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THE ROADMAP TO SMART GROWTH

AN INTRODUCTION

Hello, I am Ed Hess. I am a professor of business administration and the Batten Executive-in-Residence at the Darden Graduate School of Business at the University of Virginia. I have spent the last ten years studying how public and private companies successfully grow. Before becoming a professor, I worked with growth companies first as a lawyer and then for over twenty years as a strategy consultant and investment banker. Along the way, I built four small businesses of my own.

THE CONTENT

The content of this book was derived from my business and consulting experience and from research that I conducted called the Darden Private Growth Company Research Project (DPGC) that studied fifty-four high growth private companies looking at the challenges of managing growth. That research became the foundation of a course that I have taught at Darden for years called Managing Small Enterprises. That research also led to the creation of over thirty formal business school case studies about the challenges of growing a private business—all of which were the basis for a business school text/casebook that was published in early 2011 by Stanford University Press entitled *Growing An Entrepreneurial Business: Concepts & Cases*.

In addition, I have written seven other books and have been fortunate to have my work featured in many prominent business publications and media channels. Through these experiences, I encountered more business builders from whom I have learned.

THE AUDIENCE

This book is about growing a small business, not about starting a business. It assumes that you have successfully started a business, have a commercially viable product or service, and have been able to achieve profitability. Now you want to grow your business—to get bigger. This book focuses on the common challenges that a growing business will face and shares the experiences of other successful business builders.

As you grow your business, new challenges will constantly appear. Growth is recurring change. The people, processes, and controls that worked at one level of growth may not work at the next level of growth. In fact, you will learn that the same people, processes, and controls will most likely not be effective as the business grows. In other words, as your business grows, it will continuously face new challenges requiring you to put in place different processes, controls, and people. Growth produces waves of change, and, like waves in the ocean, they naturally keep coming.

I think that you will find the foregoing to be especially true up to the \$250M revenue level. Then at some point again—maybe at about \$750M in revenue—your business will hit another big inflection point. Many of the issues discussed in this book are being faced now, as I finish this book in 2011, by many of the Executive Education clients whom I teach, whose businesses earn around \$5B in revenue.

The lessons, tools, and concepts put forth in this book are applicable at each step of the growth journey. The point is that managing growth is not a one-time event; it is a continuous, ongoing process until you decide that it is time for your business to stop growing.

This book is an attempt to prepare you for the reality of growth so you can better plan for growth, proactively manage the pace of growth, and understand your risks of growth, which must be proactively managed so that growth does not overwhelm your business.

THE LEAD ACTORS AND ACTRESSES

You will meet twelve leaders in this book, all of whom have experienced the challenges and the ups and downs of business growth. Growth requires change. Growth is a bumpy ride. Through their experiences you can learn ways to prepare for and make your growth ride less turbulent.

That is the purpose of this book—to make your growth ride less bumpy and to help you avoid destroying your business in the process.

Yes, growth can destroy your business if not properly managed.

But from the experiences of the twelve leaders featured you can learn how others have successfully managed the turbulence of growth.

LEARNING TOOLS

Real-Life Growth Stories

Each chapter contains at least one story adapted from a Darden Business Publishing case that I wrote. These cases are used in business schools to teach MBA students. From the real-life experiences of these entrepreneurs, you will learn concepts and approaches to successfully manage growth. I suggest you read these stories twice and write down points that you find relevant to your current growth challenges. As you grow, you will face new challenges, so come back to these stories to reread them because new learning points will catch your eye.

These real-life cases are strategically placed primarily at the end of each chapter to maximize your learning. The cases will reinforce points made in the chapter as well as reinforce key points in other chapters. So, I recommend that you read the cases after you have read the chapter.

CEO Quotes

Within many chapters, you will find anonymous quotes from CEOs that participated in my research projects. These quotes represent gems of experience.

Workshops

The book contains six workshops that are designed to give you the opportunity to learn by doing. Three workshops each contain a discussion

section outlining possible answers. In the other three workshops, you will apply tools and concepts from the text to your business.

