

CHAPTER 16

Managing growth and transition

Learning objectives

After reading this chapter, you should be able to:

- explain the various dimensions of growth in a business enterprise
- discuss the four basic theories that explain how and why organisations grow
- explain the various business growth strategies
- outline the changing role of the entrepreneur as the business grows
- identify different methods of 'harvesting' a business venture.

Most small businesses have one of the following goals: to survive; to consolidate and continue to be successful; or to expand and grow. However, on closer inspection, it becomes clear that these three basic activities are often variations on the same theme, and they can be reduced to a focus on expansion and growth in one way or another. After all, growth is a dynamic process and means more than just an increase in size. It also encompasses development and change within an organisation, and it alters the way the organisation interacts with its external environment.

Once a business has grown, what happens next? Entrepreneurship is seen by many as a journey, not a destination. A common sentiment among successful entrepreneurs is that it is the challenge and exhilaration of starting up and building a venture that gives them the greatest kick. Once they have reached this goal, they may seek to enjoy the fruits of their labour through various 'harvest' strategies, such as management buy-outs, mergers and acquisitions, public offerings or outright sale.

This chapter outlines the various dimensions of growth, and presents four basic theories on how organisations change. Finally, several strategies for harvesting and maximising return from the successful business venture are detailed.

The dimensions of business growth

The growth of the venture can be seen from various perspectives, such as: (1) *financial* — growth in income, expenditure and profits; (2) *strategic* — growth in market share and competitive advantages; and (3) *organisational* — growth in organisational form, process and structure.[1]

The various dimensions of business growth must be considered in relation to one another (figure 16.1). Financial growth is a measure of the business's performance in serving the need of its markets, and thus it is a measure of the resources the market has allocated to the firm. The firm must convert those resources into assets. These assets are configured by the organisational structure. Financial growth provides the means by which a business can obtain additional resources (such as staff, equipment, information) to fuel strategic growth and to acquire additional assets. In turn, financial growth is fuelled by the performance of the strategic options taken, and by the accumulation of assets within an extended organisational structure.

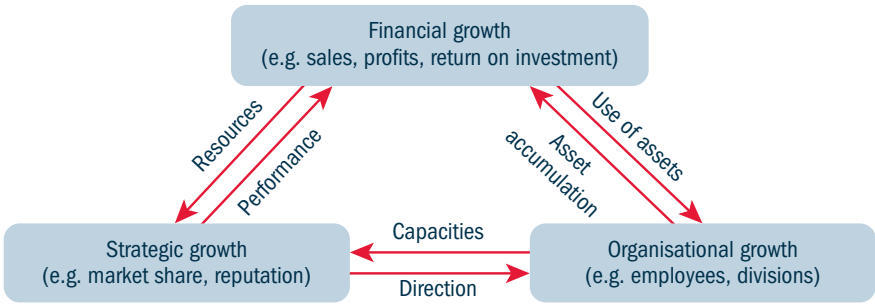


FIGURE 16.1 The dimensions of growth

Financial growth

Financial growth relates to the development of the business as a commercial entity. It is concerned with increases in sales, the investment needed to achieve

those sales and the resulting profits. It is also concerned with increases in what the business owns: its assets. These different financial elements help to establish the value of the business — that is, the price a potential buyer would be willing to pay for it.

Analysis of the various financial documents of a business venture, such as its balance sheet and profit and loss statement, can give those interested (the entrepreneur, investors, fiscal authorities and other stakeholders) a general overview of the financial health of the venture. However, there is no absolute measure of performance, and the performance of the firm must be considered relative to its industry and over a period of time. This means that it is important for the firm to compare itself with industry-wide benchmarks in order to assess its own financial performance.

Growth will also bring some financial problems. Some growth will create a need for more spending. If extra stock, larger premises, new tools or additional staff are needed, money has to be found to pay for them. New loans may need to be taken out (in the case of long-term asset purchases), or additional working capital may need to be found for short-term requirements. Although some businesses will already have retained profits that can be drawn on, others may have to set up or extend their overdraft facilities. Businesses that do not have enough cash flow to service debt and to finance current expenses will find themselves in trouble; others may find that they do not have a suitable track record or security to obtain a loan, and so they stagnate from a lack of capital.

Strategic growth

Strategic growth relates to the changes that take place in the way the organisation interacts with its environment as a coherent (or strategic) whole. This is concerned mainly with the way the business develops its capabilities in order to exploit a presence in the marketplace. From a strategic perspective, businesses are able to successfully compete in the market by developing and maintaining a competitive advantage. Growth represents the business's success in drawing in resources from its environment. It is a sign that business has been effective in competing in the marketplace. However, a competitive advantage is not static. Sustaining an advantage simultaneously develops and enhances it. Growth will influence the two basic sources of competitive advantage identified by Porter: cost and differentiation.[2]

The main source of cost advantage is experience effects. As a result of the learning experience, costs tend to fall in an exponential way as output increases linearly. Cost leadership means that the customer can be offered a lower price, leading in turn to an increase in demand and thus an increase in output.

A differentiation strategy stems mainly from knowledge advantages. These arise from knowing something about the customer, the market or the product that competitors do not know, thus enabling the business to offer something of value to the customer. The customer is prepared to pay a premium for the extra value perceived. The development of a knowledge-based advantage depends on two factors: the significance of the knowledge advantage and the rate at which it will be eroded. Clearly, these two factors work against each other. The more valuable the knowledge, the more that competitors will be encouraged to get hold of it for themselves.

Organisational growth

Organisational growth relates to the changes that take place in the organisational structure, process and culture as it grows and develops. The structure of the organisation and the way that structure develops as the organisation grows are both a response to the circumstances in which the organisation finds itself, and a reaction to the opportunities with which it is presented. One well-explored approach to understanding how an organisation defines its structure is provided by contingency theory. In essence, contingency theory regards the structure of an organisation as dependent on contingencies or types of factors[3] such as organisational size, operational technology, strategy, business environment and the role of the entrepreneur.

The choice of not growing

Although market forces may press for quantitative growth, this does not necessarily coincide with the personal interests of the small business owner. The relationships between personal and organisational objectives are important to understand, because they often overlap in the small firm. Thus, for the majority of small business owner–managers, the need to maximise growth, or indeed to grow at all, is not self-evident. Growth is rarely seen as an end in itself, and will often be sacrificed in pursuit of other objectives.

The first barrier to growth relates to the choice of the owner–manager. Exploiting the growth potential of a firm requires an active commitment to growth on the part of the owner–manager. In many instances a fundamental reluctance to grow, fear of the risks of growth, or a desire to use the business simply to support an established lifestyle rather than to generate maximum capital appreciation constitute the major barriers to growth.

The second inhibitor of growth is the belief on the part of owner–managers that continued growth of the firm will lead to an erosion of their managerial and financial control over the business. The willingness to forgo growth in favour of maintaining financial self-sufficiency and managerial control inevitably sets limits on a small venture's growth.

