The Talking Law Podcast

Episode 109 – 6 steps to increasing the multiplier of your business - Part 2

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Transcript

Joanna: Hi, it's Joanna Oakey here and welcome back to Talking Law, a podcast proudly brought to you by a commercial legal practice Aspect Legal. Now today we have part two of our three part series which is all about the most important steps in fact, six steps to increasing the multiplier of your business, i.e. increasing the value of your business exponentially. And in order to talk about this topic we have on board, Marc Johnstone from Shirlaws group and Nathan Williams from Customer Return. Now, if you have not listened to part one of this three part series, I highly recommend you head back and go to the episode just prior to this one that you're listening to right now, so that you can hear us talk about what it means to increase the multiplier of your business and why you would care about that anyway. And as we delve also in that episode into step one, which was all about talent, capability, and culture. Now in this episode, we're continuing on with our six tips to increase the multiplier of your business, launching right into step number two. So let's Take it away.

Joanna: Okay, Marc and Nathan, I just want to say very big thank you for coming back for part two of our three part series, all about the six steps to increase the multiplier of your business. And of course, we had so much to say about this topic that in part one, we got to step one. But the aim is to try and get through steps two to six in this episode, guys, do you feel up to the challenge?

Nathan: Absolutely, Jo. Thanks for having us.

Marc: Definitely.

Joanna: Look I'm loving this discussion and that is clear by the fact that we only got through step one in part one. So in step two, let's just launch straight into it, for any of our listeners out there who missed part one, maybe go back listen to that first because we started up off with the first step of the six steps to increase the multiplier for your business and that's talent, capability and culture. So we've done that we've ticked that off. If you're interested in hearing more about that, well, you better head back to episode one. But now we are talking about step two. So guys, hit me with it. What is the second step to increasing the multiplier of your business?

Step 2: Product Innovation

Marc: Thanks, Joanna. The second step is to create product innovation in your way of doing business. So too many businesses we see out there, especially in the SME world, don't actually invest enough time in continuing to innovate their product, and systematize the way in which they do things. So what that means is you can get caught with a product that isn't ready to respond to market changes, or events like COVID. So that ability to have an innovation mindset around your product means that you're constantly changing your value proposition and restructuring your product so that you can create the most valuable revenue An example is taking, you know, a product That's got a large transactional revenue component, which is the customer only buys it once or twice, and changing that to a recurring revenue where they're, you know, on an annuity product base so that you've got recurring revenue because that's three times as valuable. And that's where Nathan spends a lot of his time with their clients, you know, moving that product based from transactional to reoccurring.

Joanna: And how do you do that Nathan? can you step us through what it is? How is it that you move the business from that once off into the recurring?

How to achieve an innovation mindset

Nathan: Thanks, Joanna, I think part of it is simply looking at what's the totality of the issue or the problem that the client is trying to solve. So what are they trying to get done for their clients? And then once you've understood the totality of what what the clients the business is trying to get done, then reverse engineering that and effectively productizing so as opposed to a one soft delivery, you know, whether it's once a product or once a service, so It's looking at stepping it out over 12 months, for example, and dealing with issues in a descending order from from most to slightly less important, and looking at what needs to be delivered, perhaps, whether it's face to face or over the phone and what can be done digitally.

And just look at different means of service delivery, as opposed to a soft one because, you know, I'm of the belief that if people want to get something once fit around a workshop, or once associ delivery, it's not enough to change behavior. So you really need to look at what's the totality of what the client's trying to get done. What can be delivered face to face, or as an event versus what needs to be stepped out being over the phone, online video, it's so different means of delivery, and making that subscription cost, not so high that people don't engage with it in the first case. So it's understanding the message, helping them prioritize the delivery of it, and then looking at the pricing that makes sense. So it's scalable so you get more users within a business or more individual users.

Joanna: Yeah, this and it's such a good point that that you make and I think many businesses perhaps don't understand the multiplier effect of having recurring revenue that we're talking about here. But certainly, most businesses I deal with understand, you know, the benefits of having this recurring revenue income stream coming into their business, but it's one thing to understand that, you know, it's one thing to understand it. So can you give us an example of, you know, maybe sort of a simple case study, an example of a business that didn't have a recurring revenue component and how you're able to turn that into recurring revenue for them.

