Industry Knowledge for Business Advantage

PO Box 463
Cummaquid, MA 02637
United States of America
Tel: +1 508 362 3480
Fax: +1 508 362 4162
www.cambashi.com

Simplifying Business Multiplication

Use information to execute a growth strategy

Julie Fraser, Cambashi Inc.

August 2010

Federal ID No. 26-2432982. Registered office as above.

Table of Contents

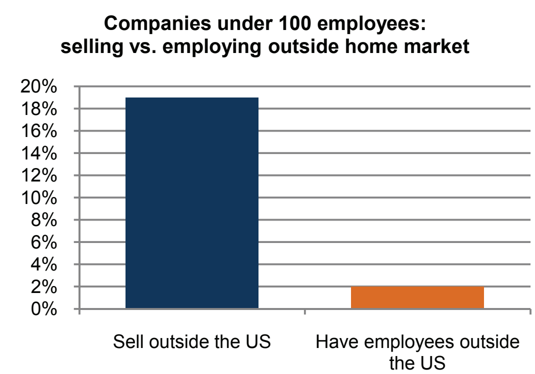
Thank you to Sage Software for its sponsorship which has allowed us to report our views in this format.

Growth by Business Multiplication

Small and medium size businesses often thrive by being high-value specialists. The dilemma is how to stay specialized in a particular niche yet grow aggressively. In early start-up mode, this is rarely a problem. However, once a company establishes itself, new sales may suffer as the number of unserved prospects dwindles. The math for growth may not work by a simple approach of trying to add customers. One obvious approach is to multiply rather than add, expanding the available market by targeting new markets or demographic groups, often in new regions.

There are two obvious approaches to this geographic expansion. 1) Distribution: Sell or distribute products in regions or countries that the company does not currently serve. 2) Multiplication: Open and operate a subsidiary in a region that is not currently served or not fully penetrated.

Selling outside of the home territory – and indeed outside of the native country – is increasingly attractive. A study of privately held US companies of under 100 employees by the University of Maryland Robert H. Smith School of Business and Network Solutions, *The State of Small Business Report*, found that 19% (or nearly one of five) surveyed sell outside the US. This survey showed 2% (or one of 50) of those companies have employees outside the US (Figure 1).



Source: ©2010 *The State of Small Business Report*
University of Maryland Robert H. Smith School of Business and Network Solutions

Figure 1: Companies of fewer than 100 employees may sell internationally, but few employ people outside their home or headquarters market.

Many smaller companies have selected option 1 listed above, distribution. They are selling in remote regions of the country or the world with no local staff. This partner / distribution approach can be very successful, but does have serious challenges. These include:

- loss of control over the sales process and customer relationship
- lower visibility into customer needs and preferences in these new regions that can hamper development of market-leading products and services
- risk of intellectual property theft or inappropriate sharing with competitors
- risk to the brand if the products are not sold, (or where applicable, displayed, implemented, or serviced) to the customers' satisfaction
- eroded profit margins, since the local partners in each country will gain a cut of the revenue.

To mitigate these risks and grow successfully, companies of all sizes are using Option 2, multiplication. Multiplication is a new type of growth equation. It involves multiple locations, multiple languages, multiple currencies, and multiple operating companies. Subsidiaries are a necessary legal entity for expanding beyond a single country's borders. Subsidiaries can be useful even inside a single country to simplify compliance with regulations such as Sarbanes-Oxley. As with most business decisions, it is a trade off. This paper explores the challenges and how to overcome them.

Complexity Challenges

With expansion by subsidiaries comes an array of new complexities for the business. At the core, it's challenging to see exactly what is happening. It can be daunting to manage processes and information from separate businesses in a way that both allows the subsidiary to run successfully and helps managers gain a view of the total company.

Management: Knowing where to focus management attention is critical and, with separate sets of financial and operating data, that overall view can be challenging. Simply analyzing the health and performance of the overall business is difficult.

Transactions: Having one company that comprises multiple legal entities creates the need for transactions that span between these companies. Certainly financial transactions can become complex work processes among various subsidiaries and the main company.

The Allure of Globalization

The global opportunity is nearly irresistible. As the US and other industrialized countries struggle to move out of the economic crisis, emerging economies in China, Brazil, and many other countries, are now growing rapidly. To capture this growth opportunity, companies must have appropriate business processes and practices in place. To ensure that the growth is also profitable, those processes must be efficient and, ideally, automated.

The trend toward operating in multiple countries is accelerating. In some industries, such as medical devices, three-quarters of companies under $100M have internal or external operations outside the headquarters country[1]. As Figure 2 shows, the bulk are on the same continent, but that does not mean the issues are simple.

Currencies: Dealing with multiple currencies is complex. This is an issue whether the company has adopted option 1 or option 2, or simply buys materials from other countries. This issue has become far more challenging recently as exchange rates now fluctuate in a wider range and on a more frequent basis. Currency fluctuation can make it difficult to get a clear picture of how international sales and purchasing impact the bottom-line performance of a company. Sometimes a region appears to be underperforming to headquarters when it has made a profit in its own currency.