However, there is a more fundamental reason to caution against the universal and uncritical growth ideology, and for small business owner–managers — whenever possible — to secure profitability before they go ahead with growth. Empirical evidence on the relationship between growth and performance is inconclusive. In addition, to the extent a relationship exists, it has not been determined whether this is primarily because growth leads to profits or, conversely, because profitability drives growth.[4]

Conceptualising growth and organisational change

In a review of development and change in organisations, Van de Ven and Poole identified four basic theories about how and why organisations change.[5] These are based on the notions of life cycle, teleology, evolution and dialectic. These

four theories represent different sequences of change events that are driven by different conceptual motors and operate at different levels.

Life cycle

The notion of life cycle suggests that the business venture undergoes a pattern of growth and development much as a living organism does. A life cycle model depicts change in an organisation as progressing through a necessary sequence of stages. Numerous authors have proposed stages of growth or life cycle models of organisations.[6] These authors vary in the number of stages they propose and the labels they use, but the prevailing themes are clear. Often, the stages follow a pattern of start-up, growth, formalisation and so on. As it is a matter of mathematics and economics that keep rapid growth from continuing indefinitely, growth is typically a 'stage' between struggling inception and relative stability later on.

New venture development

This first stage consists of activities associated with the incubation and initial formation of the venture. At this stage, the budding entrepreneur displays a strong intention to start a business. Intention is a conscious state of mind that directs attention and, therefore, experience and action, towards a specific object (goal) or a pathway to achieve it (means).[7] This concept goes beyond that of entrepreneurial propensity: people with the intention of starting a business have not only a propensity to start, but also rational behaviour that will allow them to reach their goal. They have already, therefore, taken some steps towards this goal — developed a prototype, gathered some information, conducted initial market-research and saved some money.

Start-up

The second stage encompasses all the foundation work needed to formally launch the business venture. During the start-up stage, a business plan is drafted and presented to the potential key stakeholders in the venture — investors, suppliers and employees. The entrepreneur puts together various resources: financial, human and information. Different measures can be taken to protect any intellectual property owned by the firm, such as registering a patent, a trademark or a design. The entrepreneur must also decide on a business name and legal form of organisation.

At this stage, the founders of the venture are usually technically or entrepreneurially oriented, and they generally disdain management activities; their physical and mental energies are absorbed in making and selling the new product. Another characteristic is the frequent and informal communication among employees. Long hours of work are rewarded by modest salaries and the promise of ownership benefits. Decisions and motivation are highly sensitive to marketplace feedback; management acts as customers react.

Growth

Sustained growth is typically characterised by a strong increase in demand and sales, leading in turn to a growing number of employees. This 'go-go' phase is often accelerated by technological breakthrough, aggressive or ingenious

marketing, a hungry market, sluggish competition or some combination of these. Three basic challenges[8] usually confront rapid-growth firms:

- *Instant size*. When firms double or triple in size very quickly, this in turn creates problems of disaffection, inadequate skills and inadequate systems.
- *A sense of infallibility*. By virtue of their success to date, owner–managers often view their strategies and behaviour as infallible and immune from criticism.
- *Internal turmoil*. There is a stream of new faces — people who do not know one another and who do not know the firm. The business founders find themselves burdened with unwanted management responsibilities. They long for the 'good old days' and try to act as they did in the past. Decision making suffers, internal political battles abound and people burn out.

Maturity

The firm enters the maturity or stabilisation stage just after reaching its prime, when everything comes together. During this period, the business is consistently able to meets its customers' changing needs; internal discipline and organisational culture are operating effectively; and production is run with maximum efficiency.

However, this highly desirable state of affairs can quickly be lost. The maturity stage is often characterised by increased competition, consumer indifference to the firm's products and services and a saturation of the market. Internally, staff welcome new ideas but without the excitement of the growing stages. Financial managers begin to impose controls for short-term results. The emphasis on marketing and research and development wanes. This phase is often a 'swing stage', in that it precedes the period when the firm will either innovate and move back into the growth mode or, alternatively, start to decline.

At this point, a crisis of leadership often occurs. Obviously, a strong manager is needed — one who has the necessary knowledge and skills to introduce new business techniques. But finding that manager is easier said than done. The founders often resist stepping aside, even though they are probably temperamentally unsuited to the job. Those ventures that survive the leadership crisis by installing a capable business manager usually embark on a period of sustained growth.[9]

Rebirth or decline

Several models of life cycle theory consider that decline is not inevitable for firms reaching maturity. Firms can face a 'rebirth' before they eventually decline. For example, 'continued entrepreneurship' could be the basis of the growth rate of established firms.[10] In any case, expanding the business means expanding the amount of trade it undertakes. For example, expansion from any base can be achieved by launching new products or services or by entering new markets.

If the enterprise fails to implement one of those strategies and to innovate, it will face a decline in its activities. Not making waves becomes a way of life. Outward signs of respectability, such as dress, office decoration and titles, take on enormous importance. The business institutes witch-hunts to find out *who* did something wrong rather than trying to discover *what* went wrong and how to fix it. A strong bureaucracy is typical within firms at this stage — there are systems for everything, and employees go by the book. Cost reduction takes precedence over efforts to increase revenues.

In all life cycle models, the development stage of the business determines the importance of different management tasks and leadership styles. Research has focused mainly on differences in internal organisational characteristics (such as leadership and policies, structure and strategy) across theorised stages. Table 16.1 provides a summary of these characteristics.

TABLE 16.1 Life cycle stage characteristics

Feature	New venture development	Start-up	Growth	Maturity	Rebirth or decline
Size	One or two people, part-time	Small	Medium to large	Large	Growing (rebirth) or declining
Sales growth rate	Non-existent	Inconsistent	Rapid and positive	Slow	Bounce back (rebirth) or declining
Business tasks	Evaluate opportunity; build prototype	Set up the organisation; launch product	Capacity expansion; set up operating systems	Expense control; establish management systems	Revitalisation (new products, new markets, diversification) or recrimination (decline)
Organisational structure	Embryonic	Individualistic and entrepreneurial	Directive	Delegative	Participative (rebirth) or autocratic (decline)
Control systems	Embryonic	Market results	Standards and cost centres	Reports and profits centres	Mutual goal setting (rebirth) or red tape (decline)

Teleology

Teleology is the study of design and purpose, and it argues that 'form follows function'. In teleology theory, the purpose or goal of management, such as growth, is the final cause for guiding movement of the organisation. In this perspective, the business venture sets goals, and by adapting its actions it tries to reach its goals. Therefore, a teleological model views development as a cycle of goal formulation, implementation, evaluation and modification of goals based on what was learned by the organisation. Central to this theory is the notion of purpose in organisational change and growth. Entrepreneurs can use their vision of the future to pull the organisation forward. Comparable with the life cycle theory, teleology theory focuses on a single organisation. However, teleology theory does not prescribe a sequence of events or specify in which direction an organisation must develop to reach its goals. It can only set a possible path and then rely on norms of decisions or actions.