Nathan: Marc, I might divert to you on that one. Sorry.

Understanding recurring revenue and case study examples

Marc: Yeah sure, a really good sector where this plays out a lot is the financial services sector, where you know, we've had a new because of superannuation introduced in 1992. We've had the emergence of the financial planning or the wealth management industry, whether they typically evolved from was stock broking and or accounting. So, what we see with a lot of the second and third tier stock broking companies is they've traditionally had stockbrokers that buy and sell stocks on behalf of their clients. So if I bring up my stock broker and say I want to buy $10,000 worth of bhp, well, that's $10,000 worth of revenue into the business, but it's only worth one time revenue on the balance sheet so that $10,000 is worth 10,000 bucks on their balance sheet.

If I speak to one of their financial advisors and say I want to become an advice client, and that company charges me $10,000 per year for that advice, during which I may or may not buy bhp that $10,000 sits as $30,000 on their balance sheet so it's three times more valuable so what we're seeing a lot of the stock broking firms to is trying And change their product mix or innovate their products in their offerings to what's called Wealth Management Services, wealth plus things like that, so that they can transfer their existing clients off trading or transactional, I want to buy stocks because you can go to comm sec, or there's plenty of websites to do that cheaply, and move them to advice based wealth plus wealth management processes, because it's much more valuable because it creates an annuity income.

Joanna: It's also a more holistic service, though, isn't it?

Marc: Yeah it is better for the client.

Joanna: You know more broadly about what it is that you can provide that value not just as a once off, but you know, that deep value that a client will want to continue paying for.

Marc: Exactly.

Joanna: But there lies the issue of you know, I love that you've called this product innovation, but it does require innovation at some point, you know, there has to be some creativity and thought,

Marc: And that's a really important point you make because what you've got to do is have it as a part of the way you do business, so you can't go to the Hunter Valley or Mornington Peninsula for an off site or to the Napa Valley if you're in San Francisco. And think about how we can do a product differently, what it has to be is through client surveys, internal processes, whereby on a monthly basis, you're looking at feedback, real time data around what people are buying, where the markets are moving, and the value proposition you can create. So it's got to be part of doing business. It's got to be month is scheduled on a monthly basis, using real life data, because that way you can control or create the return as opposed to most people do it as an afterthought is a strip at the strategic off site. And it doesn't really change anything in the business.

You know, you have a bunch of good ideas on the whiteboard. But nothing actually happens at the implementation level. So the importance of having data and processes and having an ongoing feedback loop internally and externally. You'll learn much more from your clients than you will from internal conversation, and critically, internally, it can't be just the partners or the directors, it's got to be through the whole business. It's got to be people that are speaking to clients at delivery and service level and support level. And they have to have a voice to provide that unvarnished feedback. Because you know, you're better off responding to the market quickly rather than reacting way too late.

Nathan: And just on that, yeah, I love that example mind because it does breed a lot of client examples where we did some work with a financial services dealer group that is one of the bank lawn dealer groups, this is not that long after the GFC. And the short version of the story is that they had some real hesitation about reaching out to their clients at that time because it was just like the GFC and things weren't going that great on the markets. But what ended up happening was we got engaged and ended up doing 1500 client feedback surveys, that effectively asked about three key areas. of the business, around product service delivery, those sorts of areas.

And why they in some ways are many ways fed. Well, the responses might be, what came out of that is they got an uplift in retained replacements, and also referral business such that the return on investment engagement was about seven times, wow. You know, and within about three to six months at the conclusion of that, or that engagement. So the point being that often businesses I find, can sometimes be reaching out to their clients, when things aren't going great. But that's actually when you want to do that because you'd rather hear the problem to be able to respond to it then not know. And so, you know, they were looking for new clients at this time at this GFC time, but the real goal was already in their database.

Joanna: I love it.

