



**Teaching Case Study:**  
**purepotions ltd**



## **purepotions ltd**

### Origins

In 1998, Natalie Balmond's daughter, Lula, then aged 2, was causing her continual concern. She suffered from the skin condition of chronic eczema, causing her perpetually to have blemished areas on her skin which were the source of endless irritation and itching. For the small girl, her eczema led to distress and to interrupted sleep for her and the whole family. "Her skin was raw and inflamed, and she scratched herself until she bled. Our doctor suggested creams and treatments but nothing worked." Natalie had tried all types of treatment for Lula's condition including conventional, homoeopathic and Chinese solutions, with no success

She had always held an interest in alternative remedies and was aware of a range of herbal options for the treatment of eczema. But she was also concerned to avoid the use of chemicals and artificial additives in any treatments that she gave her children. The available alternative remedies and herbal options all contained preservatives or other constituents that she wished to avoid.



Natalie with Lula, here aged 8 and with the eczema now under good control

Natalie realised that what she wanted was a herbal remedy in a natural base and, as none was available, she started to research the effects available from various herbal extracts. Some investigation led her to formulate her own product with hemp oil and beeswax, and avoiding the inclusion of any water or preservatives. She cooked a batch of this up in her own kitchen.

After applying it that night, Lula slept for seven hours, the first time for many years, and it rapidly became Natalie's standard remedy for controlling her daughter's condition. A name for the preparation suggested itself to her, "Skin Salvation", and she started cooking the product regularly for their own use.



**The first purepotions product, Skin Salvation**

### Early Development

Over the following few years Natalie encountered more and more parents who were searching for a remedy for their children's skin conditions. She began to increase the amount of Skin Salvation that she was making and to provide it to other parents through selling it informally, for example, at local fetes and school events. Natalie adopted quite a low key approach, and was not at this stage thinking of it as a business.

In July 2002, an article appeared in the local *Argus* newspaper covering Natalie's story of a young mother developing her own solution for her child's eczema. She was quoted as saying "I don't want to start mass-producing my products because then preservatives and chemicals would have to be put in. But I do need to expand to bigger premises.

"I think of those parents going to the doctors each week struggling to find something that works. If I can get the lotion out to them on a bigger scale it will be fantastic."

In the days that followed the article's publication Natalie received hundreds of calls and e-mails from people who shared her concern and who were keen to see the benefits of using Skin Salvation for themselves. The high level of interest that the article had generated gave an indication of the scale of potential demand. Order levels grew to about 100 per week with pricing at £8 per pot. Skin Salvation and a developing range of associated products started to generate many testimonials and good levels of repeat orders.

Natalie realised that the business was too big for her alone, and out of the *Argus* article she had also received a number of approaches by people offering to develop the business with her. Some were from financial opportunists but one, Malcolm Prescott, interested her particularly as he was concerned about issues of organic production, sustainability and recycling. The appeal of a shared ethical outlook led her to opt to accept the approach that he had made and she decided to go into partnership with him.

### Business formation and development

In 2003 Natalie formed the purepotions business as a limited liability partnership shared 55/45% with Malcolm. The format was clear: he would handle the business procedures and systems side of the operation including the property lease for their small kitchen, storage and dispatch area, as well as financial oversight. Natalie would work on the areas that interested her most and in which she had shown such flair: formulation, design, advertising, literature.

Scope for licensing the product was seen to be quite limited since the packaging listed its ingredients which could be slightly modified and then copied by anyone. Natalie regarded the design and the marketing presentation of the product as being important elements which would protect the business against competitors. She was very satisfied with the key product's name – "Skin Salvation" – as it captured the essence of the product so well: it was a salve and it was for the skin. It had indeed been her daughter's salvation.

The Skin Salvation product cannot be marketed as a medicine (which would allow it to make statements such as "relieves, cures, reduces") without a Medicines Licence. It must be sold as a cosmetic which allows it to declare properties such as "nourishes, moisturises" etc. Product safety assessments have been completed and jars carry a Best Before date, but full licensing and intellectual property protection was not seen to be a viable step.