A business venture can pursue different goals; growth can be one of them. Similarly, there are different ways to reach growth objectives. Also, growth is not necessarily a result of accomplishing the goals. Growth can have different meanings — a business can pursue growth in size (employees, sales); in profit (profit before tax, return on investment); in value (shareholder value, stakeholder value); and in quality (image, know-how, innovation).

Evolution

Evolution is a theoretical scheme that explains changes in structural forms of organisations across communities or industries. As in biological evolution, organisational change proceeds through a continuous circle of variation, selection and retention. Variations — the creation of new forms of organisation — are often seen to emerge by chance; they just happen. The selection of organisations occurs through the competition for scarce resources, and the environment selects entities that best fit the resource base of an environmental niche. Retention involves forces (including relative inertia and persistence) that perpetuate and maintain certain organisational forms.

Although one cannot predict which business venture will survive or fail, the overall population persists and evolves through time, according to the specified population dynamics. Birth rates, merge rates and mortality rates influence the characteristics of the population. This process is influenced by competition and legitimation. As a metaphor, evolution reminds entrepreneurs that they are operating in a competitive environment, that they must compete for scarce resources and that the venture must be efficient ('fit') in the tasks it undertakes. As business ventures perform reliably and accountably over time, they demonstrate their fitness and may acquire legitimacy.

Dialectic

The dialectical theory focuses on stability and change based on the collision of power between opposing entities. The dialectical theory begins with the assumption that organisations or members within organisations compete with each other for domination and control. This creates a collision between the entities. Change is the result of the appearance of opposing views (thesis and antithesis) and balance or imbalance of power between entities. Change occurs if an organisation or a stakeholder has sufficient power to confront and engage the status quo (the existing state). If this is not the case, the status quo will remain.

In organisational change and development, the dialectic illuminates conflict and conflict resolution at a number of levels; for example, between stakeholder groups such as investors and employees, and within stakeholder groups. The latter would include, for example, political manoeuvring by managerial factions within the business. Accordingly, one of the central tasks of the entrepreneur is to resolve conflicts and bring together stakeholders (whose interests may differ), so that all benefit.

Entrepreneur profile



Shi Zhengrong, Suntech

In 1963, Shi was born into a family of peasant farmers in China. However, after developing fluency in English and receiving a Bachelor's degree in Optical Science and a Master's degree in Laser Physics in Hangzhou and Shanghai respectively, he was chosen to undertake further graduate studies in Australia. He joined the University of New South Wales in Sydney, and pursued a Ph.D. in electrical engineering.

In the course of his research, Shi assisted in the development of thin-film solar cells. These were commercialised in 1995 by an Australian photovoltaic company, who appointed Shi as

deputy director of research. Five years later, he received Australian citizenship and began negotiations with the Chinese government to secure US$6 million for a solar cell manufacturing plant near Shanghai.

Shi founded Suntech in 2001, and by 2005 the company was one of the word's largest photovoltaic manufacturers. It was then listed on the New York Stock Exchange, whereupon the share price rocketed.

The rise wasn't always smooth, and Shi was required to have more than technical skills to make Suntech succeed. Sharp elbows helped too. When the company showed it could be profitable early on, board members appointed by the government suddenly became interested. Shi and the government-appointed chairman clashed in late 2003 over how rapidly to expand the business, and on the amount Shi was spending on the equipment needed to do so. 'For some reason he didn't seem to trust me,' says Shi. In 2004, he went to the other board members and persuaded them to ease the chairman out. 'That's when I realised that having a controlling position in the company was critical.' So he got a capital injection from Goldman Sachs, and bought out the rest of the state-sponsored shareholders in 2005 for US$100 million.

Climate change by then had become a global issue, and governments around the world began boosting subsidies for renewable energy. Suntech's stock hit an all-time high of US$85 in late 2007. Its biggest markets for the solar panels and modules it makes are in Europe. In the following years, the rapid success of Chinese solar companies such as Suntech has spawned lots of imitators. The market became plagued by overcapacity, and at the end of 2008 Suntech fired 800 employees — the first layoffs in the company's short lifetime. However, Shi believes that the scale of enterprise that Suntech has already achieved will enable the company to withstand the industry-wide shakeout.

Source: Adapted from Ernst & Young, 'The sun shines on Dr Shi', *Entrepreneur*, 2008, pp. 21–22; B. Powell, 'China's new king of solar', *Fortune*, 11 February, 2009.

Growth strategies and growth enablers

Research has shown that fast growing companies are extremely competent at building growth perpetuating systems, which help them create sustained growth from entrepreneurial ideas. These systems incorporate three elements — visions, strategies and business models — to drive such growth, and their efficacy depends on them being clearly communicated throughout the organisation.

Growth strategies can be either internal or external. The former utilises measures within the company, such as international expansion, improving products or increasing market share, whereas the latter is focused outwards and may include forging third party relationships through licensing, strategic alliances or even acquisitions.[11]

For these 'seeds' to grow effectively, they need to be planted in an environment populated by 'growth enablers'. Growth enablers comprise elements that favour growth: an attractive growth culture, networks that serve as growth platforms and the characteristics of the company and its founder(s).

Internal growth strategies

Internal growth strategies involve efforts taken within the firm itself. The distinctive attribute of internally generated growth is that a business relies on its own resources, competencies and employees. Internally generated growth is

often called 'organic' growth because it does not rely on outside intervention. Almost all companies grow organically during the early stages of their life cycle.

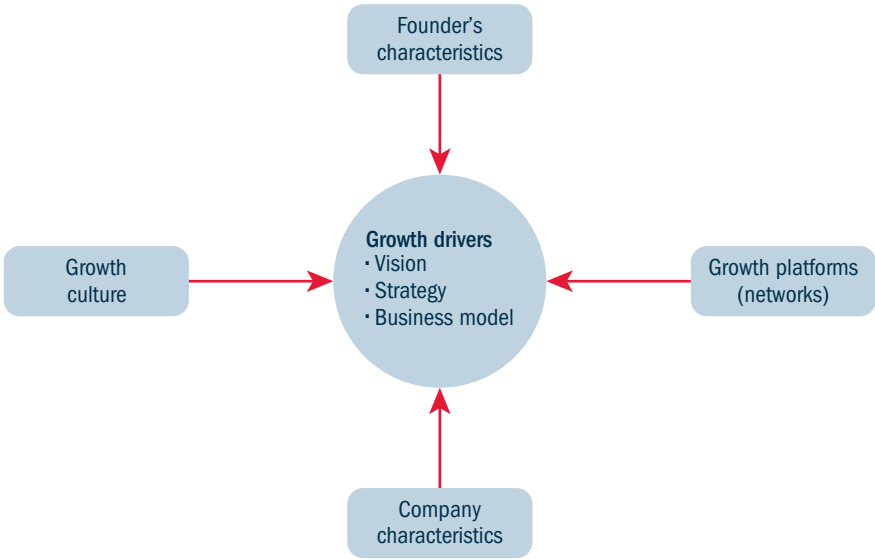


FIGURE 16.2 Growth drivers and growth enablers

Increasing market share

When they first begin, most new ventures capture only a small portion of the market they enter. A useful growth strategy, therefore, involves increasing this share through greater marketing efforts of increased production capacity and efficiency. An increase in a product's market share is typically accomplished by increasing advertising expenditures, offering sales promotions, lowering the price or increasing the size of the sales force.