Compliance: Regulations in multiple regions may also create challenges. Tax laws and environmental regulations may vary even among various states or provinces in the same country. When moving into a global environment, there are many more localization issues to address with regulations often only available in that local language. As the sidebar above and Figure 2 show, some heavily regulated small companies have significant multi-national operations.

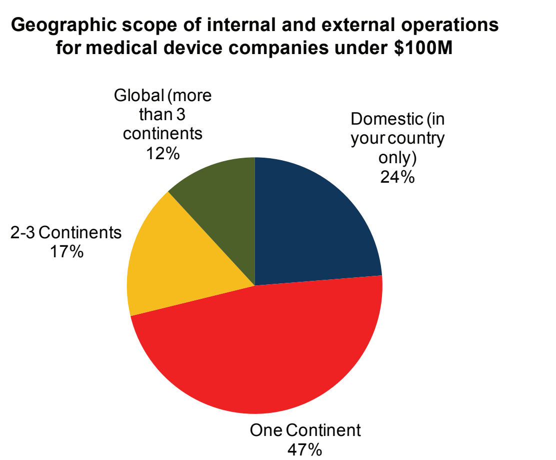


Figure 2: Most medical device companies – even smaller ones– sell products outside their home market.

Consistency: Companies moving to a multiplication strategy may find it challenging to ensure everyone deals with customers, suppliers and employees in the same way. Having a consistent face to the world requires consistent policies, practices, and effective communication across all parts of the company. Efficient internal operations can also present hurdles. Manufacturers and distributors that do not have a way to ensure everyone is executing to the same rules may suffer from confused and frustrated suppliers and customers, particularly those that are multi-national.

Yet the logic behind multiplication is sound. Growth beckons. Companies of all sizes have succeeded with multiple subsidiaries and employees in far flung corners of the world.

Key Information Systems Support

Companies that use this “multiplication” strategy to grow must be ready to create and sustain business processes that span the organization. Figure 3 shows some examples of these business processes that might span multiple legal companies and disciplines within those companies, and the new requirements that the multiplication strategy brings to those processes.

One of the only ways to efficiently create and sustain these complex multi-disciplinary processes is to have information systems in place that support them at headquarters and across all subsidiaries. Companies that have not yet made the move to establish a subsidiary may not know whether they have a business software system designed to support a multi-entity, multi-currency and possibly multi-country organization.

Fortunately, many ERP systems today have capabilities to support these multi-subsidiary and multi-national business models. In deciding whether the business software system you have will support you, there are a number of major areas to consider.

Localization: One of the obvious areas that companies do recognize in expanding, particularly into new countries, is the need for local language and local currencies. What may be less obvious is the need to comply with local regulations for taxes and financial reporting as well as in operational areas such as human resources, environmental health and safety, hazardous materials handling and reporting, and product labelling.

Consolidated Financials: Naturally, the company must be able to roll up a financial view across multiple subsidiaries with multiple currencies. This challenge is very difficult without a single IT system designed for this

Business Processes	Multiple Entity and Global Needs
Order-to-Cash Procure-to-Pay	Inter-company transactions Process payments and receipts in customer or supplier currencies Currency conversions (local and other) Intercompany general ledger entries Inter-company accounts payable invoices Inter-company credit notes & accounts
Accounting Financial Reporting	Distribute entries to each subsidiary Integrate with local tax services Roll up results from multiple entities Convert currencies Reconcile results with an audit trail Meet local regulations Manage functional and source currencies Restate balances for currency fluctuations
Manufacturing Quality & Compliance	Central views of purchased materials Plan and schedule to multi-entity capacity Local language employee support Make production location decisions Track materials across all suppliers and subsidiaries Meet local regulations at subsidiary sites
Distribution Customer Service	Fulfill customer orders across companies Multi-currency inventory accounting Local language customer and distributor support Cross-border import and export customs processes and paperwork Single face to the customer across subsidiaries and locations
Manage Performance Set Strategy	Roll up performance to company views with currency and other normalization Drill down to subsidiary views Analyze performance in local currency Analyze across subsidiaries

Figure 3: Key business processes for multiple-subsidiary businesses have complications that can hurt productivity if not handled in an efficient and automated manner.

multi-company and multi-national, multi-currency model. Beyond traditional system integration, this provides collaboration and faster reconciliation.

Multi-currency: Handling multiple currencies for buying, selling and operations is essential. Customers and suppliers expect it. Sound business systems today should handle an unlimited number of currencies and rate types. It's also important to be able to report either in source currencies or the functional currency of the headquarters company. Gains and losses from currency fluctuations need to be visible independently of the consolidated business results. Volatile exchange rates mean that reports are only accurate if the system provides comprehensive currency revaluation.