Nathan: We just gave them a framework by which to do that professionally independently, so we got feedback that they otherwise wouldn't have got. For example, the planner growing them up because most people don't tell. So when it comes to recurring revenue, while they didn't develop a whole lot of new products like deep increase their the number of products or services that the clients were buying, they got more thorough business. So after recurring revenue, you can just be getting more of who's already in your database, not just for product innovation, but by getting them buying more, coming back and getting them referring.

Joanna: And I guess when we talking about increasing the multiplier, this also then about having a system around that to you know, show that this is something that you can, that isn't a once off, you know, it's something that's happening, you know, either in the business,

Nathan: yeah, absolutely.

Marc: That as Nathan said, so that it's repeatable, so you just don't do it once but you have to make it part of your business practices. Yeah. Every month, you'll touch a certain number of clients and have a strategic review quarterly, so that you actually are part of how you do business.

Joanna: So I love this. So this is about product innovation and recurring revenue is about constant iterations. I say and I think some of the things that can be seen here are just so important, because many businesses, as I said before, businesses generally get recurring revenue is the thing that they're all out there fighting for. But it's quite often it's done exactly as you say, sort of in a silo. And what you're really talking about here is developing it by constant iteration, as you're constantly testing it, and making sure you're getting feedback from the market along the way regularly and doing that in a systemized way and to Nathan's point

Marc: It's unvarnished feedback. As Nathan said if someone who's delivering to the client brings up the client that will say nice things. Most people are nice people. So having an independent third do it, it is absolutely critical because they will say things to you or to your clients that they won't say to us so having someone else do that is really important and having your your frontline delivery stuff trained to listen to clients, most people train on, you know, if the client says this, say this back on what we're actually gonna do if a client says this, ask them why they asked me that, what more could they like, drill down on it and actually get them to tell you more because those little bits of information are worth gold to your business because the clients will tell you what you need to do and have and iterate and innovate in your business.

Nathan: And the follow up is really important. And I've heard Marc speak about this before that, you know, once you've got that feedback, often the next step, and again, this applies to product innovation is the most important and a lot of businesses don't do this. They might gather feedback, whether it's themselves or by using an independent provider. But then there's not an obvious next step for methods I mean, implement some terms of making part of the way you do business. The next step would obviously be, go to your clients and say thanks so much. Here's what we've heard, here's what I've learned. Here's what we'd like to explore doing, and then explore with the clients, you know, what products or services could then this serve them moving forward and almost take, like a research based mentality, you know, to that process, so you giving them feedback and then easier to implement on new products and services. Yeah,

Joanna: I absolutely love it. Obviously we're talking about something here that can completely change a business but I just want to throw it in there, sometimes it can be easier than it might look at. So I do a lot of work in recruitment. And one of the simple ways to move to increasing recurring revenue is to increase a temp placement where business where you might just be in perm placement. So there's some sort of, I guess, simple example. But you know, what we're talking about here obviously is looking at things in a more innovative way. But I just mean, they can find simple ways to look at this as well sometimes, yes. All right, brilliant. So let's move on to step number three, then the step six steps to increase the multiplier of your business what step number three.

Step 3: Product extension

Marc: So step number three is product extension. And this is where, you know, steps one and two are really important for a business that talent capability and culture and product innovation and systematisation, but where the rubber really hits the road and the highest impact for an SME are the next two steps which are both product extension and distribution channels because they are where the the highest impact and the highest return on investment. They're the most valuable things that an SME business owner can focus their attention on. Yeah, so step one, let's talk about the product first before we get to the channel extension. So if we go back to our business we've talked about which is a $3 million EBITDA business times three is a multiplier with a $9 million enterprise value. Well, that $3 million profit is probably coming off the back of nine dollars revenue, if it's a 30% margin business, which a lot of SMEs are. So if that $9 million revenue is all from one product, that business is less valuable than if it has two products doing $4.5 million.

So just to add a risk management level and above and an evaluation level, a business with two products is more valuable than a business with one because the market goal might go away, the market can change, and you've got nothing to fall back on. Whereas if you have two products doing $4.5 million, well, one of them might suffer from COVID, but one of them might actually be enhanced through COVID. So you have that inherent risk management. And of course, the other thing to recognize the second step to recognize when we look at product is that if you're doing $4.5 million of two products, well, we could probably get those to $9 million anyway, so if you spent $9 million you know, getting revenue normally knows revenue for one product, we can probably increase that 4.5 million dollars to nine anyway. So at a second step, there's that capacity for growth. But where it really comes into play is by creating product extension opportunities. Because as you roll them out, you get to leverage the brand and the value proposition that we're creating for our clients.

