The next management meeting

Charan Dill switched the overhead projector off and asked for comments. He looked around the room. There was a stunned silence. Not one of the directors wanted to make the first move. Charan had just presented his vision: *"to grow IRS Ltd into a £100 million turnover company by the end of 2009"*. My *"end of decade blockbuster"*, he called it. Charan had outlined the targets for the growth of Innate and the OEM (Original Equipment Manufacturer) business, and had talked excitedly about new developments. Paul, Andrew and Ian looked excited; David and Alex, however, had seen this all before with the failed Sato venture.

Alex and David are becoming increasingly concerned about the general management of the company. It is growing too quickly. David feels that he does not have the experience of running anything but a small company. Everyone seems to be fire-fighting and dealing with an increasing number of quality problems. *"No-one is in control",* was David's frequent remark. Alex is also concerned about the issue of signing yet another bank guarantee.

Neither Alex nor David wants to dampen Charan's enthusiasm; after all they would not be there now were it not for his drive and determination. Nevertheless, they feel that they need to sit down with Charan and Khan (the company's external Malaysian investor), talk frankly about their fears and set out formal action plans to ensure that IRS Ltd makes progress towards the £100 million objective.

The new strategy

Charan outlined that the growth of IRS Ltd to a £100 million company by 2009 was based on product and new market development. *"Already IRS Ltd would reach £13 million of sales in the current year in the UK. However, because of the strong penetration rate of IRS Ltd products in the UK supermarkets, it is not going to be easy to build the UK market sales significantly higher on the basis of the existing product range."* Charan continued with his strategy outline, spelling out the move of IRS Ltd into the heating and ventilation controls business so as to offer what he termed *"total building management control – or TBMC"*.

"The major UK supermarkets want the ability to save costs as well as giving their customers a better shopping environment. Even a small change in overall store temperature involves the cabinets using additional electricity to regulate temperature. This can cost a lot of money when multiplied across the stores. We can get a contract of £130,000 to £150,000 per store for the TBMC as opposed to just £40,000 to £50,000 for the Innate system. The present technology is boring technology. Food loss still occurs and costs the big supermarket groups many millions a year in perished goods. Maintenance and alarm calls also cost substantial sums."

Charan continued: *"As you all know, we are just about the biggest refrigeration control systems company in the UK. We cannot get much in the way of real growth from an acquisition strategy in the UK and any acquisition would just not be worth the trouble. I am therefore proposing a growth strategy based on global expansion. We are going to move into the US and European markets with our building control range of products. This will take us to the next level of technology with freezer controllers and other devices that talk to each other. I believe that the US market offers us the potential to reach sales of at least £40 million to £50 million by the end of the decade. The European market offers sales potential of just around half of the US market. If we can grow the European market to around £25 million and increase the UK sales from £13 million to £25 million, we will be a £100 million company by the end of the decade."*

The US market

IRS Ltd already had an informal alliance with a major US-owned OEM which operates in the UK. Charan indicated that with its recommendation, a provisional agreement had been made with a major US supermarket group, Atlantic and Pacific (A&P), to install Innate systems in a number of its stores. Once the Innate system proved itself to A&P management, the aim was to sell the TBMC to A&P and to other large supermarket groups.

A&P had a major presence in both the east and west coast states of the United States. IRS Ltd would therefore need to open support offices in both California and New England to support this new client. *"We need to be able to offer the same overnight support and maintenance service to A&P that we currently offer to our UK customers. If this works well, we will have a number of these support office facilities located near major hub airports in the US. There is a lot to learn about this market, and the experience we get with A&P will tell us a great deal about the logistics of selling into, and supporting, the US market. Too many British companies have failed to make the grade in the US for us to take this lightly."*

The European market

The European market was then covered by Charan in his presentation. He outlined the nature of the contacts developed by Paul Hunter. Again, the strategy was to make a breakthrough with one major European supermarket group, and from that to demonstrate to the others the quality of service that IRS Ltd could provide. However, Charan did not feel that IRS Ltd could, at least initially, cope with an expansion into both the US and Europe at the same time. *"We will open the formal dialogue with our European contact some time in 2002, once we see how the US strategy is developing."*

The UK market

Charan repeated his view of the UK market as one which offered limited growth compared to the US. *"It is, however, our core business"*, he said. Charan outlined the aim to double sales in value terms over the period of the 2009 strategy. This would involve selling the existing range of products, with the gradual introduction of TBMC to the UK supermarkets. *"It is likely that the supermarkets will only see the value of installing the TBMC in their larger stores. However, by 2005 we aim to have annual sales of 30 systems, accounting for approximately 25% of the total sales in the UK and for this to gradually increase over the period of the 2009 strategy to 40% of the total UK sales of IRS Ltd."*

Charan then provided a review of the projected outcome for 2001 and the estimated sales for 2002 for the UK. **[These are shown in the additional (shaded) columns in Exhibits 1, 2 and 3 *(see pages 8 – 11)*.]** *"As you can all see, we are on course for a good year despite some difficulties in the general economy. Thankfully we are in a strong sector of the economy and that should see us in good heart for the exciting period to come."*

The financial strategy

Charan then asked Joe Halley to take over. Halley had been brought in to the business in 1999 as a consultant. He had an accounting background, had worked for a number of major international consultancies in the financial systems area and had a good reputation in the investment banking business. In his short time at IRS Ltd, he had so impressed Mr Khan and Charan that they had recently hired him as the new Financial Controller. Charan indicated that Halley would also have responsibility for the implementation of a new IT strategy.