Increased market penetration can also occur though increased capacity of efficiency, which permits a firm to have greater volume of product or service to sell. In a manufacturing context, an increase in product capacity can occur by expanding plant and equipment, or by outsourcing a portion of the production process to another company. For example, a firm that previously manufactured and packaged its products may outsource the packaging function to another company, and as a result free up factory space to increase production of the basic product.[12]

New product development

New product development involves designing, producing and selling new products or services as a means of increasing firm revenues and profitability. In many fast-paced industries, new product development is a competitive necessity. New products must be developed to replace existing ones and to keep ahead of competitors as the customers' expectations develop.

Whatever the nature of the product, its complexity and the resources involved in its launch, the key is to remember that a product is not a thing but rather a means to an end. The value of a product lies in the benefits it can bring to its users. The entrepreneur must apply the same market-oriented insights to the development of new products as were brought to the innovation on which the business was originally founded. Because new ventures have limited resources

and competences, they should follow these guidelines to move toward the new products they seek:

- *Focus on the markets they know — the ones they are already serving*. Existing customers can provide valuable information about problems that need to be solved and how to position the product in the marketplace.
- *Develop new product or services that are related to the ones the company already offers*. Jumping off into 'left field' is not a useful option for new ventures. A much better strategy for obtaining growth is to stick with products or services that are closely linked to the ones they now produce or provide.
- *Get pricing and quality right*. New ventures cannot afford to find out the hard way that they have set the price for a product too high. Not only must new products meet customers' needs, they must also do so at a price that offers good value. Similarly, offering new products that are lower in quality than earlier ones can be a fatal mistake. Every product thus represents a balance between quality and pricing.

Improving existing products or services

Although the word 'new' is something many companies like to place on their packaging, the word 'improved' may sometimes be more appropriate. In order to attain high growth, it's not always essential to have completely new products or services; significant improvements in the existing ones may be as, or even more, effective.

Improving an item means increasing its value and price potential from the customer's perspective. There are different ways to improve a product or service, such as enhancing quality, making it larger or smaller, making it more convenient to use, improving its durability or making it more up to date.

International expansion

In its early stages, a business tends to serve a local geographic area. Many entrepreneurial businesses grow simply by expanding from original location to additional geographic sites. Ultimately, this might include expansion into the international arena through exporting, alliances or even setting up subsidiaries overseas. In fact, few businesses can achieve any real size without taking on the international option.

Several factors have facilitated the development of international trade over the past decades. For example, tariffs and trade barriers have significantly decreased at the global level as a result of successive rounds of negotiations that led to the World Trade Organization (WTO). At the regional level, Australia, New Zealand and the ten members of the Association of South-East Asian Nations (ASEAN) signed a free trade agreement in 2009. Technological developments, such as the internet, and the increasing mobility of capital and people led to further globalisation of the economy.

External growth strategies

External growth strategies rely on establishing relationships with third parties, such as licensing, strategic alliances and acquisitions. In a sense, these strategies all involve leveraging the company's resources be entering into mutually beneficial arrangement with other organisations. An emphasis on external strategies

usually results in a more fast-paced, collaborative approach toward growth than the slower-paced internal strategies. There are other advantages in external strategies, including getting access to proprietary products or services, obtaining technical expertise and generating economies of scale.

There exist some disadvantages too. Cooperation with third parties can lead to a clash of corporate cultures, increased business complexity and the loss of organisational flexibility.

Strategic alliances

A strategic alliance is a partnership between two or more firms that is developed to achieve a specific goal. Various studies show that participation in alliances can boost a firm's rate of patenting, product innovation and foreign sales.[13] Technological alliances and marketing alliances are two of the most common forms of alliances.

Technological alliances feature cooperation in research and development, engineering and manufacturing. Research and development alliances often bring together entrepreneurial firms with specific technical skills and larger, more mature firms with experience in development and marketing. By pooling their complementary assets, these firms can typically produce a product and bring it to market faster and cheaper than either firm could alone. Marketing alliances, on the other hand, typically match a company that has a distribution system with a company that has a product to sell, in order to increase sales of product or service.

Licensing

Licensing is the granting of permission by one company to another company to use a specific form of its intellectual property under clearly defined conditions. Virtually any intellectual property a company owns that is protected by a patent, trademark, or copyright can be licensed to a third party. Licensing can be a very effective way of earning income, particularly for intellectual property-rich firms, such as software and biotech companies.

The terms of a license are spelled out through a licensing agreement, which is a formal contract between a licensor — the company that owns the intellectual property — and the licensee — the company purchasing the right to use it. Several types of licensing exist, but two that are increasingly important are technology licensing, and merchandise and character licensing. Technology licensing involves granting the right to use knowledge contained in a utility patent (a patent for a specific kind of product) to the purchaser. In contrast, merchandise and character licensing involves licensing a recognised trademark or brand that the licensor controls.

Acquisitions

Another way to grow externally is to acquire other businesses in their entirety and 'add' them onto the existing business venture. There are three sorts of acquisition, and these differ in the way in which the integrated firm sits in relation to the venture in the value chain.

The first type of acquisition is vertical integration. This happens when the venture acquires a firm that is either upstream or downstream in the

value-production chain — that is, it acquires a business that is a customer or a supplier. The acquisition of customers is referred to as 'forward' integration and that of a supplier as 'backward' integration. The second type of acquisition occurs when the venture integrates a business that is at the same level of value production as itself — that is, a business that is, ostensibly at least, a competitor. The third type of acquisition occurs in the remaining cases when the integrated business is not a supplier, nor a customer nor a competitor. These might be referred as 'lateral' or 'unrelated' integrations.

Growth enablers

Strategies are the 'seeds' for an organisation growth and development. These seeds need suitable conditions or enablers for growth to materialise. Growth enablers include the founder's and company characteristics, an appealing and motivating growth culture, and the presence of networks as growth platforms.

Founder characteristics

Entrepreneurs at the helm of high-growth ventures seem to possess characteristics that contribute to the success of their companies. First, they are passionate about what they are doing, and know the direction they are heading. In addition, they are remain tenacious even after major setbacks. Third, these entrepreneurs have a clear growth vision for their companies, which is made very clear in vision statements and other sources.[14]

Even if entrepreneurs do want to achieve rapid growth, it may not be feasible because they lack the managerial skills needed to effectively attain this goal. In other words, they lack what is known as managerial capacity — the skill and experience necessary to take advantage of opportunities for new products or services that could help expand their business.

