Getting the contract right at the outset is, of course, also critical. That means agreeing delivery requirements upfront and reflecting those in key performance indicators, service level credits and descriptions of service-level quality to which providers can be held to account.

Finally, it is vital to ensure you do not get locked into a contract that is in practice very difficult to get out of if service standards are not up to scratch. Abbate says: “Make sure the contract has the appropriate handover provisions, so that if you choose later down the line to move to another provider, the contract reasonably provides that the existing provider has got to do its best to effectively transition you to the successor. Only then do you have a meaningful right of termination, if you know that the incumbent has to provide all reasonable support in the event of a handover.”

Negotiating IT procurement arrangements can be a lengthy and exhausting process. Committing to becoming a savvy purchaser is important, as is getting the contract right, monitoring delivery against pre-determined metrics and having the courage to move on if service is not entirely up to standard. Transferring IT operations to the cloud can bring immeasurable benefits, but scrutiny is required on an ongoing basis.

UNLOCKING REGIONAL GROWTH IN THE UK

The north-south divide in the UK has long been recognised, with wealth being unevenly distributed across the country and those living in London and the South East benefitting from profoundly different economic conditions to those living in the north.

Successive governments have rolled out policies aimed at re-balancing regional differences, with perhaps the most high-profile being the devolution measures that gave additional money and power to councils in the north. Andy Burnham was elected Mayor for Greater Manchester in 2017 and took control of £1 billion in devolved funds to spend on improving the city and attracting new businesses.

Dan Butler partner in the Manchester office says: "Historically, Manchester has boxed above its weight, but there is clearly a north-south divide that is going to take generations to rebalance.

"The key lies in being outward-facing and not allowing UK cities to compete against each other, as they have done for centuries, but rather to play to their own strengths."

Manchester has a rich heritage in innovation and manufacturing, with the largest and fastest growing economy outside London and a proud tradition of entrepreneurship, creativity and innovation. Population growth is a major fact in its continued success, with students, young professionals and new communities increasingly choosing to stay in Manchester as a result of its knowledge-based economy.

Amardeep Gill, a partner in the firm's Birmingham office, adds: "There is certainly a need for a bit more understanding of each region's strengths, and more mutual respect. Birmingham is not competing with Manchester and Leeds, it is competing with Paris and Frankfurt."

In 2014, the chancellor of the time, George Osborne announced the need to create a Northern Powerhouse, attempting to galvanise the 15 million-strong workforce across the northern cities and seeking to attract investment into the region. Before that, the coalition government established Local Enterprise Partnerships, which partner local authorities with private sector businesses. The intention being to determine local economic priorities and lead economic growth and job creation in an area. The coalition government also established Combined Authorities, which allow councils to collaborate across boundaries.

Gill says: "For me, the creation of local enterprise partnerships and Combined Authorities was one of the big policy drivers behind addressing regional inequalities. These big institutions are relatively new on the landscape and their responsibility is to bring their priorities together and act as a voice for the region. They continue to deliver and work on a pan-regional basis, particularly in Greater Manchester and the West Midlands, and they are doing great things."

"He adds, "I now know that if I wanted to work in Peterborough and Cambridgeshire, there is a central point that I can use for making contact. That is very important if you are a business looking at moving into a new area and contributing more to the local economy."

While such initiatives are embryonic and are only now bedding in, there are growing signs of businesses engaging and understanding what might be on offer in the form of financial incentives, research and development grants, incubator support or tax breaks.

Gill says: "There has to be consistency of policy so that people can play into what's on offer and we can start to see more signs of success. The money being distributed to Local Enterprise Partnerships is being swallowed up, and people now really want to work with the combined authorities because they know those are a helpful place to start."

There is already evidence of growth in the Manchester economy, thanks in part to the success of the international airport, which is undergoing a £1bn expansion programme and has added routes direct to China and India. Additionally the arrival of the BBC and the subsequent ITV relocation have enhanced the idea of the city as a media destination. "Businesses are at least now considering the need to have a footprint in the north," says Butler. "There is much more recognition that it makes economic sense for people to be here, whether that is the large Amazon hub that has been set up outside the airport or the growing number of law firms opening up."

A lot of the responsibility for social infrastructure has fallen on the shoulders of the public sector and local authorities have been dynamic in setting up joint ventures to provide services and facilities from local funds.

When it comes to regeneration in the north, further issues are raised in connection with struggling town centres, Butler says: “As well as changing the face of cities, there is a further consideration around towns – including the old mill towns and struggling seaside towns – which are also in need of regeneration. Much more needs to be done to encourage the growth of towns now that the cities are starting to put strategies in place.”

Connectivity is a vital feature of successful cities. Strong connections across and beyond Manchester ensure that people are able to fully access all the opportunities the city can offer. Improving Manchester’s connectivity, across the city region, the UK and internationally, will make it an increasingly attractive place for people to live, for businesses to invest and for visitors to enjoy.

Gill says: “Anecdotally, we are seeing big institutional investors wanting to come to the region now. There is a wealth of opportunity that will actually become far more important as the UK recalibrates its relationships with the rest of the world in a post-Brexit dynamic. There is a lot of potential for growth within our own borders, as much as elsewhere, and businesses need to be paying closer attention to the skills and opportunities of our local economies.”

A new report published by the British Foreign Policy Group, Manchester: Soft Power Entrepreneur, explains that Manchester is particularly well placed to succeed internationally. This is largely thanks to its global outlook and innovative approach to nurturing and harnessing its global reputation in areas such as sport, tourism, education, music, science and innovation and culture.

The report says Manchester is disproportionately important to the UK’s place in the world precisely because it has always done things its own way – blazing a trail for others to follow.

