Managing **fast growth**

An overview of the strategic issues companies need to consider in planning growth.

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Growth is key to the survival of any business. Businesses that do not grow stagnate an eventually die. According to a study carried out by the economist L Hannah in 1999, of the 100 largest US firms in 1912, 29 had, by the time of the study, gone bankrupt, 48 had disappeared, and just 19 of them were still in the US top 100. In the current era of rapid change growth must be equally rapid or the opportunity will be lost as competitors respond and the zeitgeist changes.

"It is not the strongest of the species that survives, nor the most intelligent, but the one most responsive to change".

Charles Darwin

Rapid growth is rarely by accident. Companies that grow rapidly have strategies for growth. Companies must learn how to scale up and extend its business, lengthen its expansion phase, and accumulate and apply new knowledge to products and markets faster than competitors. Young companies often fall into the trap of focusing on short term survival and relying on short periods of 'catch up', whereas larger more mature companies often struggle to identify and successfully grow the key growth elements within their business.

"There are only two kinds of problems in business: growth problems and liquidation problems."

Steve Conover –The Skeptical Optimist

No business can afford to leave their growth to chance, they need a consistent plan that incorporates a vision for growth (market and product combinations) with plans for how they will support expansion by marshalling the know-how, resources and organizational structures at the companies. In essence there are broadly two strategies for growth: acquisition or organic. However within these broad categories there a number of different options.

1. Acquisition versus Organic Growth

Making Acquisitions Work

Evidence suggests that making acquisitions work that involve integration of the businesses can be extremely difficult but following some simple guidelines can significantly increase success:

Larger high performing companies making smaller acquisitions do better then average

Companies that have a formal structured integration programs have lower restructuring costs

Acquisition can be a faster and generally more visible shortcut to growth. It can be argued that growth by acquisition is less risky and easier to finance due to the known quantities and financial performance of the acquired company versus unknowable forecasts of a new product launch or expansion into a new market.

However finding the right company takes considerable time and effort, and once found, realizing the gains to be made from the synergies and economies of scale and scope can be elusive. Recent studies by McKinsey & Co showed that about 60% of all acquisitions failed to generate a return in excess of the costs of acquisition. About 17% covered costs and 23% were successful.

In addition various studies have shown that 30-45% of companies acquired were later sold at a loss. Organic growth on the other hand tends to be slower in generating results but can be cheaper overall and have less institutional risk. The balance of risk and reward between acquisition and organic growth depends upon the strategic objectives, effective implementation and (in the case of acquisitions) detailed due diligence.

2. Acquisition Strategies

Acquisition strategies fall into four broad categories:

· **Horizontal.** In essence companies are acquired who do the same thing as you do. Value is created through; risk reduction (through increased diversification of the customer base), geographical spread, reduced cost of capital (due to increased scale reducing risk), and increased market power. However the cost base is increased and there can be significant cultural barriers to successful integration which can generate substantial restructuring costs. When the accountants and consultants Peat Marwick acquired Thomson McLintock in the mid 1980's, within a year, half of the McLintock partners had left and it took over three years to create a unified firm.

· **Vertical.** This involves acquiring companies further up or down the supply chain. Value can be created by cost reduction, reduced risk and by increased scale reducing cost of capital. Sony acquired Columbia Pictures Entertainment in Hollywood for $3.2 Billion. The rationale was that owning a media provider ensured that Sony would have content for its hardware platforms in the future. This has proved to be a very expensive strategy with Sony Pictures losing X million in 2007.

· **Umbrella Branding.** This involves acquiring businesses that can be leveraged by values inherent in a brand. Value is created by increasing consumer confidence and thus attracting new customers. Perhaps the best example is that of Virgin which has lent its name to everything from credit cards to trains. Tesco and Marks and Spencer have also gone down a similar route to great success.

· **Diversification.** Famous conglomerates such as General Electric and Berkshire Hathaway tend to have a strong financial rather that strategic or operating visions and focus on rewarding managers for achieving targets.

Scaling: Netscape
"move fast, keep going – or end up on your butt"
Jim Clark Founder of Netscape

1994 Founded by Jim Clark and Marc Andreesen
1995: $80m in sales
1998: $500m in sales, more than 3000 employees, acquired by America Online for $10 billion.

Specific tactical acquisitions may also be undertaken to acquire specific strategic assets such as technology that can be exploited through the existing client base.

3. Options for Organic Growth

For many businesses organic growth remains a favoured route to growth. It is felt to be more stable, the management more in control. It also tends to be slower than acquisition. Organic growth requires a detailed strategic plan that sets out a coherent vision for growth and then must focus on the knowledge, skills and strategic assets within the business. Most importantly it is a plan with an internal focus that should be developed irrespective of competition. Below are three options for organic growth strategies: scaling, duplicating and granulating.

i) Scaling: "More of what you're doing"

This approach is applicable where the company can demonstrate a product with unique value that addresses a large market, and is easy and cheap to distribute. This strategy requires aggressive investment in marketing and continuous product development as well as good knowledge of mass marketing and product support.

Key accomplishments as you scale up are: the ability to specialise and standardize, to hire the right mix of people, adapt the corporate and implementation structure and learn and share lessons from customers quickly. Netscape is a classical example of growth by scaling moving from startup to revenue of $500 million, and 3,000 employees in 4 years.

ii) Duplication: "Clone business model in new geographic region"

Duplication is ideal for a business where a physical presence is required and/or where distribution needs to be improved. The key is adapting experience in original market to the new regions. Key accomplishments are the ability to package know-how and yet be able to adapt that know-how to new markets: a tension between the benefits of standardization and adaptation. Oracle is a very good example of this strategy. To reach their target market they have developed a network of 20,000 partners in over 100 countries.