Company characteristics

Founders are only one of the growth enablers that are necessary to achieve company goals. Companies must also have mechanisms in place to enable even the most brilliant and passionate entrepreneurs to generate growth in sales and profits. There are three characteristics which distinguish high-growth companies from others. First, the central value that often appears in the venture's mission's statement is growth. Second, the building of relationships with external partners — suppliers, research institutions or even competitors — is more evident in high growth companies. These relationships can take various forms such a strategic alliance, joint-venture or licensing agreements. Finally, high-growth companies plan for growth. Specific goals are set and strategies for reaching them are developed.

Company culture

The entrepreneurial vibe that pervades a new business in its early days and powers its success should be sustained through the development of a healthy growth culture. In order for everyone in the company to share a dedication to growth, they should hold a sense of ownership in the vision, strategies and the day-to-day responsibilities towards their peers and other stakeholders. The placement of a charismatic leader, supported by a committed and skilled key

management team and an efficient internal communication network, will foster such an atmosphere and fortify team spirit.

A good management team will be motivated, proactive and not averse to taking risks. Its people distinguish themselves through frequent promotion and their emphasis on continuous education and training. A growth-oriented company often supports such learning through programs, and will also set up incentives (for example, stock options) to motivate its employees.

Networks as growth as platforms

Growth invariably requires the development of suitable networks, which are both internal and external to the company. For example, partnerships with customers and with suppliers often enable a better understanding of the marketplace and how it changes. There is no one particular partner arrangement that facilitates growth; rather, it is the company's 'network ability' to engage with others on an equal footing.

Internal networks help too. Dynamic enterprises tend to build a network of autonomous business units that, nevertheless, share critical information and experience. Such companies predominantly have flatter hierarchies and project-focused teams that, with advanced IT support, function more openly, quickly and independently. This configuration is one that attracts like-minded entrepreneurial workers and allows them to work in closer proximity to their markets.[15]

From the entrepreneur to the manager

Managing any business venture is a tough job. Managing a rapidly growing enterprise, however, presents a particular challenge because the essential nature of the manager's job changes with growth. As the number of employees increases, and the volume and complexity of work expands, entrepreneurs must change their fundamental approach to managing. To understand this evolution, it is essential to first define the manager's job in a way that explains the pressures being added to the system, the changes that are transpiring as a result and the responses available to the manager.

Defining the manager's job

In order to frame the management task in a way that allows us to predict and understand the challenges that growth creates, we need to develop a model of the manager's job. Roberts[16] suggested a model that revolves around three key elements that are part of the manager's responsibilities:

- *Strategy and operation*. What task should the enterprise perform? The firm's activities are driven by its goals and its strategy. The strategy is the rationale for a set of operating activities, so the goal-setting and strategic-planning processes are key pieces in the management of the business. Where strategy is an idea or an objective, however, the firm's operations are that idea made real. Thus, the firm's strategy and operation are the set of tasks and activities that the firm is required to execute.
- *Organising*. How should tasks be structured and coordinated? This aspect of the manager's responsibilities includes all the choices about how to accomplish

the strategy and operating activities — how these responsibilities are assigned to organisational units; how they are broken down into specific tasks within units; how these tasks are grouped to comprise a job; how those jobs are defined according to performance standards and procedures, tied together with systems, and coordinated to achieve the desired objectives.

- *Staffing*. Who should do the work? This element includes the people who actually fill the jobs and do the work, as well as their selection, training, development and compensation.

These three sets of duties cannot be managed in isolation. There must be some fit between strategy and structure, and between implementation and the skills and capabilities of the people in the organisation.

The steps towards professional management

Many issues need to be considered when small entrepreneur-driven structures evolve into larger, professionally managed ones. For example, strategic planning in younger and smaller firms tends to be based on personal feel or intuition, or on 'firefighting' approaches. Consequently, such firms will undergo a great deal of pain and distress unless those making the decisions learn to adopt rational and systematic approaches to decision making as their organisations grow.[17] In order to make their businesses grow beyond a certain point, entrepreneurs must be prepared to move from an *entrepreneurial* management style, with centralised decision making and informal control, to a *professional* management style that involves the delegation of decision-making responsibility and the use of formal control mechanisms.

The following four steps[18] have been identified as contributing to any successful transition to professional management:

- *Recognise the need for change*. This is often extremely difficult because it is a by-product of success. Success reinforces beliefs and behaviour that are appropriate to the entrepreneurial mode but inappropriate for the needs of a larger, more complex firm. Often, a crisis will highlight the need for change. However, knowledgeable business advisers can help the entrepreneur avoid a crisis by spotting the warning signs, and indicating the need and path for change.
- *Develop human resources*. Given the change of personal role in the organisation, the entrepreneur's next step is to develop the human resources required to implement the growth model chosen. Often, people who can accept and execute responsibility are not present in the entrepreneurial organisation, because the entrepreneur's style has made it difficult for self-sufficient, independent employees to remain with the firm.
- *Delegate responsibility*. The power of professional management arises from placing decision-making responsibility close to the sources of information. Typically, this means delegating responsibility to managers who are close to customers, suppliers and other partners of the firm. The entrepreneur–CEO must be careful, however, not to give up responsibility on key policy issues that require personal perspective.
- *Develop formal controls*. The final step in the transition process is developing formal control mechanisms. Successful entrepreneurs realise that, with the onset of delegation, they can no longer control the behaviour of

individuals in the organisation; the focus of control must shift from behaviour to performance.

The founder's dilemma

Many entrepreneurs strive for the success of Bill Gates or Richard Branson, each of whom have launched companies and expanded their business empires. However, Wasserman[19] indicates that successful founders-cum-CEOs are quite the rarity, and that it's the founders who surrender more equity to entice co-founders, employees and investors who are the ones more likely to build a more valuable business. Founders need to consider the trade-off between maximising their wealth or control of the company — for often greater returns necessitate bringing in a more experienced CEO to best tend to the growing company's needs.

Those founders who seek wealth over control will be more enthusiastic about ceding leadership, and will readily open their capital to external investors or depend on seasoned executives to manage and grow their business ventures. By stepping down, they'll receive a smaller piece of a bigger pie.

Conversely, should founders determine control over their empire as a measure of success, they'll be happier with a bigger piece of a smaller pie. This type of entrepreneur would be ideally suited to businesses that don't require a lot of capital investment, and where they already possess the necessary skills and contacts. In order to ensure they have developed the management skills required, they may delay the launch of the business until late in their careers.

What would you do?



Softy Fruits

Softy Fruits Sdn Bhd is a soft drink and fruit juice manufacturer located in Miri, Western Malaysia. The company was established in 1973 by Mr. Yap Beng Leong, and currently employs 85 staff. Softy Fruits sells most of its products in eastern Malaysia and nearby Brunei. The company produces two different flavours of lemonade, and three types of fruit juice (mango, pink guava and lychee). Mr. Yap is now over seventy years old and would like his youngest daughter Stacy to take over the business in the near future. Mr. Yap approached you to get some advice about his succession planning.