Intercompany Accounting: Accounting transactions must travel by very configurable routes to reflect relationships between subsidiaries and parent company on multiple levels and allow automatic distribution of transactions. The intricacies of intercompany transactions touch on general ledger items such as dividends and assets, accounts payable, loans, and taxes. A single transaction may involve multiple currencies, and intermediate and destination companies that might be multi-currency or single-currency entities. Reconciliation and audit trails must be able to take all of the currency exchanges and fluctuations into account.

Centralized and Local Management: It can be a challenge to extend streamlined lean practices across multiple subsidiaries, so some functions may be centralized while others are executed at a local level. Those that might make sense to centralize to some degree (or use a central process to decide where to execute locally) include purchasing, sales, production planning, logistics planning and inventory planning. Having the capability to move materials around, and buy and sell in the most profitable or local currency can impact efficiency and profits. Increasingly, these decisions also impact the green or sustainability credentials of the company.

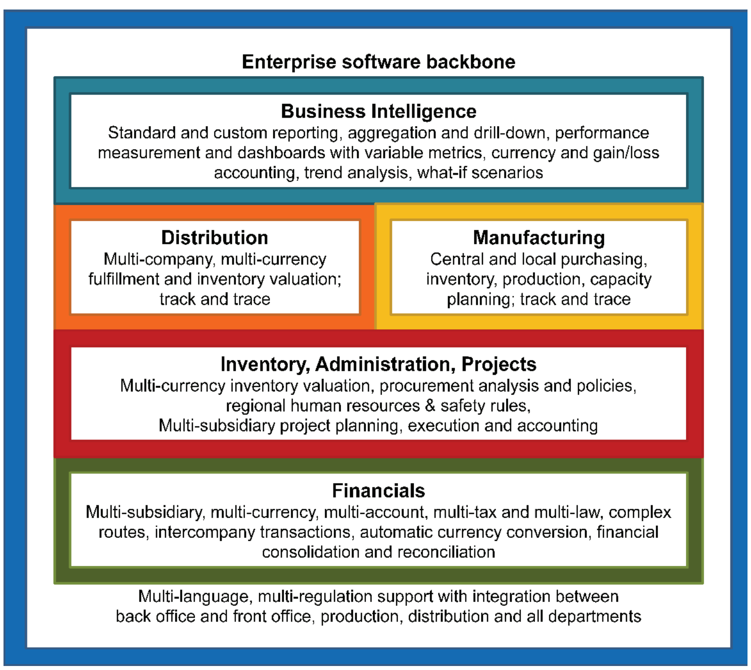


Figure 4: An integrated business management or ERP system with specific capabilities can simplify support for a multiplication strategy.

Business Intelligence: Even when business software automates transactions across multiple subsidiaries, making sound decisions in a multiplication model company can be a challenge. To achieve this, companies need the ability to aggregate and normalize data, analyze it for business meaning in reports and key performance indicators (KPIs) and then view it in a meaningful way. The views must support managers in the main company and the subsidiaries, in many different roles, levels and departments.

Figure 4 shows a concept of the major elements of such a business software system and key special features and functions the systems need to support a multiplication or globalization strategy. As with these business processes, the names of the major modules are familiar. However, since the processes are more complex, the business systems should automate these, or productivity and profitability may suffer.

Multiplying Opportunity Simply and Profitably

Companies of all sizes know there are opportunities in many parts of the world. Those trying to sell overseas without a local presence may find, or may already be finding, the competition difficult to beat. Others have found their intellectual property or brand image is at risk. To take full advantage of market opportunities, companies are choosing to multiply – create multiple subsidiaries that serve specific countries, regions, or segments.

The revenue opportunity from a multiplication strategy can be enormous. Then again, it is significantly more complex to deal with multiple languages, currencies, regulations, and operating companies than to operate in a single country or as a single legal entity. To ensure that a multiplication strategy fulfills its potential not just revenue but also for profit, companies must streamline the processes and information flows that support them.

While some of the processes will need to be developed to suit the specific company, good software can show the way. Support for business processes that work across subsidiaries can be delivered through the workflow capabilities of an enterprise software system. The system must support local subsidiaries fully, and ensure that each part of the business is both efficient and compliant.

When a company wants to grow faster than adding new customers in its current market scope allows, multiplication can be a sound business strategy. Many of the companies fear expanding to add a subsidiary effectively. Many will find that the ERP system they have today can automate complex transactions, operations, and decisions. This prevents multiplication complexities from overwhelming the business and hurting profits. In many cases, companies are finding that business software can pave the path to success with multiplication, making it both simpler and more profitable.

About Cambashi

Cambashi, based in Cambridge UK and Cummaquid MA, USA provides independent research and analysis of the business reasons to use of IT in industry world-wide. Its specialist fields include Engineering, Enterprise, Plant, and Supply Chain applications and the infrastructure to enable industrial firms to use IT effectively. Cambashi publishes market size estimates in the Engineering Applications Market Observatory and multi-client studies in Cambashi's Industry Directions. Its clients vary in size from small to large and include most of the leading software vendors and many pioneering IT users. Cambashi is a member of CATN, an international association of consultants. www.cambashi.com