The Good, the Bad, and the Ugly Truth About Growth:

The C-Level Executive's Number One Challenge

By John W. Myrna

After taking the oath to "never do anything stupid — because of something written on a piece of paper," the executive team set out to create a shared visualization of their company's future. This was a key element of their strategic planning process. As their facilitator, I asked each team member how big they wanted the company to be within five years. I wasn't asking for a forecast or prediction, but their personal visualization, with an explanation of why they picked that number. Before answering, Bob, the Director of IT, spoke up passionately. "Growth creates nothing but problems. Why can't we just stay the size we are?"

The ugly truths about growth

One ugly truth is that you can't assume that every executive, much less every employee, understands why growth is important. We asked Bob why he felt so negative about growth. "Well, we have doubled in size over the past five years, but the only difference I see is that we seem to be working twice as hard with no obvious benefits." Getting wound up, he continued. "We added all those people and machines and when the revenue didn't immediately show up we had to tighten our belts and downsize. We ended up breaking promises to a lot of good people, and the survivors' morale really tanked."

It is an ugly truth that during the early days at Bob's company, all they had to do was focus on revenue, and then profit would take care of itself. Expenses always seemed to lag revenue, with the gap filled by growing productivity. Now profit had to be managed, the same as revenue.

There are myriad reasons why it isn't enough to focus exclusively on revenue. For one, growth is non-linear. Too often I see companies budgeting by taking the forecasted annual revenue and generating a monthly budget by dividing by twelve. Revenue just doesn't happen that way. It doesn't grow by a fixed percentage monthly. Similarly, revenue over a five-year horizon doesn't increase evenly every year. The reality is that companies operate within a recurring two-step cycle. Investments in business development lead to a jump in sales one, two, or three years later. The growth in revenue leads to a mix of business with uneven profitability and pressure on capacity. Rationalizing the business and increasing capacity then becomes the focus. The investments companies make in rationalizing their business and increasing capacity serve to increase costs while creating excess capacity. In turn, this drives the company's focus back to business development.

There is a sweet spot when business exactly matches capacity, but that moment is fleeting. This is also the most dangerous period for a company. The profit margins are good, leading to hubris as the company commits to

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fancier company cars, unsustainable benefits, and above-market compensation. As the company grows, management tends to spend more time looking internally, compared to the early days, when the CEO and her team spent time with actual customers. But as the company grew, they spent all their time interacting with other company employees, losing touch with the marketplace.

Growth is also subject to a natural law of physics that increases concentrations. For example, one of our manufacturing clients woke up one day to see 80% of their revenue coming from one major customer that was purchasing one product, supported by one salesman in one niche market. Growth was easy. All they had to do was continue to sell a product they knew how to produce to a client who knew them. That was fine — until the client went bankrupt. Only then did they realize they hadn't been developing new customers and products. They thought they were investing in the future, but, alas, when we drilled down we found the investment dollars were actually subsidizing inefficient operations. Growth had covered up this reality. STSC Inc., a company where I spent fifteen years, stopped signing up new customers for our product several years before revenue started to decline. Growth from existing customers hid the fact that our business model was no longer viable. Warren Buffet captured this phenomenon best when he observed that "you don't know who's swimming naked until the tide goes out."

Another ugly truth is that often you have no choice but to grow. Markets mature as competitors and customers get smarter every year. Like a poker game, every year the ante to stay in the game gets bigger. Customers' expectations for quality, quantity, timeliness, and cost keep ratcheting up. Keeping your company competitive requires ever-increasing levels of investment. Without revenue growth you won't have the resources to upgrade your people, products, and systems. Sometimes you have to grow or die, even if it requires making a "you bet the company decision."

The good about growth

So with all these ugly challenges, why would you want to grow? Ray Kroc, founder of McDonald's, had a terrific answer. "Are you green and growing or ripe and rotting?"

Bob's fellow executives found it easy to enumerate the reasons for growth. The Operations Manager pointed out, "We can't afford to invest in process improvement until we have sufficient volume to justify it. More revenue, and the profit it generates, provides the resources to acquire more modern and productive machinery. Further, how else could we have afforded the new ERP system and your staff expansion, Bob?"

The HR Director noted that the first thing every potential hire asks is "are you growing?" Growth creates new opportunities for advancement and potential for annual increases in compensation. A steady stream of new employees sustains a healthy diversity. She pointed out that without new employees, the average age of employees gets a year older every 12 months. Eventually the entire workforce will reach retirement age at the same time.

A growing company provides career paths and attracts the best talent. The CFO reminded the team that banks don't want to lend to stagnant companies. They want to lend to well-managed, growing companies. The Sales Manager noted that prospective customers preferred to work with vendors they believed would have the resources to support them in the future. "The cost of sales is lower when we have strong word of mouth and testimonials from existing customers. We are now seen by our top two customers as partners. They even invite us to their planning meetings."