Halley indicated that the initial cost of the IRS Ltd 2009 strategy, for the first two years of operation in the US market, was estimated at £2 million. These costs were additional to the normal sales support and engineering costs associated with every order. The greater part, £1·4 million, would be incurred in 2002, and the balance of £0·6 million in 2003.

The US presence would involve a small team of engineers, six in total, moving to the US to support the IRS Ltd equipment installed in A&P stores. These engineers would travel to any store as required and deal with any problem in the same speedy way that alarm and control problems are dealt with in the UK. This would mean IRS Ltd maintaining a stock of parts and accessories in each of their support locations. The marketing arm of IRS Ltd would involve two people initially, one servicing the east coast states and the other in the west. They would be supported directly from the UK.

The £2 million would be funded through the issue of equity to the venture capital arm of a bank. The bank would then hold a minority shareholding in the company. The venture capitalist had indicated agreement to provide further funding in 2005, assuming satisfactory performance.

Joe Halley continued: *"We are seeking sales in the US of £2 million from 40 Innate systems in 2002. In 2003, a further 40 Innate systems would be sold to A&P, again at £50,000 each, plus 24 TBMCs at £150,000 each. Once A&P see the benefits of the TBMC package, then the sales of Innate systems would gradually be phased out with A&P. With the TBMC proving itself to A&P, we can build sales in the US of the larger system with other supermarket groups. The Innate system will really only come into play as a starter package for some stores or as a more economic option in the small outlets whose selling space does not warrant the larger system."*

Joe Halley presented a slide of the total sales forecast for the years 2002 – 2004:

Year	***UK Innate***	***USA Innate***	***USA TBMC***	***Total***
	£000	*£000*	*£000*	*£000*
2002	15,200	2,000	Nil	17,200
2003	16,300	2,000	3,600	21,900
2004	17,400	2,000	9,000	28,400

He commented that the draft UK budget details for 2002 [shown in the Exhibits] had been prepared by the various individual managers and had not yet been reviewed. However, the sales shown in the draft UK budget and all of the other sales forecasts shown in this slide were fully in line with the overall strategic vision.

For simplicity, all UK sales have been assumed to be of Innate systems – sales of all other products will be relatively minor. Pilot sales of TBMC in the UK in 2003 and 2004 have been ignored.

Halley followed this with a slide comparing margins and operating profits **per unit of product, based on his assessment of current and planned performance:**

Effect on profit of manufacturing and selling 1 additional unit:

		UK Innate		*USA Innate*		*USA TBMC*
	% of selling price	*£*	*% of selling price*	*£*	*% of selling price*	*£*
Selling price		50,000		50,000		150,000
Cost of sales	75	37,500	75	37,500	50	75,000
Gross profit	25	12,500	25	12,500	50	75,000
Administration	20	10,000	20	10,000	20	30,000
Operating profit per additional unit		**2,500**		**2,500**		**45,000**

Halley continued by saying that *"debtor behaviour in the US is much better than that in the UK. In the US, the pattern is for prompt payment with debtors paying in half the time taken by UK supermarkets. This outweighs the extra stocks needed."* He illustrated this:

Effect on working capital of manufacturing and selling 1 additional unit:

		UK Innate		*USA Innate*		*USA TBMC*
	Days	*£*	*Days*	*£*	*Days*	*£*
Debtors	65	8,904	33	4,521	33	13,562
Stock	72	7,397	102	10,479	102	20,959
		16,301		15,000		34,521
Less creditors	91	9,349	91	9,349	91	18,698
Extra working capital required per additional unit		**6,952**		**5,651**		**15,823**

The effect on working capital can be summarised as:

Effect on working capital of additional sales:

	UK Innate	***USA Innate***	***USA TBMC***
Extra working capital required, as a % of sales	**13·9%**	**11·3%**	**10·5%**

Halley continued: *"IRS Ltd will need to make further major investments in 2005, but we expect the venture capital arm of the bank to help us to fund £2 million to £3 million of investment then. Half of this investment will be used to double our factory capacity to service the growth in sales, and the other part of the investment will go in further support measures, including additional bases.*

In each of the years 2002, 2003 and 2004, the increase in fixed assets will be £200,000."

IT issues

Charan then took over the presentation by describing his concept of the IT support system for the enlarged company. *"We have to be able to support our engineers in the field wherever they are. They need direct dial-in access to be able to order parts and equipment from on site straight through to us. We also need to be able to monitor the performance of our equipment on a twenty-four hour basis. Our client supermarkets need the same facility."*

Joe Halley commented: *"This is one element of the IT provision for the company. What is needed is a clear IT strategy for the future that accommodates our development plans."*

Management structure

Charan then moved on to outline his ideas on the structure for the business.

"In order to implement the 2009 strategy, we need to build on our existing structures which have served us well. Over the last few weeks, I have discussed the operation of the individual functional areas with each of you and this is how I see the structure that will take IRS Ltd forward."

Charan then displayed a slide of the chart shown on page 19 as Exhibit 5 and stated: *"With this new structure I want to introduce a clearer role for the board, which will involve changes. The board will comprise Mr Khan, David, Alex and myself with someone from the venture capital company. It will be tasked with making sure we keep IRS Ltd sound both strategically and financially throughout the course of implementing the new 2009 vision."*

Exhibit 5, the revised board and management structure for IRS Ltd, is on page 19

IRS Ltd –
revised board and management structure

Notes:
** = Board Members*
There are 182 staff at 22 November 2001.