Stacy recently obtained her Bachelor of Commerce degree, and she has been working with her father for the past 18 months. To clearly signal that Stacy is to be his successor, Mr. Yap appointed her Deputy Managing Director immediately after she started working for Softy Fruits. Stacy is now in charge of the newly created function of business development. They both share an office so that father can teach daughter the ropes of the trade. Mr. Yap is thrilled to work with his daughter, as it gives him extra motivation to arrive at the office every morning for his usual 8 am start. He is still overseeing the daily business activities together with Mr. Lim, his trusted accountant, who has been with the company from the beginning.

Stacy has conducted a lot of research on the beverage industry. After reading a report from Euromonitor, she discovered that Malaysia has a large and increasingly sophisticated soft drinks industry. In 2009, soft drinks in Malaysia continued to post strong growth and achieved sales of 967 million litres. Stacy is also aware that as Malaysians become more health conscious, competitors are embarking on healthier alternatives that will appeal to these consumers. Some of the best performers were bottled water, fruit juice and functional drinks.

However, Stacy is not very happy with her job. She recently clashed with her father about the growth strategies she had informally suggested. 'This is going to cost a lot of money,' said Mr Yap. 'You know that we have always pursued a low cost niche strategy,' she was told. Another issue of concern was the recent appointment of Mr Lim's son, Steve, as key account manager for the restaurants in eastern Malaysia. Stacy has known Steve Lim for many years, but she has always disliked him, and considers him to be lazy and incompetent. However, Stacy's father was adamant that Steve deserved at least one chance. 'Remember that Softy Fruits is like one big family,' he said.

Questions

1. Identify the current weaknesses of Softy Fruits' leadership style and strategy.
2. What growth strategy would you recommend the company adopts in order to expand its business?

Harvesting

If building and growing a business are the first two steps in creating wealth, **harvesting** can be regarded as the third. The harvesting of a venture is one of the more significant events in the life of an entrepreneurial firm and its owner. After a total immersion in the business, a huge workload, many sacrifices and quite often burnout, many entrepreneurs want to reap a reward for the effort they have put into launching and nurturing a business venture. Entrepreneurship is often seen as a journey, not a destination, by many people who become 'serial entrepreneurs' — that is, people who build new firms and then exit them to get a maximum profit before starting yet another firm.

Harvesting *The process entrepreneurs and investors use to exit a business and realise their investment.*

This section outlines the key elements to take into consideration when planning an exit. Four exit strategies are presented: sale to a strategic partner or corporate investor, management buy-out, strategic alliance and merger and initial public offering.

Key elements to consider when planning an exit

If the entrepreneur is to take full advantage of an investment opportunity, it is essential not only to evaluate the merits of the opportunity at the outset, but also to anticipate options for exiting the business. If the entrepreneur's goal with the venture is to provide a living, then the exit strategy is of no concern. But if the goal is to create value for the owners and the other stakeholders in the business, a harvest strategy is very important. The exit is more than simply leaving the business; it is the final piece in creating the ultimate value to all participants in the venture, especially the owner, managers and employees.[20] Even if the entrepreneur does not plan to sell the business, there is still a need to prepare a succession plan in the event of retirement, illness or death of the founder. In any case, exit should be an active decision, rather than a passive, externally driven process.

As shown in figure 16.3, there are three main elements to be considered when planning an exit:

- *Strategic elements linked to the business environment*. An exit is attractive for the entrepreneur only if potential buyers are interested in the firm. The business

must have a good stream of successful products that are well established in the market. In other words, the entrepreneur must be able to show that the business has a track record and that there is some potential for growth once the entrepreneur has pulled out of the business.

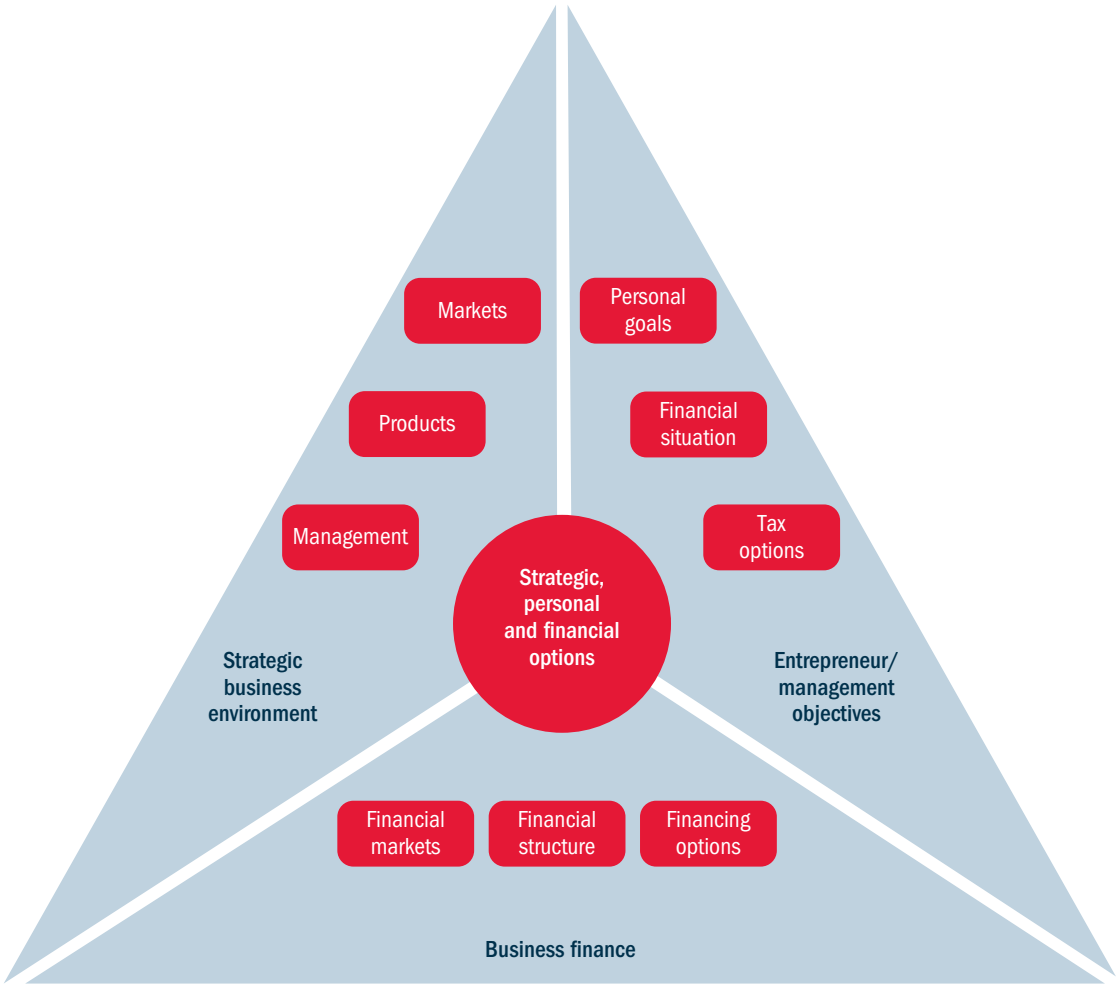


FIGURE 16.3 Balancing of strategic, personal and financial goals in a harvest strategy