Tools

You will also be given three tools for your use as you grow your business to help you make better decisions about whether to grow, how much to grow, how to grow, and what you need to do to manage growth.

Those tools are a Growth Decision Template, a Growth Risks Audit, and a Growth Planning Template.

Chapter Takeaways

At the end of each chapter, you will find a summary of key learning points that you can refer to easily and quickly as you manage your business. Different learning points will become more relevant at different points in your growth journey, and I recommend you review these Takeaways frequently in a disciplined manner.

THE RESEARCH

This book has been built on my research findings, case studies, and consulting experience. The DPGC involved fifty-four growth companies. The average age of those businesses was 9.6 years, and their average revenue at the time I studied them was \$60M. Those companies were based in twenty-three different states. Twenty-one were primarily product companies, and thirty-three were service companies.

Other characteristics of these businesses relate to some basic metrics of their growth. Of the fifty-four companies,

- forty-nine had reached or exceeded \$10M in revenue;
- thirty-six had reached or exceeded \$20M of revenue;
- twenty-two had reached or exceeded \$50M of revenue; and
- twelve had surpassed \$100M of revenue.

On average, the approximate amount of time to reach particular revenue levels was

- \$1M in revenue in 3 years;

- \$5M revenue in 4.8 years;
- \$10M revenue in 6 years;
- \$20M revenue in 6.7 years; and
- \$50M revenue in 8 years.

I also examined characteristics of the entrepreneurs themselves:

- thirty-four CEOs had prior work experience in their business's industry;
- twenty-eight CEOs had no prior start-up experience;
- forty companies were self-funded by the founder, family, and friends;
- thirty-four companies had more than one founder; and
- five companies were started by women.

If the CEOs had prior start-up experience, their companies grew measurably faster than companies with first-time entrepreneurs. If a company had two founders, it reached the \$1M, \$5M, and \$10M levels more quickly than companies with one founder or more than two founders, but it did not achieve higher revenue levels more quickly. There was no real difference in the time taken by product versus service companies to reach the \$1M and \$5M levels, but product companies reached the \$10M, \$20M, and \$50M revenue levels much faster than service companies.

THE ROADMAP TO SMART GROWTH

This book approaches growth from four perspectives. Growth is viewed in terms of both organizational design and individual behavior and from both strategy and execution perspectives. In addition to looking at growth from different perspectives, this book provides discussions of the key research findings, extensive case studies and practical examples as well as workshop exercises to promote experience in applying the concepts. It is both a “thinking” and a “doing” book.

The book is divided into three parts. Part I includes Chapters 2 and 3, which deal with the issue of whether you should grow your business and arm you with the tools to strategically make that decision. Part II includes Chapters 4 through 6, which deal with the issue of how to grow your

EXHIBIT I.1

Growth is change.
 Growth is evolutionary.
 Growth requires constant learning.
 Growth requires disciplined focus and prioritization.
 Growth requires processes and people.
 Growth creates business risks.
 Growth is constant improvement and scaling.

business. Part III includes Chapters 7 through 10, which focus on the finding that growth requires the right kind of leadership, culture, and processes.

The takeaway lesson from the chapters is that smart growth requires the right leadership, culture, processes, and people. This book gives you tools to start planning and executing growth strategies. Throughout this book, you will see the themes outlined in Exhibit I.1.

It is important to understand that this book focuses on growing a business after a successful start-up. All businesses go through a lifecycle characterized generally by birth, growth, maturity, and decline. Our focus is growth, not birth, maturity or fighting decline.

PART I: WHETHER TO GROW

Chapter 2, The “Truth” About Growth

This chapter explains what we know about growth from business research so you can think about growth in a realistic way. What does that mean? Well, we know from research that, contrary to popular beliefs:

1. Not all growth is good. Growth can be good or bad. It depends. Growth can stress people, processes, controls, and culture. Growth can create business risks: quality, financial, customer, reputation, and legal. If not properly managed, growth can destroy value and, in some cases, even destroy the business.

2. Bigger is not always better. The bigger a business gets, the more complex it becomes to manage. As it gets bigger, it requires more employees, processes, controls, financial strength, and experienced managers. Becoming bigger exposes your business to bigger and better competition.