By 2004 the partnership had grown the business to a customer base of 650 across the UK including about 100 local buyers. Its sales channel was primarily through small health food shops, accessed via distributors, (75%) and personal direct sales (25%). Four out of five personal sales came via an online ordering facility. Annual revenue stood at £30,000, and by 2007 the revenue figure had grown to £120,000. The product always enjoyed a healthy gross margin of over 80%, but the partners were drawing little financial benefit themselves out of the business at this stage.

Production processes were and still remain quite simple, essentially comprising the sourcing of organic ingredients of the right standard and combining these according to pure potions' formulations in a small commercial kitchen environment. Cooking is done in small batches and does not yet need to be a full-time running operation.

### Issues emerge

During this period of growth Natalie began to find herself grappling with two issues which had emerged. She was beginning to see that there was a substantial potential business within the purepotions brand and that this had been her own invention. Whilst she was not strongly financially motivated, it did appear to her that the partnership format was tending to create barriers to the maximisation of the business' potential and to the benefit that she could gain from it. The second issue was that she was surrendering a good deal of power because Malcolm knew much more than she did about the operation of the business and its management in which Natalie had relatively limited involvement.

Furthermore Natalie wanted to become more involved in the management of the business both as her confidence grew and as she was released from other commitments as her family started going to school. These changes began to form the seeds of a clash of personalities with Malcolm, who resented the changes that this would bring about to his own position. In spite of the potential tension, the two partners approached the dilemma in quite a consultative manner and spent much time discussing the options and trying to work out a way forward. They even considered mediation and counselling.

In view of the absence of ready sources of personal capital they needed to look quite widely at the options open to them and to ways of valuing the business which would allow one of them to disengage on any reasonable basis. Whilst the option of Natalie leaving Malcolm with the business was not disregarded, it was clear that the right outcome would be for a way to be found which would allow her to continue with the business. After looking at various options, it was agreed in May 2007 that Natalie would buy Malcolm's interest in the partnership. The financial settlement was for a payment to him of £27,000 followed by further payments of £2,500 p.a. for five years.

Natalie had little scope to raise the money for this transaction through a personal bank loan, so she borrowed the purchase price from two friends, including Weze Hannam whom she then brought in as co-director of the business, which was restructured as a limited company.

With the departure of Malcolm, there were substantial areas of management work which required attention but which Natalie had neither the ready expertise nor immediately available time to address. This issue was resolved by Weze who, as well as becoming co-director, also started working for the company. She had a background in management which fitted her well to address the work which needed to be done.

The limited company was formed in a 76%/24% share between Natalie and Weze, and the 55/45% limited liability partnership was closed, except for purposes of holding their property lease.

### Cash flow pressures

Natalie enjoyed a sense of relief after the clearing of the pressures that had mounted in the later months of the previous partnership. She and Weze comprised an effective and supportive working partnership themselves, and she could relax a little whilst they determined the direction to take the business forward.

They were reassured that the purepotions product range cleared its breakeven point on £8,000 – 9,000 sales per month. The business was regularly exceeding this figure and so the directors could be content that financially they were in good shape, although they were not yet growing at the pace that the business was capable of.

But whilst they could see that the transition from LLP to limited company had been demanding in terms of the time which they had had to put into it, it was easy to overlook the cost of professional advice and legal fees which had not yet been billed. No sooner had the organisational crisis been settled than these bills started to arrive. purepotions' restored bank balance, supported by the healthy product margin, soon became seriously threatened when the management team appreciated the effect that these delayed bills for advice etc. would have on the overall cash position. Quite suddenly the cash position became critical, to the extent that payment of staff wages and rent were in jeopardy.

Securing additional funding therefore became an immediate priority and the company approached a number of banks. Lloyds TSB and the Co-operative Bank offered to provide loans but required a mortgage on Natalie's house as security. Natalie was not prepared to provide that and so she again approached personal contacts to explore options for funding to support the business. Through this route she assembled a sum of £11,000, primarily from members of a family, which enabled the immediate bills to be met and the business to continue trading.

The company learnt a key lesson through this period which the team summarises as "don't just look at the bank balance, but make provision for VAT, PAYE etc and other obligations which may not yet be due for payment".