- *Entrepreneur's personal aspirations*. For most entrepreneurs, the business venture is a dominant part of their lives. Thus, the decision to harvest cannot effectively be separated from the entrepreneur's personal goals and objectives. Without an understanding of what is important in life, the entrepreneur is apt to make a bad decision when it comes to harvesting a firm. The view of other stakeholders, such as outside investors and employees, also needs to be considered. Outside investors typically have expectations about their investment that include the firm either going public or being acquired by other investors.
- *Business financial situation*. The business financial situation is another key dimension to consider. For example, it might be difficult to list a business that has a high debt-to-equity ratio (leverage), in which case it may be preferable

to sell to a corporate investor who can restructure the balance sheet. Exit strategies offer different financing options for businesses in need of extra funds for pursuing growth. For example, an initial public offering is considered by many business owners as a means of raising growth capital rather than as a tool for facilitating the exit of the founders.

Whatever the final decision by the entrepreneur and others regarding the harvest strategy, opportunities to sell or go public come and go with the condition of the economy and the industry. Entrepreneurs must not only *choose* an exit strategy, but also be aware of *when* they can exit. For example, adverse financial market conditions stopped many entrepreneurs floating their businesses on the stock market during the dotcom crash and the 2008 financial crisis. Timing is important and entrepreneurs must be sensitive to the opening and closing of a window of opportunity. In shaping a harvest strategy, Timmons and Spinelli[21] suggested the following guidelines and cautions:

- *Patience*. Several years are required to launch and build most successful businesses, so patience is invaluable. A harvest strategy is more sensible if it allows for a time frame of at least three to five years and as long as seven to ten.
- *Vision*. The other side of the patience coin is not to panic as a result of unexpected events. Selling under duress is usually the worst thing to do.
- *Realistic valuation*. If impatience is the enemy of an attractive harvest, then greed is its executioner. The entrepreneur should value the business from different angles (such as book value, replacement value and discounted cash flows) to obtain a fair market value.
- *Outside advice*. It is best to find an adviser who can help craft a harvest strategy while the business is still growing, and at the same time help determine the value of the firm. Talking to an entrepreneur who has been through the experience of a merger or a sale can also give some useful pointers.

Sale to a financial or a strategic buyer

Selling the business outright is by far the most common harvest method. Sales fall into several broad categories, depending on the buyers: financial sales, strategic sales and management or employee buy-outs. Here we focus on financial and strategic sales, while management buy-outs are discussed in the next section.

A financial buyer may be a competitor in the industry or a business wishing to achieve 'vertical integration' and diversification by absorbing another business into its core business. In financial sales, buyers look mainly to a firm's stand-alone cash-generating potential as the source of value. Often, this value relates to stimulating future sales growth, reducing costs or both. Financial buyers are in business to make deals, so they may overlook some weaknesses. This has important implications for the seller, because new owners will often make changes to the firm's operations or break up the firm and sell the pieces. They often leave day-to-day operations unchanged, but they buy with a view to selling, which could disrupt the business's life a second time.

Strategic buyers, unlike financial buyers, expect the acquired business to fit in with their other holdings. Generally, these are corporate buyers seeking to effect or further a 'consolidation' strategy. In other words, strategic buyers seek to buy a number of businesses and then cobble them together to eliminate redundant and excess costs, and derive economies of scale wherever possible to decrease

expenses and, similarly, increase profitability. The best match sometimes comes about if they seek out the potential seller after having determined that the business fits their plans. Consequently, strategic sales often result in the most attractive price for the seller.

Management buy-out

Management buy-out (MBO) *The purchase of a controlling interest in a business by its management in order to take over assets and operations.*

Another harvest strategy, called a **management buy-out (MBO)**, is one in which a founder can realise a gain from the business by selling to managers or existing partners in the business. The MBO usually entails high levels of debt (leverage) and, therefore, the new owner–managers must stay clearly focused on the operating performance if they are to meet debt payments and use assets effectively. If the business has both assets and good cash flow, the financing can be arranged via banks or other financial institutions. Even if assets are thin, a healthy cash flow that can service the debt to fund the purchase price may convince lenders to support an MBO.

Three factors are generally considered essential to conducting a successful MBO: (1) the ability to borrow significant sums against the business's assets; (2) the ability to retain or attract a strong management team; and (3) the potential for the participants' (including management's) investment to increase substantially in value. The ability of a business to support significant leverage depends on whether it can service the principal- and interest-payment obligations that accompany that leverage. This in turn requires a business to be capable of generating large sums of cash on a regular basis or to have substantial assets that can be sold to pay off the debt. This usually means a business with a history of operations sufficient to support the borrowing required to fund the deal.

When a management buy-out occurs, it often means that the division or business being purchased has a strong management team in place that requires few or no changes to make it complete. It is, after all, the investor's and lender's confidence in management's ability to run the business profitably and to expand its operations that make the buy-out possible. Attracting and keeping good management also means cutting them in for a significant portion of the deal. In other words, management usually acquires a healthy percentage of the business's equity. This motivates them to stay with the business and make it grow.

Strategic alliance and merger

Strategic alliance *An ongoing relationship between two businesses, which combine efforts for a specific purpose.*

Merger *The combining of two or more entities into one through a purchase acquisition or a pooling of interests.*

The entrepreneur can also use the framework of a strategic alliance to sell part of the business to a minority investor. In addition to the cash raised, there are generally wider benefits arising from this cooperation. For example, the investor can induce some economies of scale by pooling common resources or by collaborating in an allied area where the firm needs some expertise. Within a **strategic alliance**, the two allies remain legally independent, although a substantial part of their activities depends on the alliance (economic interdependence).

If the strategic alliance takes place between competitors, it can often lead to a **merger** of the two businesses later. In this case, a new legal entity is formed. The newly created enterprise will have a higher profile and an increased ability to continue growing, and may at a later stage be sold or offered to the public.

Initial public offering

In the eyes of many entrepreneurs, taking their firm public through an initial public offering (IPO) is the 'holy grail' of harvest strategies. Through the IPO, shares are offered for sale on a public stock exchange. Because the effect of this decision is to change the fundamental financial nature of the business, it must be done with a great deal of care. The merits of going public versus being acquired rest largely on the contention that IPOs provide higher valuations, and therefore better returns, than can be expected from a straight sale. Other advantages to the firm of going public are the negotiability of its securities, the potential use of future issues of its shares to acquire other businesses and an increase in the stature of the business.

However, there are disadvantages in going public. First, there is the loss of privacy as numerous reports are required by government agencies. Secondly, going public establishes the need for the board of directors to approve certain types of decisions, imposing additional restrictions on management. Thirdly, there is a significant cost associated with going public — not only is there the cost of the IPO itself, but there are also ongoing costs associated with the provision of information required by regulators.