3. The business axiom that all business must “grow or die” is not true. Your business does not have to keep growing. However, you do have to continuously improve its customer value proposition and do so better than your competition does. “Improve or die” is true.

Chapter 2 discusses the main themes of this book. They are as follows:

Growth is change. Growth requires the entrepreneur to put in place more processes, procedures, controls, and measurement systems. It also requires that the entrepreneur change what he or she does. Growth increases the likelihood of mistakes because it is dependent on the actions of employees who, being human, will make mistakes. Managing a growing business requires minimizing the number and severity of those mistakes. Some mistakes can create serious business risks.

Growth is evolutionary. Growth requires the evolution of the entrepreneur and the management team and more sophisticated processes and controls. Often, if not always, the business model and customer value proposition evolve, too. Furthermore, this evolution is continuous.

Growth requires continuous learning and constant improvement. The entrepreneur and employees must be constantly open to learning and adapting and improving in an incremental, iterative, and experimental manner. No matter how big you get or want to get, continuous improvement is required.

Growth requires disciplined focus and prioritization. The entrepreneur must strategically focus the business on a compelling differentiating customer value proposition and achieving daily operational excellence and consistency. One CEO described the concept of strategic business focus: “Be 2 inches wide and 2 miles deep.”

Growth requires processes. Growth requires implementing processes, which include controls. Processes are like recipes for baking a cake. They are the step-by-step instructions for how to do a task. Processes are necessary to hire employees and train them, to minimize mistakes and institutionalize quality standards, and deliver products and services on time, 99 percent defect free. Controls are necessary to set boundaries on allowable behavior and also alert management to deviations from processes.

Growth creates business risks that must be managed. Growth stresses people, processes, quality controls, and financial controls. Growth can

dilute a business's culture and customer value proposition and put the business in a different competitive space. Understanding these risks is critical to managing the pace of growth and preventing growth from overwhelming the business.

The good news is that you can minimize the big risks by planning for growth, pacing growth, and prioritizing what controls and processes you need to put in place prior to taking on much growth. You will use a tool I developed called a Growth Risks Audit to learn how to identify and minimize risks.

You will also learn to use another tool called the Growth Decision Template to think strategically about whether you should grow. The Growth Decision Template will also help you decide what growth methods your business should employ and how fast it should grow. In addition, you will be provided with practical information about how to manage the risks of growth.

Then you will meet Julie Allinson, the founder of Eyebobs Eyewear. Allinson's story is compelling not just because she built a very successful business but also because she did it her way. She was aware that too much growth could overwhelm her business, and she was determined to keep control of her business. It took her six years to reach an income level of \$1M, but because she took her time, studied her business, and installed the right processes and controls that were scalable, she was able to at least double her sales every succeeding year for four years.

Chapter 3, Preconditions to Growth

This chapter builds upon Chapter 2 by introducing the concept of preconditions to growth. What must you do before your business is ready to take on more growth? What are your people, process, control, reporting, and daily information needs? What are the costs of growth and how are those costs incurred compared to the timing of more revenue?

All of these questions involve the tension between investing ahead of growth and investing after growth has occurred. Clearly, playing catch-up is more risky but sometimes unavoidable. Playing catch-up could be the result of a failure to predict or plan for growth but instead often reflects the lack of financial resources available to invest ahead of growth.

The questions raised in this chapter will illuminate your growth alternatives. Usually, successful businesses have many growth alternatives. The question is how to decide which alternatives to focus on. Prioritizing the growth alternatives is essential to help keep entrepreneurs aware of the limitations of their business: the time, people, management depth, and money needed to grow. Trying to grow too fast can be disastrous.

Two workshop exercises are included in this chapter. In these workshops, you will begin your analysis by applying the Growth Decision Template and the Growth Risks Audit to a specific business scenario.

Many businesses have a variety of growth opportunities. Sometimes these opportunities just present themselves and sometimes they are actively sought. Strategic focus emerged from my study as a critical component of successfully managing growth and not letting growth overwhelm you or your business. Learning when to say “No!” to growth and learning how to pace growth are key so that growth does not outstrip your capabilities, people, processes, or controls.

