



Barriers to Growth

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Business Evolution and Revolutions and the 3 Barriers to Growth

In 1972 Larry Greiner published a Harvard Business Review article titled *Evolution And Revolution As Organizations Grow* that has gone on to become a classic. Mr. Greiner's premise is that in organizational development we can identify a series of phases through which a company will tend to pass as they mature. Each phase begins with a period of evolution – growth, and ends with a period of revolution – substantial organizational change.

It Gets Elite Very Quickly

There are 28 Million companies in the United States plus or minus (tax filing entities). About 4% of these companies have more than 10 employees and more than \$1 Million in revenue leaving 96% below that level. While there may be other sources for the data that we will look at there are two common elements, 1) there are plateaus of organizational size that form over time, and 2) as companies move up these levels it gets elite very quickly.

Beyond the second level, the 4% of the companies, only about .4% of the total businesses make it to the next level where companies have + or - \$10 million in revenue and + or – 50 employees (full time equivalent). This is essentially the beginning of the mid-market. Only 17,000 companies make it to the next level of + or - \$50 million in revenue and + or – 450 employees. The largest 2,500 companies in the United States will make up the top level with revenue in excess of \$500 million in revenue. These 2,500 companies are the Fortune 2000 and the Forbes Private 500. Obviously, the revenue to employee ratio varies between companies and industries. However, these numbers paint the macro-level picture. You can envision these levels as an advancing staircase from level one in the lower left to the fifth level in the upper right with gaps between the rising levels. Across this you can lay the 3 Barriers to Growth. For each of the 3 Barriers there is a threshold,

or breakpoint, in order to move up the next level.

Leadership

The first barrier is Leadership. Dr. Edward Demmings said that leadership is fundamentally about 2 things: prediction and delegation. Leaders need to be able to predict and they need to be able to delegate. Prediction is not about having a “special sense” or the ability to “see the future”. Instead it is about leaders being comfortable making decisions today while looking out into the ambiguity of the future. Delegation, just for a quick review, is about four key steps: 1) pinpoint; 2) measure; 3) feedback; and 4) reward and recognition.

- Pinpoint – you must identify what is important
- Measure – to quote Dale Carnegie, “To manage something you have to be able to control it; to control something, you have to be able to measure it.”
- Feedback – you need to close the loop and follow up
- Reward and recognition – this is important for connecting human motivation to the process.

Let’s take a look at the barrier of Leadership at the different breakpoints. During the first breakpoint, we see that the entrepreneur just needs to learn how to delegate in order to move beyond the first level. Sometimes this is where a partner may enter the picture in order to balance out the ability of the entrepreneur. For instance, if the entrepreneur is selling oriented it may work well to have a partner who is operationally oriented. In order to move through the next breakpoint to the third level someone needs to move to the middle and create a management team. Call the person in the middle the CEO or President and around them would be the management team of V.P. of Sales and Marketing, CFO, COO, V.P. of HR, etc. Sometimes this person who moves to the middle is the entrepreneur and other times it is not. The entrepreneur needs to recognize at what point they need to step aside and stay in another role. For example, again, if the entrepreneur is selling oriented they may find it best to stay in an active sales role or in the role of V.P. of Sales and Marketing reporting to the CEO. Relatively few individuals have been able to take a company from the start-up to Fortune 500. Michael Dell and Bill Gates would be a couple of the examples in the last 20 – 25 years and even they have brought in others to complement where they are weak. At some point the entrepreneur will “top out” in their ability to see the organization to the next level.

Next the leadership issue becomes building a strong middle management. This is initially accomplished when each of the executives reporting to the CEO learns how to delegate and build a leadership team within their functional area. Then the final breakpoint is all about adding layers of middle management. The size of the organization determines the number of middle management layers needed within an organization.