So the simplest example of that is Disney. It started with a comic strip in 1934. And Walt Disney was suriphobia, which means allergic to mice. So for the entrepreneurs out there, it doesn't necessarily mean it has to be something you love. He hated mice, but he saw a gap in the marketplace as an entrepreneur. So he started with a comic strip. His second product is P2 and that was cartoon characters. Their P3 was toys. Their fourth product was theme parks. their fifth product was TV and movies. And in fact, you know, for over 18 movies they have the touchstone brand, because Disney's brand is fun and safe for families and their P6 were cruise ships. In the world they are the second largest cruise line operators. So across that product extension, they've extended off that value proposition and created, you know, significant uplift in revenues.

So as a business extends out its products. What it creates is more opportunities and your products you extend are often more valuable from a margin perspective than your initial product. So your core product can be sometimes you know, where it's competition and it's commoditized because you're in a saturated market, but as you extend products out, what you tend to do is identify new market opportunities. So as you're entering a new market, the margins and the profitability is much higher because there's not as much competition. So it allows you to continually enter into high margin areas and growth markets. And 3M is another example of a company that is three m actually stands for Minnesota mines and manufacturing.

Joanna: I did not know that. Thank you for that Marc.

Marc: It is no longer in Minnesota and they're no longer in mining. And they manufacture the odd thing. But what we're what companies will extend their products do is they actually continually, as I said, create those high margin high profit growth areas, and they're actually able to piggyback that growth. So the importance is if you've got an existing product today, when we look at creating a P2 and P3, one of the one of the contexts or the key criteria will be where is there a hyper growth market? If you are providing mining services back in 2001, to the mining industry, you had a hyper growth 15 years because of the resources boom. So what it can do is get you thinking entrepreneurially about where the growth markets are, can we leverage our key skills and our key competencies, and how can we package that rapidly.

The risks of adding extra businesses and extra products

Joanna: One of the risks though, of adding extra businesses extra products, product extension can be that the most management team has a diffuse focus.

Marc: Correct.

Joanna: So where is the point that you think? What are some of the telltale signs that maybe you're not big enough? Or you're not ready or versus you are?

When should you create a new product?

Marc: Yeah. And look, that's a really great question. Joanna, one of the first things when someone talks to us about wanting to create a new product, the first thing we ask them is, is this a bright, shiny new thing? So distract from you having a fixed product one. So often, we'll see firms, especially in services, they'll open up you know, if they're an accounting firm, they'll open financial planning or other things because they haven't fixed the underlying organic issues in that.

So that's a really good question. So what we need to do is have product one or the foundation product really solid and operating because if as a leadership team or as a shareholding team, if you're working in your existing product in new actually on the tools delivering it, your business is worth less than a competitor, who has paid staff to do that. So what we need to do is create the capacity in the business to allow the senior leadership team to actually get into these higher value functions like product creation. So if it's an accounting firm, and you're doing 2000 hours a year on the tools in accounting, well, if we can release you to spend 600 hours a year creating a new product, and have someone else deliver the counting that 600 hours a year, it's worth $4,000 an hour, because you're worth much more working on your multiplier.

So as a shareholder, you're actually worth more off the tools and your business is worth more and you can create that compound growth. So we absolutely need to make sure we have the underlying business working and operating. But this is where critically one of the mindset shifts when you think about the valuation multiplier and, and how to, you know, go up the range is if you're thinking as an income person or a person working in the business. Sometimes you can say well, how we don't have the skills Do that as soon as you're thinking about your share price as an investor. So what we talk to owners about is actually let's really think about let's shift your mindset as an investor. And if you own a business that has an opportunity to create a product, and it's a hyper growth market, well, we then we then talk to them about following what they do in Silicon Valley.