In the first workshop, you will meet Susan Feller, a retired teacher and guidance counselor who began a second career when she developed dietary need that was not being met by the market. Without any formal business training, she built a successful gluten-free baking business, 3 Fellers Bakery, through which she creates, manufactures, and sells gluten-free desserts to her retail bakery customers and grocery chains including Whole Foods and Ukrops.

Feller’s business growth problem was that she had too many growth opportunities and too little capital, management experience, and time. She had to choose. Her decision was complicated by her love for creating new recipes and baking cakes; she was at the stage in life that she did not have to make more money; and her dream was that someday one or more of her sons would take over the business.

After reading the 3 Fellers Bakery story, you will use the Growth Risks Audit and the Growth Decision Template to decide whether, how, and in what order 3 Fellers should grow. You will also examine, most importantly, 3 Fellers’ preconditions to growth.

Then, you will be given an opportunity to do a workshop analysis of your company’s preconditions to the next phase of growth.

PART II: HOW TO GROW

Chapter 4, The Four Ps: Planning, Prioritization, Processes, and Pace

Chapter 4 focuses on the recurring findings of my research that managing growth requires planning, prioritization, processes, and pacing the speed of growth.

Planning for growth requires the entrepreneur to think about organizational structure, organizing jobs by function, and creating a layered management structure as well as adding more infrastructure.

Infrastructure includes everything needed to produce and deliver the business's product or service and manage the business. Infrastructure includes space, equipment, technology, supplies, processes, and the means to produce and deliver the goods. Using that definition, infrastructure also includes people.

Planning for infrastructure requires an entrepreneur to think about what activities must be done internally and what could be outsourced. In addition, you will face the question of how much infrastructure to invest in: do you invest and build more capacity than you need now for growth or do you conserve your cash and build just enough infrastructure for current growth needs.

Planning for growth requires an entrepreneur to think about how the business will scale manufacturing or production as well as sales. Planning also becomes a communication tool in that strategic plans can be used to set employee expectations, inspire them, and focus them on critical activities and get people aligned with overall organizational objectives. Lastly, this chapter introduces the concept of “firehouse” time—that is, time to think and plan away from the daily “fires” of every business.

The second topic discussed in this chapter is the challenge of prioritization. Every entrepreneur has limited resources and time. How do you decide where to focus? You will learn from successful business builders about bottlenecks, huddles, and prioritization heuristics.

Growing businesses, by definition, will need more people, processes, and controls. Processes are the checklists, instructions, and ways of doing every aspect of your business. Processes are the means by which you can achieve consistent high performance.

We know that growth can overwhelm a business and, in some cases, destroy the business. Managing the pace of growth using what one CEO calls the “gas pedal” approach is introduced in this chapter, too. One can describe the four Ps as the hardwiring of the business. Driving home all these points is the story of Global Medical Imaging.

Ryan Dienst is the lead actor of the Global Medical Imaging story, and you will learn how he methodically put in place people, processes, and controls to support Global Medical Imaging’s growth. After reading this story, you will be introduced to another tool, the Growth Planning Template and have the opportunity to use this template in a workshop to practice planning for growth.

Chapter 5, The Four Ways to Grow Your Business

Chapter 3 focused on some critical questions: Should you grow? Why? How should you grow? What are your risks of growth? What are your risks of not growing? In this chapter, I explore how to grow a business by discussing the four different ways to grow a business: improvements, innovations, scaling, and acquisitions.

Improvements are doing what you do faster, better, and cheaper. They are the fundamental way to stay in business. No matter what you decide about whether to grow or how much to grow, every business must continuously improve to maintain its customers. How much do you have to improve? You must improve enough to stay better than your competition. What must you improve? You must improve what your customers deem to be important and of value to them.

Improvements can also create growth by allowing you to do what you do more efficiently and cheaply. This allows you to sell to more customers. Most value-creating improvements are improvements to business processes—the “how” you do business.