The Purchasing Manager added: "Don't forget the leverage we get with volume purchases from our vendors. When we are a major, growing customer, we get priority treatment when there are shortages." The head of R&D recalled that "our last product launch went a lot faster because we had lots of ready-made alpha and beta customers to quickly work the bugs out."

Paul, the CEO, said, "It's all about our ability to manage risk. With a stable customer base and recurring revenue, we can manage riskier investments." The nature of the risk he mentioned was how long it would take to reach break-even with a new product, office, or market. "All things being equal, the greater the risk, the greater the potential return." The CEO also highlighted the competitive advantages of gaining and retaining market share leadership. "Our competitors are finding it harder to afford to keep up with us. As long as we manage the company well, our superior productivity and profit margins will make us the best bet for our customers."

As the planning meeting's facilitator, I pointed out that their growth, and the systems and processes it funded, enabled them to remain profitable during economic downturns and market shifts. I also reiterated the power of the "learning curve." The more units you produce, the better you get at it. In Malcolm Gladwell's book Outliers, he shared research that suggests it takes 10,000 hours of experience to become a true expert at anything. Customers migrate to vendors they see as experts.

What's bad about growth?

There are surprising limits to growth and performance. Growth changes everything. If you embrace it, change isn't automatically bad. However, as with all change, there are short-term winners and losers. For example, the skill sets of employees need to change along with the company. Sometimes this requires the replacement of hardworking, loyal employees. For example, it is unlikely that a Bookkeeper can be trained as a CFO, so the loyal Bookkeeper will have to be replaced, becoming one of the "losers." I've seen many CEOs hesitate to act because of the personal promises they made years ago to attract these very people.

Corporate culture manifests itself in how employees prioritize their daily tasks. As a company grows, the things that are most important change. For example, a small manufacturer can cherry-pick customers and prioritize large orders over small ones. Operators who "know" that they have to prioritize large orders from existing customers will impede a company's ability to attract and support emerging (i.e., initially smaller) prospects in the market. Further, large customers are generally not interested in new technologies. They are very interested in optimizing the features and costs of the existing technologies they are getting. (This phenomena has been dubbed "the innovator's dilemma." For example, PC manufacturers weren't interested in physically smaller disk drives. They pushed their vendors to make the drives have more capacity, operate faster, and be cheaper. Small drives enabled new products like the iPod, but ended up being developed by new companies without an existing customer base they had to cater to.)

Most founders enjoy applying their operational skills to growing the company in the early years. With growth, the CEO's focus needs to move from being the chief salesman or product developer to concentrating on the three non-delegatable CEOs tasks:

- building the management team,
- making the "you bet the company decisions," and
- leading the strategic planning process.

We once had to drive this home with a client who insisted on reviewing each and every vendor payment. While that was a reasonable use of a few minutes of his time when there were only dozens of checks a week, it made no sense when it consumed hours of his time to review hundreds of checks, many of them less than half a percent of the company's monthly budget.

A company risks change with growth. When a company is growing rapidly, office space, branch offices, and new computer systems come in ever bigger-dollar chunks and multi-year commitments. Cutting back incurs a larger short-term expense. When you're making decisions like this, ask yourself, "what's the worst that could happen?" As you grow, the "worst" gets larger and requires more consideration before committing resources.

Growth leaves a wake of legacy customers, products, and employees. The old saying that "you need to leave the dance with the girl you brought" is a formula for failure. As you grow, you'll find there are customers that are no longer large enough to warrant the company resources they consume. There are products that aren't strategic enough to attract the corporate resources to keep them competitive. There are employees who haven't grown their competence as fast as the company has grown. Healthy companies "rationalize" their employee, customer, and product bases regularly. Successful companies have a process for rationalizing "legacy." With integrity and caring, they facilitate the transition of their legacies to other companies that can better serve them.

When you are a start-up, operating from a garage, customers have modest expectations and tend to be understanding and supportive. "It's amazing how good they are given their size." Employees expect minimal compensation and investors are patient. However, once you've "made it," everyone's expectations jump, often to unsustainable levels.

A secret about growth

I went to graduate school in Bozeman, Montana. When I wasn't in the computer center doing programming, I was at Bridger Bowl skiing. There were skiers who would fall every 10 yards, even when moving slowly down the beginner or "bunny" slope. And then there were skiers who could navigate the extreme slope at blinding speed, handling moguls, recovering with quick tucks, never even stumbling. The difference in performance wasn't how fast they were moving. The difference was skiing only as fast as their ability to remain in control. With training, coaching, and hours spent on the slopes, I eventually was able to go faster and handle more advanced slopes.

So too do high-growth companies reap the rewards that come from investing in improving their people's competence, their processes, their forecasting ability, and their control systems. No company grows by cutting expenses or staying on the "bunny slope." They grow by improving their productivity, business acumen, and overall ability to manage risk. Remember that all things being equal, the higher the risk you can effectively manage, the higher the ultimate gain you can realize.

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