Systems and Structures

To understand the Barrier of Systems and Structures we first need to look at the underlying issue of complexity. If you have two people, locations, systems, etc. there are two channels of communication – one each direction. When you increase the number to three people, etc. you end up with six channels of communication – two between each of the three people. In adding a fourth person, etc. you now increase the number of

communication to twelve.

As you grow arithmetically, your complexity increases geometrically! This is what bites you as an organization. Executives will say, "...all we did was add the 200th employee", or "...all we did was open the new location", or "...all we did was set up one new overseas partnership" and the wheels fell off. Yes, only "one" was added but it was the geometric increase in the complexity within the organization that caused the problems. It is analogous to the tip of the iceberg where 90% is hiding under the water. Complexity lurks below the "surface" as an organization adds mass.

Now let's look at Systems and Structures against the different breakpoints. At the first breakpoint the challenge is getting the basic office systems setup. This is where the business is moving out of the basement or the garage into a real office. You need to get a phone system, computer system, email system, copiers, etc. It becomes "real important" where people sit and whether or not they are on email. By the way, these issues don't go away. You will continually need to deal with the "office system."

When moving through the next breakpoint, you need to put in place good operational and functional systems within the organization. For instance you have your financial system (including the accounting system and all the processes), your operational system, and your sales and marketing system, etc. Sometimes you will hear it referenced that this is the point in time where you are "franchising" your business – where you are putting all the repeatable processes and systems in place to provide a consistent quality of product or service to the customer. And you want to be able to provide that consistency regardless of the people involved.

Getting through the third breakpoint is simply placing an Executive or Strategic System, if you will, on top of the functional /operational systems within the organization. **What is a Strategic System?** It is a system that allows for the following:

1. Long-term strategic thinking,
2. The process of executing strategy, and
3. Building a cohesive executive team at the top of the organization.

It is beyond just having a good strategic planning method in place. There needs to be a system that forces the execution or implementation beyond the planning.

At the fourth, and final, breakpoint the systems and structures issue becomes one of putting in place an ERP (enterprise resource planning) system. This is well beyond a technology (hardware and software) problem. There needs to be an over-riding integration of the processes within the organization (people, technology and information). These integrations can be complex as organizations in this size range will have multiple businesses and geographic locations, a number of which may be international. Chief among the concerns is making sure you institutionalize these processes without creating a bureaucracy.

Beyond the breakpoints, there is an issue related to systems and structures that merits brief comment at this juncture. We are going to look quickly at the 3 types of organizational charts and the issue of accountability.

The first type of organizational chart is what you might typically view as the Traditional organization chart. It is the hierarchical view with one box at the top and then spreading down with each box connected to one box above and a number of boxes below. This represents the reporting structure within the organization. The problem with this organization chart became when people started using it with dotted lines from this box to that box across departments or multiple levels up or down the organization. Executives would say things like, "...well Susie over here reports to John but she also works with Sam and Anne on certain projects", or "...Fred has all this great experience and knowledge of the industry and our business and needs to be on the executive team, therefore, he needs to have people reporting to him." Well maybe Fred isn't a good manager. Maybe he really doesn't like working with people. Then what do you do? So out of all these boxes off to the side of the organization chart and lines running all over the page consultants came up with a new type of organization chart in early 1990's called the Nodal Network. They declared the Traditional organization chart "dead". The thinking was that the emergence of the information age the organization chart must look different. So they came up with a chart where there was a dot for every person in the organization and then lines all over like a spider web connecting the dots where information flowed or there was any sort of formal or informal communication.

Well, they were wrong! It is not a matter of Either/Or, it is a matter of AND. Both types of charts are needed within the organization. First, you need to have the Traditional organization chart because it reflects lines of accountability. Accountability is important to distinguish. It is different than responsibility. For example, within the organization many people, if not all people, have responsibility for sales. Everyone has the "ability to respond" to sales. But who has accountability? Who is the one person whose name is on the line, who will "stand up and be counted" for the particular assignment, objective or result? For sales, this would generally fall to the V.P. of Sales and Marketing. So we need to be clear when talk about accountability and it is important to have those lines clearly delineated within the organization.