Innovations involve doing something new that your competition is not doing. True innovation—doing something completely novel—is both rare and high risk. It is high risk because customers are often not willing to pay for the new product or service. Innovations can be less risky if entrepreneurs adopt experiential learning and customer co-creation processes

that engage customers in the creation to help ensure that the end result is something that customers both need and are willing to buy.

Scaling, the primary way to grow a business, is simply doing more of what you are already doing. Scaling is a replication process. To do it well, you need the right hiring, training, and execution processes along with the right information, measurement, and reward systems overseen by competent managers.

Acquisitions are a more risky way to grow. Acquisitions are buying growth by buying more customers, more products or services to sell, or geographical expansion. Acquisitions are risky because they require due diligence, integration, valuation, and financing expertise.

These concepts will be brought to life through the Sammy Snacks and Enchanting Travels stories. In the Sammy Snacks story, the entrepreneur tried to grow the business through aggressive geographic expansion and lost control of her company. The successor CEO then returned the business to profitability through improvements and then, through iteration, learned how to scale the distribution of its products.

Enchanting Travels is a story of successful scaling that illustrates the necessity and payoff of hard work in creating the processes needed to scale successfully and the difficulties of scaling a personal service business.

Chapter 6, Creating Three Growth Plans

I am a big believer in learning by doing; therefore, in this chapter you will use the concepts of Chapters 2 through 5 to devise growth plans for two companies, C.R. Barger & Sons and Hass Shoes. You will then have a chance to apply what you've learned in Chapters 2 through 5 by creating a growth plan for your business taking into account the four different ways to grow a business.

Barger is a story of a successful business that was in decline. It sells a commodity product. In commodity products, the lowest priced product usually wins. To make money, you must sell a high volume. Barger presents the challenge of how a business escapes the perils of commoditization and reignites growth.

Hass Shoes presents a different challenge. In Hass Shoes, you must examine different avenues to growth of a product business such as selling complementary products or services, expanding geographically, or increasing the number of customers, the amount purchased by each customer, or the number of buying times per customer.

To devise growth strategies for both Barger and Hass Shoes, you will utilize the Growth Decision Template and the Growth Risks Audit discussed in Chapter 2, figure out the preconditions to growth as in Chapter 3, and utilize the four ways to grow to create a portfolio of growth opportunities from Chapter 4. You will also utilize the Growth Planning Template to consider the more granular details of your growth plan.

After you have created your growth plans, Chapter 6 will present some answers for you to consider. Obviously, you will get the most from this chapter by doing your homework before you read the answers.

Lastly, you will do another workshop in which you create your growth plan for the next stage of your business's growth using the concepts learned in Chapters 2 through 6.

PART III: GROWTH REQUIRES THE RIGHT LEADERSHIP, CULTURE, AND PEOPLE

Chapter 7, Growth Is Much More Than a Strategy

In my research of successful growth companies, I found that alignment into a consistent, linked, internal self-reinforcing system was necessary to produce the enabling environment for consistent, excellent execution of the business model. Aligning a business's strategy, culture, structure, execution process, leadership model, human resource policies, measurement, and rewards on motivating the right behaviors that create long-term value are mission critical. As one can imagine, this is no easy task.

Building such an enabling system takes years of iteration and development. An entrepreneur must start simply with a few critical behaviors and increase breadth and depth as a business grows. Over the last ten years, I have studied over one hundred high-performance companies. One of my favorites is Room & Board, which is based in Minneapolis, Minnesota and led by John Gabbert.

I discovered Gabbert through a *BusinessWeek* article. The article marveled at how Gabbert built Room & Board by refusing to grow as fast as others thought he could and should. Gabbert also refused to use bank debt or private equity or to go public.

Gabbert's story is both inspirational and illuminating. He built an internally consistent system that fostered relationships between the business and all its stakeholders: suppliers, employees, and customers.

You will also meet Steve Ritter, the head of human resources at Leaders Bank, based in Oak Brook, Illinois. Ritter shares with you how Leaders Bank created their unique system that resulted in high employee engagement and high customer satisfaction. Ritter's story demonstrates that human resource investments, both in time and money, pay off.