Government initiatives are starting to deliver on objectives of unlocking regional growth, and businesses now have a role to play in supporting those efforts moving forward, with any opportunities they can capitalise on throughout the country.

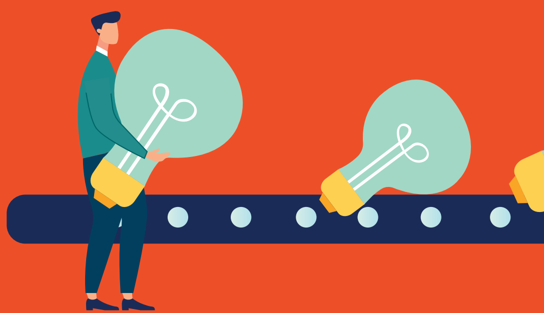
Supporting an environmentally sustainable future

There is growing evidence that the next generation of consumers, employees and investors views environmental sustainability as a fundamental priority across its activities, as demonstrated through the worldwide youth strikes on climate change and the everyday pressure being exerted through purchasing decisions. Large companies like Nike, Coca-Cola and Nestlé have made significant commitments to sustainability initiatives in response to consumer demand and there is now an onus on many others to start doing the same.

According to a Morgan Stanley report published in 2017, a younger generation of investors now overwhelmingly believes that investment decisions should be made with a view to making an impact. The Institute for Sustainable Investing report found 86% of millennials to be interested in sustainable investing, with that generation twice as likely as the overall investor population to invest in companies targeting social or environmental goals.

Whether driven by customers, current or potential employees, or investors, business leaders can no longer afford to ignore the question of environmental sustainability in their organisations. Rebecca McKay, a partner in the Towers & Hamlins pensions team, says:

> **"There is a groundswell of momentum gathering around the green issue and companies need to be much more aware of their own impact because the discussion is becoming so high-profile."**



Many of the large companies that have been driven to act have done so as a consequence of crisis, having been forced to be reactive, rather than proactive. Nike, for example, faced boycotts in the nineties as a result of poor labour practices in places like Indonesia, and became a pioneer in establishing transparency in its supply chain as a result.

In the absence of such crises, however, there are signs of a knowing-doing gap: research published by Boston Consulting Group and MIT found that whereas 90% of executives believed sustainability to be important, only 60% were incorporating it into their company's strategy and only 25% were putting it at the heart of their business model.

"Businesses recognise the importance of this and understand it is of value," says Alison Chivers, a partner in the London corporate team at Trowers & Hamlins. "But when push comes to shove, there are often other issues that are higher up the agenda. Many business leaders pay lip service to the environment rather than really getting to grips with a strategy that makes their business greener."

There is a clear distinction to be drawn between those businesses that see these topics as a matter of compliance with the growing body of regulation on minimising environmental damage, and those that seek to excel as a means of achieving a competitive advantage. While companies must undoubtedly address compliance first, particularly in relation to waste management, pollution and human rights, which are of significant concern to investors, they can undoubtedly go further. Indeed, there are now many industry-led initiatives putting pressure on companies to up their game, such as the Global Real Estate Sustainability Benchmark, which is an evaluation system for measuring the performance of property companies and real estate funds against sustainability criteria.

Amanda Stubbs, a partner in the firm's Environment, Health and Safety team, says one way that businesses can immediately take action is by making their buildings both healthier and more environmentally friendly. She says: "There is clear evidence that if staff feel better about the place in which they work, they will view their employer, and the business as a whole, more positively.

"Having staff committed to what the business is doing locally and within its own premises, is one of the quickest ways of making a difference and improve productivity."

Whether those day-to-day changes involve putting recycling stations within easy reach of every desk, switching from plastic to glass bottles or moving towards paperless offices, the results can help workers recognise that their employer is taking its environmental impact seriously, as well as introduce efficiencies that support the bottom line. Some companies are moving towards using electric vehicles across their businesses in place of petrol or diesel, and there are even now providers that can offer companies access to ‘transport as a service’, whereby businesses get access to a fleet of zero emission vehicles and are charged on a pay-as-you-use basis.

Firms that take the lead on such initiatives win a competitive advantage with their customers, save money, and immediately become more attractive to millennial recruits. Statistics show that greener companies are often more efficient and profitable, if not immediately then certainly in the longer term.

“You have both the very large global organisations taking a lead on this, and the smaller start-ups. The big businesses are taking action because they are in the spotlight, but at the other end of the scale, many early-stage companies are really focused on creating a particular brand for themselves around sustainability, transparency and appealing to the socially-conscious consumer.”

Chivers adds, “The people in the middle are perhaps going to struggle the most with this, because they are of scale already and maybe the benefits of taking action are not so immediately obvious. Those businesses should be encouraged to not only comply but to put together a business case where they can try to link some of these environmental and sustainability issues with strategy, using metrics that they can measure.”

Whether the practical initiatives that make sense for a business are focused on reducing waste, eliminating plastic bags, installing sensors to turn lights off in buildings, improving water usage efficiency, sourcing materials sustainably or reducing pollution across the supply chain, success can only really be achieved through buy-in both at board level and across the business.

"The advantage that younger companies have," says Stubbs, "is that they are often run by entrepreneurial thinks free from pre-conceived ideas about how things should be done, with fewer long-standing employees resistant to change. They are open to doing things differently from the outset, and that's why that is where we are seeing real change driven by the belief in doing something better."

Chivers concludes: "The challenge for all company leaders now is to recognise this as a future trend and appreciate that action is going to be required. The sooner they can get on the front foot, the better positioned they will be."

She adds, "By factoring sustainability into strategic decisions today, it really is possible to achieve genuine competitive advantages for the future."

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