One adjustment you may need to make with the Traditional organization chart is for technical specialists – people with technical brilliance. These individuals may be better marked as a technical center of excellence – off the organization chart – and given no direct employees to manage. This would relate to the earlier example situation with "Fred".

The Nodal Network organization chart is really an information and process workflow chart. In any given business there are generally 4 – 6 major processes. Each of these key processes needs to be identified and mapped out. Sometimes it is easiest just to get a big piece of paper and some sticky notes and put it all down. That way you can move the sticky notes around as you re-engineer the process. It is unfortunate that the reengineering label was picked up and applied to many job-slashing initiatives of large

businesses because it has given the term a negative connotation. In the first chapter of *Reengineering the Corporation*, Michael Hammer and James Champy really do an excellent job of describing how to best identify processes (customer-centric vs. departmental or functional) and the general notion of re-engineering processes.

There really is value in re-engineering your organization's key processes. In fact, it is imperative for survival, let alone growth, because the marketplace changes. To give you a simple example that many of us can relate to, think of the front hall closet, the garage or the storage room in the basement of your home. You probably did a massive cleaning and organizing last fall but what happens by springtime when you open the door or walk in? It is, once again, in complete disarray! You can't find what you are looking for, stuff is tumbling off the shelves, etc. You get the picture. It is time to clean and re-organize. It is the Law of Entropy. The Law of Entropy is the second law of thermodynamics that states the degree of disorder is always increasing. Within a system there is a natural moving toward a higher degree of disorganization. The same thing holds for the key processes in your business, they need to be cleaned and re-organized from time-to-time. The third type of organizational chart is the Almost Matrix. You can think of a matrix where the key executive roles, CEO, CFO, V.P. of Sales and Marketing, etc. are across the top and the business unit or division leader roles run down the left side. With the original matrix type organizational chart, promulgated in the management classes in the 1980's, there was a problem – people got caught in the middle. Many times they ended up with 2 bosses and conflicting priorities. Take the divisional controller as an example. They were getting priorities and pressure from the CFO and, sometimes, different priorities from the divisional General Manager.

Why we call it the Almost Matrix is because you need to make sure the line of authority/accountability only runs one-way – toward the divisional or business unit leaders. These leaders then have accountability up to the executive team. Where does that leave the individuals in the key executive roles? They need to move away from directly managing the individuals to toward becoming a resource for the individuals within the matrix. They are no longer “yelling and telling” but would be “coaching and selling”. Back to the earlier example with the divisional controller and the CFO, the divisional General Manager would be providing the prioritization of what the controller should be working on in order to support the objectives of the division. In the process, the controller could tap into the knowledge and expertise of the CFO in order to complete the assignment.

The point in time an organization should make a transition to the Almost Matrix depends on a number of factors including the type of business and the industry in which you compete. In our experience, this type of organizational structure is not generally seen until an organization has pushed up beyond 100 employees although it is not uncommon to find this type of structure in professional services firms that are smaller.

Market Dynamics

We have looked at the first two Barriers, Leadership and Systems and Structures. Let's turn our attention now to the third Barrier, Market Dynamics. Throughout the life of an

organization, revenue, gross margin, profitability and cash flow are all important all the time. However, within the stages, each of those things takes on significance over the other.

At the first breakpoint it is all about revenue. You just have to get out and get the next customer. Get the revenue in the door in order to cover the overhead. Remember what is happening at this breakpoint related to the Leadership and Systems and Structures? Staff is being hired – there has to be someone to delegate to – and an investment is being made in some fixed systems – space, office equipment, technology, etc. The organization needs to secure revenue volume sufficient to afford this increase in overhead.