Although IPOs are attractive for several reasons, many privately held firms will never find themselves in a position to go public. They will not qualify because they are too small or they are not in the 'right industry', or they lack the management skills to do so. Therefore, the IPO strategy is appropriate for a very limited set of firms.

SUMMARY

The growth of the venture can be approached from the financial, strategic and organisational perspectives. These three dimensions interact with one another and cannot be considered separately in the dynamics of growth. Although market forces may press for quantitative growth, this does not necessarily coincide with the personal interests of the entrepreneur. The relationship between personal and organisational objectives is important to understand, because they often overlap in the small firm.

Four basic theories can explain how and why organisations change: life cycle, teleology, evolution and dialectic. The notion of life cycle suggests that the business venture undergoes a pattern of growth and development much as a living organism does. Often, the stages follow the pattern of new venture development, start-up, growth, maturity and rebirth or decline. In teleology theory, the purpose or goal of management is the final cause for guiding movement of the organisation. In this perspective, the business venture sets goals and adapts its actions to reach its goals. The third approach, evolution, is a theoretical scheme that explains changes in structural forms of populations of organisations across communities or industries. As in biological evolution, organisational change proceeds through a continuous circle of variation, selection and retention. The fourth theory, dialectics, focuses on stability and change based on the collision of power between opposing entities.

High growth companies set specific goals and they develop strategies for reaching them. It is possible to distinguish between two main categories of

growth strategies: internal and external strategies. Internal strategies for encouraging growth involves actions within companies themselves, such as efforts to increase market share, new product developments or internal expansions. Conversely, external growth strategies rely on establishing relationships with third parties through strategic alliances, licensing or acquisitions.

Managing a rapidly growing enterprise presents a particular challenge because the essential nature of the manager's job changes with growth. Fundamentally, the key responsibilities of the manager revolve around operating, organising and staffing. In order to make their businesses continue to grow beyond a certain point, entrepreneurs must be prepared to move from an entrepreneurial management style with centralised decision making and informal control towards a professional management style that involves the delegation of decision-making responsibility and the use of formal control mechanisms.

If building and growing a business are the first two steps in creating wealth, harvesting can be regarded as the third. Harvesting is the process that entrepreneurs and investors use to exit a business and realise their investment in a firm. There are four main exit strategies that entrepreneurs can use to harvest a venture: sale to strategic partner or corporate investor, management buy-out, strategic alliance and merger and initial public offering.

REVIEW QUESTIONS

1. What are the different dimensions of business growth?
2. What are the four basic theories that explain how and why organisations change?
3. What are the different strategies a venture can consider to grow its business?
4. What are the key steps for a successful transition towards professional management?
5. What are the main elements to be considered when planning an exit?

DISCUSSION QUESTIONS

1. Why are many owner–managers not interested in growing their business?
2. To what extent do the four organisational change theories (life cycle, teleology, dialectics, evolution) differ from the unit of change and mode of change perspective?
3. What are the weaknesses of the life cycle theory?
4. Why is it generally more difficult to manage growth and transition issues in family businesses?
5. 'Harvesting a business venture is as much about choosing an exit strategy as deciding when to exit.' Explain.

SUGGESTED READING

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Case study

Les Mills International

Jill Tattersall, Chief Executive Officer at Les Mills International (LMI), world leader in the development of fitness programs, located in Auckland, recently heard that the potential distributor for the Western US region had declined the offer to represent LMI. She wondered whether LMI should set up its own agency or continue to search for another option.

Les Mills – Background

Les Mills opened his first gym in Auckland in 1968, and subsequently developed a series of standardised exercise-to-music classes that were franchised to other gyms, first in New Zealand and later Australia. After focusing on building a chain of local gyms, in 1990, he invented the BODYPUMP (a weight-lifting class) in his own living room. Today, LMI offers a series of different programs, including BODYCOMBAT (martial arts), BODYBALANCE (yoga, pilates and tai chi), BODYSTEP (high energy cardio), BODYJAM (a free flow dance format) and BODYATTACK (high intensity cardio aerobics).

Les Mills International was incorporated in 1997, funded by Phillip Mills (61%) and a group of private investors, to license Les Mills programs worldwide and to separate licensing from the health clubs business in New Zealand. Today, LMI classes are running in more than 13 000 clubs in 70 countries.

The company employs some of the world's best instructors, who trial new classes every three months, based on intensive market research to respond to consumer feedback and industry trends. When the class is judged 'perfect', it is videotaped and dispatched with a licensed music CD and written choreography notes to the 70 000 accredited Les Mills instructors around the world, who then teach to the club members.

There is also a management system to support licensed clubs, covering areas such as the recruitment of instructors, studio design and marketing. The company protects its intellectual property through trademark registration and through the vigilance of its distributors.

Purpose, vision and goal

Phillip Mills says, 'Our purpose is to inspire life-changing fitness experiences, every time, everywhere.' He adds, 'Our long-term vision is that Les Mills International will play a role in reducing obesity and its associated diseases in the Western world, and try to make people fitter, healthier and happier worldwide.' He aims to grow the numbers of gyms, offering Les Mills classes to 25 000 by 2015.

Phillip feels it is important to reach as much of the world market as possible, capitalising on his 'first mover advantage.' He therefore believes that a licensing approach for club owners was the proper way to go, using national or regional distributors to sell club owners on becoming LMI licensees, to distribute LMI programs, provide training programs and translate LMI materials into local languages. Although there was no initial cash payment to LMI for the right to become a distributor, the distributor was responsible for hiring the appropriate staff and assuming their adequate training with the help of LMI professionals. Phillip says, 'What we provide is a quality assurance method for clubs.'

The distributor would collect all licensing monthly fees from club owners and remit about 25% of this total to LMI. Normally, a distributor, starting from scratch, could expect to break-even within one and a half to three years, once 250 to 300 clubs had been signed up.

The US market

Phillip Mills believes the US market, with at least 20 000 gyms, represents half of the total world market for LMI programs, and that more than 20 per cent of the US population attend gyms. Attending gyms has become the most popular 'sport' in the US. Jill Tattersall and Phillip Mills consider the Western US region a crucial one in the US market. California is seen as the key state in this region, which also included Arizona, Nevada, Washington, Oregon, Utah and Alaska. LMI has currently 100 licensed clubs in this region but no distributor. Approaches have been made to several potential distributors. None of these turned out to be suitable for a variety of reasons, including lack of financing.

One prospective distributor looked promising however. First contacted at a Las Vegas trade show, this potential distributor seemed to meet LMI's requirements. Over the subsequent months negotiations were carried out and it appeared that an agreement might be reached. However, now, the prospective distributor for the Western US region had declined the LMI offer, ending months of speculation.

Sources: Based on author's interview with Jill Tattersall and Phillip Mills.

Questions

1. What alternatives do you have to develop the Western US region and what decision criteria are applicable?
2. What factors explain the rapid growth of Les Mills International over the past years?
3. What current social trends may have an impact on Les Mills International?

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