Chapter 8, The Entrepreneur Must Grow, Too!

Growing a business requires more people, processes, and controls. Growth requires strategic focus and analyzing and managing the risks of growth. A less expected consequence of growth is that it requires the entrepreneur to grow, too. One growth-generated change requires the entrepreneur to learn how to delegate. One CEO told me: "Delegation is not a natural act." As a business grows, an entrepreneur must learn how to manage people. With more growth the entrepreneur must learn how to manage managers.

In addition, growth requires an entrepreneur to learn to live with employee mistakes and to manage constant change, volatility, and the roller coaster ride of growth. At this point, some entrepreneurs decide that they do not want to manage a growth business and bring in outside management. Some entrepreneurs redefine their role to the business, focusing on strategy and culture as the business gets bigger.

Building a growth business is like painting a picture: each entrepreneur will create his or her own work of art. But one constant is that for the business to grow, the entrepreneur must grow. That means change and learning: changing what you do every day and how you do it.

To illustrate these concepts you will read Dave Lindsey's story of how he rebounded from being passed over for a corporate promotion and left the corporate world to build a successful business: Defender Direct. It is

the story of iterative learning, installing processes, scaling, adapting to external changes, overcoming a major financial challenge, and then scaling again with different products and a different role for the founder. Lindsey's story is also the story of how he continuously redefined his role in the company and what the business meant to him. After a certain point, making money was not enough for Lindsey.

Chapter 9, The Silver Bullet: Highly Engaged Employees

It is the unusual business that can grow without adding more people. Basically, every business is a people business in that they are built on customer relationships and serviced by and through employees and managers. Most successful businesses are dependent on people.

To grow a business, the entrepreneur must figure out how to attract, train, and retain employees who are highly engaged in the excellent daily execution of their jobs. This chapter deals with that awesome challenge. High performance companies generally have highly engaged and happy employees. The research is overwhelming that happy employees create happy customers, which creates financial success.

High employee engagement results from meaning, the right culture, and the right leadership behaviors, policies, measurements, and rewards. This chapter discusses what that means and how to create the right culture and internal environment in which employees will find meaning and be emotionally engaged in more than making you money. How do you make it more than a job for them?

The glue that binds everything together is culture. When entrepreneurs have their often-frightening personal awakening that the business's success depends on others, they learn that what the employee wants is not that much different from what the entrepreneur wants.

This chapter looks at the power of employee "ownership," promotion-from-within policies, hiring for "cultural fit," creating a family atmosphere, information transparency, emotional rewards, and the leader's behavior. Money is not enough.

This chapter pulls together critical lessons about high performance environments from the Room & Board, Defender Direct, Enchanting

Travels, and Leaders Bank stories and introduces you to Trilogy Health Services, another successful company with a highly engaged workforce.

Chapter 10, Building an Effective Management Team

Chapter 9 focused on creating a highly engaged workforce. As you grow your business you will need managers, and, ultimately, you will need a management team that helps you manage and grow your business. Most of the entrepreneurs in my study had between four and seven direct reports—that is, managers reporting to the CEO who had functional responsibilities such as sales, technology, human resources, operations, legal, finance, and customer service.

Building an effective management team turned out to be much more difficult for most CEOs in my study than they expected. You will learn from their trials and tribulations that the right hiring process is critical. Hiring during the “adolescent” stage of growth is very difficult. Often, big company managers fail to adjust to an entrepreneurial growth company environment. Growth often requires hiring several new managers in a short period of time or working with a mix of in-house veterans and new people, which requires expertly managing the managers to ensure they are getting along and “playing nicely together in the sandbox.”

Mike Cote of SecureWorks in Atlanta, Georgia, transformed an underperforming company with great technology into a great company. The SecureWorks story is a good conclusion because, not only does it deal with the specific challenges of building an effective management team, but Cote’s story reinforces the key themes of this book.

Let’s get to work by focusing on the first important questions: How do you decide whether to grow your business and how much should you grow? Exhibit 1.2 outlines ten of the most common growth challenges.