So what a venture capitalist does in Silicon Valley is, they recognize that 98.4% of the returns come from the asset class, not the individual company. So when we look at where hyper growth is, we'll say, Well, what product do we need to create to hyper growth or a higher growth? What's the margin we'll make out of that? And then thirdly, what's the capability required? Because what an investor does or a venture capitalists do, they say there's a growth opportunity. I would rather hire or joint venture or bring those skills into the business to run that because I don't want you to know, put that at risk rather higher on credentials, not potential. So the conversation we'll have with the owners is, we've identified a significant product extension opportunity.

We've done our research and there's an opportunity to capture some of the market. And there are two choices, we can skill up the existing leadership team. Or we can bring in additional the right competencies from the market. And that will accelerate that growth, and critically not distract the original leadership team from the business. So adding that competency into the business or that skill set to prosecute the strategy is what a shareholder would do. And that's a mindset shift. If we think as an owner, we think as someone who works in the business in a partnership, might be worried or concerned about that.

But if we're thinking as a shareholder, well, of course, if we you know, if we owned bhp on the stock market, and they made it and they had an opportunity to create a new mine in Chile, and but the leadership team didn't want to recruit someone who was really to make the mind make a lot of money as shareholders, we would throw rocks at them at the AGM. So we need to think like a business and say there's an opportunity there. Let's bring the right skills in because it's going to make us more money as a shareholder. The other critical thing is to extend off as you said, Really elegantly Joanna off their core proposition. So all Disney's product extensions were off safe fun and family. So if you go on a Disney Cruise, it's a Disney experience. If you product it's the Harley Davidson release perfume. Now for those on the call that know Harley Davidson, they would fail spectacularly. Why did it fail spectacularly? it had no relevance to the brand or their existing customer base.

Joanna: I get that.

Marc: That's why you know, to your point that you do have to do it from within your value proposition. But again, Richard Branson has done this with eight different products.

Joanna: Yeah,

Nathan: Just don't do it all the same, an example of that firsthand recently with a client who is a return to work provider, they help injured people get back to work. Long story short, there is an acquisition journey, as well as bolstering the value of what they were doing before they started acquiring businesses. And they went through and solicited business and they went through a merger. And it's a bit of an iterative process. So your question, Joanna. And also to Marc's point, they saw the value in acquiring a business in a related expertise.

So they were working with businesses helping prevent injuries and manage injuries and return workers to work, more physical injuries than their psychological services businesses out there. They saw that as being a natural extension, like a product extension, if you will. But as they're extending it, of that product, and it was the right way to go, because this was a growing part of the industry. It was a synergistic fit for them. So it made sense to Marc's point about the Disney example. As they extend out to that new product, they're also sort of double tracking a little bit and making sure that they're increasing their sales capability, if you will, and their delivery capability in the existing core products stemming, but they're also bolstering what they've done as core products or services to that time, through the process you can expand and that's the bright, shiny sort of button, if you will, and it's always good to do that. But they're also reinforcing what they've done today.

Joanna: And that's a really good perspective. I think of how product extension can be achieved through acquisition, you know, when that's, that's the beauty of having your head around the acquisition. You know, we've started this podcast by talking effectively about an insert mean, you know, mentality, which is thinking about what your value is at exit and increasing the multiplier of that right but, we were also talking about how acquisition can play into that as a whole. I think we've probably had some discussions about this, I think we've got a lot together to talk about in terms of acquisition as a growth strategy for business. So let's definitely come back to that in a future episode or two, where we can really drill into that more more deeply.

Joanna: Well, that's it for this episode of talking law, where we drilled further into the second part of our three part series, all about the six steps to increase the multiplier of your business, i.e. the value of your business exponentially. Now if you'd like more information about this topic, then head over to our website at talking law.com.au. There you'll be able to download a transcript of this podcast episode if you want to read it in more detail, and then you'll also be able to find how to contact our very special guests. Marc Johnstone from Shirlaws Group and Nathan Williams from Customer Return. On that website you'll also be able to find out details of how to contact our lawyers at Aspect Legal, if you or your clients would like assistance in helping to build solid foundations from a legal perspective in a business in order to support the growth of your business, we work with clients both big and small and have different types of services depending on size and complexity.

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