### Marketing

Over the years that the business had developed, the range of products which it was formulating and marketing was showing controlled growth. By 2008 the range comprised:

- Skin Salvation and an accompanying bath oil
- Lavender Nappy Salve

- Camomile Baby Oil
- four Rescue Salves
- two gift box collections for Pregnancy and newborn baby.

Under the banner "purepotions - nothing more natural", the products are promoted on their features of being organic, 100% natural, safe, chemical- and steroid-free, and that the products do not use synthetic colours, fragrances or other additives including water or petrochemicals. Packaging is in glass jars and bottles to avoid the danger of plastic tainting the product. This positioning of sustainability and ethical trading is, if anything, supported further by the company literature noting that its beeswax is non-organic, explaining that organic beeswax is only available from overseas suppliers. The company prefers to source beeswax locally to minimise its carbon footprint.



**The purepotions Pregnancy Box**

The purepotions business is thus an attractive one to the media, which readily use the story of “a practical, ethical business set up by a young mother in need of a solution to her baby's skin condition.” Natalie trained as an actress after going to art college and her innate feel for design and presentation is evident in the company's marketing material. Indeed immediately after getting through the cash flow crisis in 2007, the company spent £1,000 out of the £11,000 loan just obtained on commissioning a PR agency – a step which many businesses in that position would have found just too bold. It was a move which paid off handsomely as it led directly to an article in the Sun newspaper in April 2008 and a number of local radio and TV features. As with the media coverage earlier in purepotions’ development, the Sun article generated a significant sales uplift followed by only a partial drop back in levels.

### Growth into the future

Marketing initiatives such as these have lifted sales to a level forecast for 2008 at £180,000 to £200,000. The company’s gross margin remains strong at 87% but so far the directors are not receiving a full salary and are leaving much of the profit within the business to support further growth.

The management team is currently exploring several options for taking the business forward to the next stage of growth.

1. Develop the export market. This is something which is well supported by the government in relation to the SME sector, and there is free government advice and some funding available to promote it. purepotions would expect to use the route of overseas distributors if they were to step into the export market. Natalie notes that there is currently some interest from Sweden, Ireland and France, but this is small in scale. The export market option is not being actively pursued at present, but may be a possibility for development in the future.
2. Extended distribution to pharmacies. purepotions is determined that the business it develops should be with organisations which it considers to be ethically sound, and which are seen by the consumer population in the same light. It would need to be convinced about the ethics of some of the larger chains. By way of potential entry into this sector, the management notes that stores such as Waitrose with its new Market Town format, or the local family feel of Lloyds Chemists may be chains through which the company could start to make inroads to this distribution route.
3. The GP market. Medical practices are free to prescribe their own choice of treatments, and are the target of heavy promotional effort by the big pharmaceutical companies. However some doctors are receptive to approaches from other suppliers and sources alternative to the mainstream. The option of adopting successful treatments referred to them by users who are convinced of their effectiveness is attractive to some GP practices. purepotions may consider ways to gain leverage through this route.
4. Obtaining a full Medicines Licence so that the products can be sold as medicines. Currently purepotions works carefully to stay within the guidelines which allow it to sell its products as cosmetics. A medical licence would allow the company to classify some of its products as medicines with bolder claims about their therapeutic effects. Obtaining a licence is a substantial commitment which would be likely to require three years of testing and the commitment of around £200,000. This is an option which is not seen as being practical or affordable at present but may have attractions for the business in the future.

In assessing these options further, Natalie is keen to bear in mind the demands which any substantial growth would place upon the company's production capability and its cash flow position.

References:

<http://archive.theargus.co.uk/2002/7/12/154375.html>

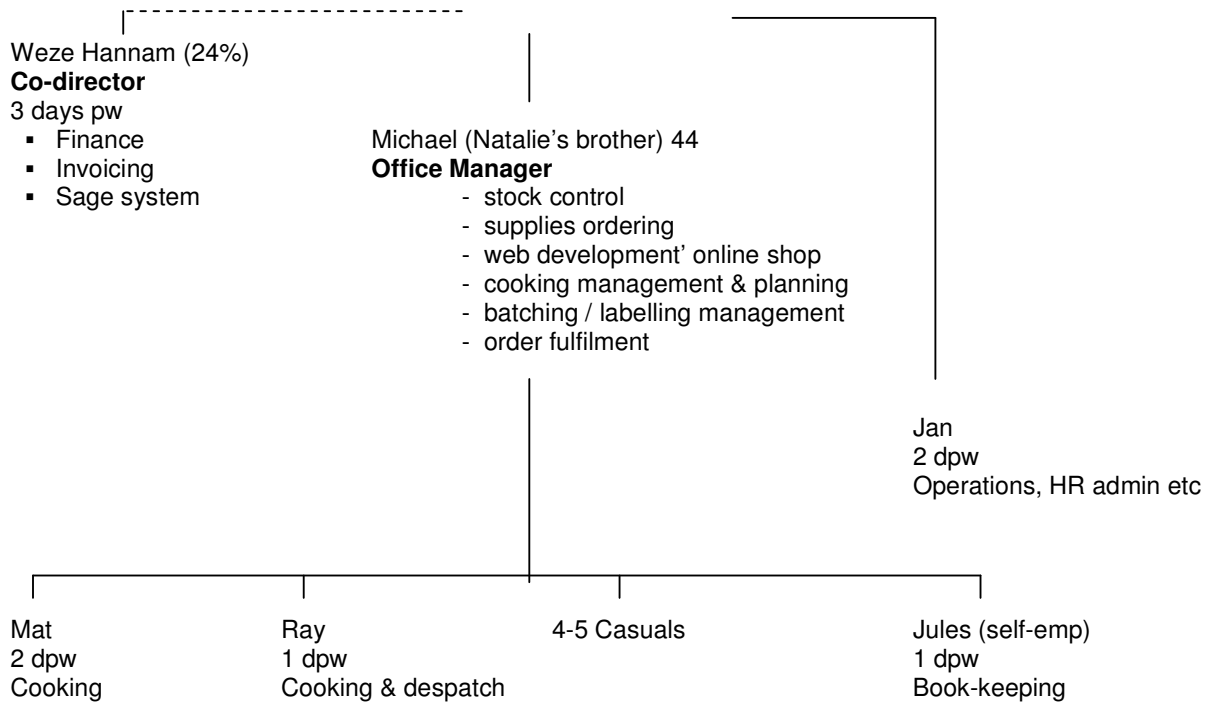
<http://www.thesun.co.uk/sol/homepage/woman/health/article1050598.ece>

### Organisation - 2008

Natalie Balmond (76%) 41

**Director**

- Marketing
- Product development
- Payroll
- General management



## NOTES FOR TUTORS

### Questions to consider

1. How should purepotions best develop the business now, going forward?
  - Licensing option to allow sale as a medicine not economic at present, but offers potential for the future when resources allow
  - Pursuit of high-street multiple stockists could raise profile and increase reach substantially – explore retailers with a reputation for high ethical priorities
  - Consider appointment of an export agent to develop that market
2. What lessons should the management team draw from the cash flow crisis which threatened to engulf the business, and how can they protect against it in the future?
  - Importance of accruals
  - Proper cash-flow forecasting
  - Buy in expertise in this area if needed
3. How does a fledgling business deal with a close member of the team who becomes dysfunctional or where the partnership becomes unproductive? Is the limited company less prone to this than the LLP?
  - Inevitable hazard resulting from the close and intensive working involved in a start-up
  - Value of setting up well-documented / formal agreements and procedures, even though the culture is initially quite informal and reactive
  - Partnership structure may carry additional risks; Limited Company not necessarily a solution to these but can help
  - Aim to separate the family and work relationships as far as possible
4. The founders of purepotions sought to divide the responsibilities and roles between themselves. How does a company at Infancy make an effective split between what the founder likes and is good at, and what is needed for sound management of the business?
  - Ensure a balance of complementary skills and expertise, and consider methods of achieving this
  - Involve third-party skills to fill gaps
  - Consider a business mentor
5. How do you assess the company's attitude to its intellectual property? What are its implications for the business as it grows, and what proposals, if any, would you make regarding protecting its assets in this area?
  - An unprotected asset, easily copied
  - Brand identity is a strength - copyrighting
  - Explore scope for patent or IPR protection