Another string to the bow can add harmony

Jonathan Moules

It has long been a sensible strategy for entrepreneurs developing capital-intensive products to create parallel service arms that can generate a steady flow of cash.

The evaporation of bank lending has made the need for this service revenue even more acute for those wishing to expand their operations.

Guy Woodcock, founder of Montpellier, the marketing services group, is one entrepreneur who has turned to the cash from his company's services to fund expansion.

He says he has a good relationship with his lender, HSBC. But when, 12 months ago – at the height of the banking crisis – he wanted to create a couple of new web products aimed at small businesses, he was wary about approaching his local branch manager for extra loan facilities.

"We were in the crux of the self-destruction of the western world, so I thought it wasn't the best time to be having conversations about ventures that required funding," he says.

So, instead of borrowing money and hiring programmers, Woodcock reinvested the cash generated by his existing marketing services and redeployed two employees to run the product development.

This meant Woodcock had to wait months rather than weeks to get the new products to market, but he claims that this slower evolution resulted in a better solution than if it was put together to a tighter deadline.

"One of the things about an IT-based product is that it takes a long time to get right," he explains.

"Doing it the way we did meant that we could test early iterations on the product to make it better, something we couldn't have done if we had built the products in a few weeks."

Sometimes, a new service operation can provide benefits that were not originally envisaged.

When hotelier Simon Lester created a hotel management service in 2000 to run other people's establishments on their behalf, he thought it would be a good way to get his hands on rival hotels when the property market dipped.

"We had seen what happened in the last recession in the early 1990s when the banks had no-one to turn to when hotels became distressed assets because there were no hotel management companies," he explains.

"We decided that we would position ourselves in that niche."

The decision was driven by the fact that a services arm could be set up at minimal cost as opposed to the large capital expenditure needed to buy new hotels.

The hardest part was winning business for the new service, says Lester. He picked up contracts through informal networking using business clubs, in particular the Academy of Chief Executives.

"It is very much a relationship business," Lester says. "People will give you the hotel to run if they like you."

The most fruitful source of investor contacts has been his bank, Lloyds TSB. “In many cases, the bank has made a lending offer [to investors] on the basis that we are involved – which is very flattering.”

The main cost of Lester’s service operation was the manpower – a couple of people to head the business and five salespeople.

As it has turned out, Lester Hotels Management Service has not been offered many hotels for sale during the recession, largely because the all-time low interest rates have enabled rival owners to continue to pay their mortgages even as bookings have tumbled. “It hasn’t worked completely to plan,” Lester admits.

He insists that the services arm of Lester Hotels has still been a boon, however, because it has helped the overall business to double its profit and substantially increase revenues with only a minimal increase in overheads.

“The key part is that we are increasing turnover without increasing risk,” he says. Lester Hotels has eight properties under management, but plans to increase that to 15 within 12 months.

“The hoteliers win because they have a professional hotel company with an entrepreneurial spirit running their hotels,” Lester says. “We are to a certain extent reducing our risk because we now have a certain amount of fee-based income.”

FoundOcean, which specialises in securing oil platforms to the sea bed using its cementing technology, is a classic case of a capital- intensive business in need of regular investment.

The company is having a good recession, picking up contracts in the booming Asian market, where 60 oil platforms are due to be installed in the next couple of years.

However, it is still finding it difficult to raise finance to build more equipment to feed the growing number of projects, says Jim Bell, the company’s managing director. “The banks will offer interesting deals, but when you are just at the point of signing, they say ‘We want this additional piece of security,’” he says.

The company has invested £1m of its own cash in the business in the last two years and is looking to spend a similar amount again to ramp up capacity further. That is not easy for a company that only turns over about £5m.

Bell would prefer to have the option of a bank loan. “Getting some decent external funding would really unlock our growth potential,” he says.

Financial Times, London, Oct. 16th 2009, Entrepreneurship, online.