Duplication: Oracle

1977: Founded by Larry Ellison, Bob Miner, Ed Oates
1981: First business plan written
1984: Venture capital backing from Sequoia Capital
1986: Revenues of $55 million
1989: Revenues $584 million
2007: Revenues $18 Billion 68,000 employees. 20,000 partner network in about 100 countries.

iii) Granulation: "Select and grow one element of the business"

This strategy comes into play for larger companies, perhaps when the former strategies have already been employed. The company needs to be large enough to be able to resource research into potential new areas. This strategy requires the company to identify and focus on the aspect of the business that can be the basis of a fast growth strategy. This can be risky as it may not fully leverage the company's knowledge base. Therefore success relies heavily upon evaluation and monitoring (much like an investor would do) and balancing influences from old and new and formal and informal networks. SAP moved from providing an online accounting system (R1) to a multiple product company based on R3 platform which is flexible enough to cater for any client needs. They learnt from their customers what was required.

Granulation: SAP

1972: Founded by former IBM software engineers in Mannhiem, Germany.
1977: Revenues DM4m
1989: Revenues exceed DM100m with 1,000 employees
1992: R3 launched. SAP penetrates SME market become global player.
2006: Revenues of €9.4 Billion

4. Implementing the Growth Strategy

Companies have successfully combined various strategies for growth as they can complement each other, but for most early stage companies it is better to tackle them sequentially albeit with an overlap.

Start-up companies will find implementation easier, but the size of a company should not drive the growth plan. Larger companies need systems for creating acquiring and sharing knowledge which will be the basis for future growth plans.

5. Our Practical Experience of Managing Fast Growth

Managing fast growth boils down to how well you manage your 2 key assets: People and Cash, in developing what it is your company does that is better than anyone else.

People. The importance of having above-average people in a fast-growth business can't be overemphasized: workloads will constantly be expanding and may not be predictable, innovative solutions will have to be implemented quickly. You need people who can think on their feet, adapt well to constant change, and put in the extra hours. You need people who can get excited about being a part of your growing business! Lessons:

"When turnover doubles year on year, and you no longer recognize anyone when you walk down the corridor, it's then you realise that managing this sort of growth is going to be a challenge!"

Recruit wisely. A fast-growth business means hiring lots of new people. Get this wrong and you can easily find yourself in deep trouble. Do not under estimate the cost and the time likely to be involved. A possible solution to this problem is to outsource the process to a freelance human resource manager. Let them carry out 90% of the work. You just have to approve the final selection.

Be prepared to let people go. Some people, even those who are committed to your business and work hard, won't be able to adjust to the changes brought about by growth. For example, the person who supervised two people in your warehouse well when you first started out may not be able to manage a team of forty. As the business grows you need to make hard and objective assessments of your key managers.

Manage the impact of new people. Current employees often feel threatened by the influx of new personnel. Involve your employees in the process of structuring new positions. If a new position will cut into the responsibilities or authority of a current employee, meet with that employee privately to discuss the need for an added position and, emphasize your confidence in his or her ability to continue being a positive asset to the company. Post all job openings internally at the same time, if not before, you place outside advertising. Consider having all employees who may be threatened by the new position participate in the interviewing process. This will make them feel more confident about their position within the organization and less threatened by the new hire.

Money. Fast-growth businesses burn money! Even with good profits, there will almost certainly be times when a growing business will run tight on cash as expenditures occur before related sales are realized. It is essential that you keep close to your bank and communicate regularly. It is also important to identify cash flow funding options such as invoice discounting. If you think that substantial funding will be required from venture capital sources to finance growth then you need to plan early. It can take up to a year from identifying the need getting the cash in the bank. Lessons:

Plan and then plan some more. The faster a business is growing or changing, the more difficult it will be to plan future expenditures or income. Careful planning and constant updating of plans, particularly cash flow projections, is of paramount importance in a fast-growing business.

Don't neglect profits. In a fast-growth business it is very easy to become excited about rapidly rising sales and lose track of profits. This is especially true when an organization shifts from a very small entrepreneurial organization to a professional organization with many managers. Be aware that during the transitional phases overhead expenses can mount rapidly! If you are trying to attract outside investors, banks, or other lenders, they will want to see good, healthy profit margins. More sophisticated lenders and investors will also pay a lot of attention to the trends in your profit margins.

The most challenging part of managing fast growth is getting and integrating the right people and ensuring that costs do not spiral and cash does not run out. The most effective way of dealing with these problems is getting the right help to recruit the right people and detailed financial planning to ensure that you don't run out of cash.

One final tip is the use of 'life and death milestones' in company growth. It helps to structure board meetings around these benchmarks that will prompt the timing of bringing on new resources and the marshalling of current resources.

Fast growth needs to be planned for, and those plans must reflect the nature and assets of your business as well the nature of the industry you are in. There are lots of options: acquisition can bring quick results but requires careful execution, whereas organic growth requires a careful marshaling of resources and a keen tactical awareness. Catalyst can help you decide which strategies to employ and help execute and finance the chosen strategy.

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This briefing paper can be downloaded from www.catvp.com

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