Which of the remaining items, gross margin, profitability or cash flow do you think is next? If you are saying cash flow you are right on. In general, these next two stages are where companies experience their fastest rate of growth – and growth consumes cash! If you were to look at the INC 500 listing of the fastest growing companies – based strictly on top line revenue growth – you would find the majority of the companies between \$2 million and \$50 million in revenue.

One of the key concerns a company has as they go through this growth spurt is that they will have enough money to survive their mistakes as they figure out the market. Like the “...let’s start a new office in Florida, Arizona, Hawaii – take your pick – because we like to go there” type decision. Or how about “...let’s start a new business. We’ve been successful in this business we can for sure be successful in that business – it can’t be that difficult”. Sound familiar? Maybe even “been there, done that”? Again, you have to have enough cash to survive your mistakes as you figure out the market.

Moving on the third breakpoint we shift our attention to gross margin. This is the position where you are in the squeeze. As you move up to this threshold you begin to “pop up on the radar” of the competition – large companies. The competition wakes up when you land some \$5 million or \$10 million deal that makes them “miss their quarter” and they don’t like that. Large companies can afford to come after you competing on price. They usually have more resources than you do to wage a price war.

From the low side you have younger, smaller competitors offering the customers lower prices – “because we don’t have the overhead” and more personal service – “you get to deal with me, the owner”. During this squeeze the company has to work hard on its own strategic positioning.

Why is it so important to maintain your gross margins anyway? Couldn’t you just say, “...so we’ll make a little less money but we’ll keep growing”? That’s a fair question but let’s look back at what we need to accomplish as an organization at this breakpoint along the other two barriers – leadership and systems and structures. With the leadership barrier the organization needs to develop middle management. Related to systems and structures the organization is working on developing a strategic or executive system and is dealing with organizational structure changes. What do both of these require? Money. What are the first things that get cut when profits go down? People, training and internal development projects – “soft items”.

When it comes to maintaining, and possibly even increasing, your gross margin at this point there are only two ways to do it. First, focus on your value proposition; your unique offering in the market. This must be something that matters to the customer. Second the organization needs to focus on aggressive process improvement. This why you see all the process improvement programs, such as LEAN, Six Sigma, TQM, etc., out there in the marketplace. As you focus on improving the process and improving your quality the cost of producing the product or delivering the service drops significantly. Profitability then is what rises to the surface for the final breakpoint. However, it is not just profitability but predictable profitability. At this level it is important for an organization to have consistent, predictable profits. This can be seen most clearly in the public markets. What happens when a public-traded company misses its quarterly forecasted earnings targets? Wham! Their stock price gets hammered. Sometimes they may only miss their projections by a few cents per share! But the market is saying to the management of the company, "...you have the best knowledge of the markets, the competition and your own internal capabilities, so if you don't have it figured out, who does?" This same importance of consistent, predictable profitability likewise applies to large privately held companies as well. When a company gets to this level you need to understand and pay attention to the macro-economic issues such as interest rates, foreign trade policies, currency exchange rates, etc.

In review, we can see the important stages for each of the barriers: leadership; systems and structures; and market dynamics. These stages and this overview are not meant to be prescriptive but rather a general awareness of the issues companies go through in their growth. Much like you have to crawl before walk and walk before you run, a company needs to take one stage at a time and address the specific complications that arise with each barrier at each stage. It is important to note that you can't run ahead, nor do you need to. As an extreme example a company going through the first breakpoint – to get on up over \$1 million in revenue – does not need to have a functioning middle management or an ERP system in place. That would be ridiculous.

Can you place your organization against these barriers? Refer to the graphic on page 4 of the TuneUp™ workbook. What key leadership issue is your company dealing with? Are your systems and structures where they need to be? Which stage are you within when it comes to market dynamics? Some companies may be more developed in one or two of the areas and/or lagging in the others. The good news is your not alone and you can learn from others who have already gone through these stages and breakpoints. There are some simple, practical habits that will help you overcome these barriers.

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