IDEAS

THE CHALLENGE OF GROWTH

GOING BEYOND 80

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There is a widely-held belief that the comparatively sluggish rate of new business creation in Europe is the result of a lack of entrepreneurial zeal. In his latest study, Prof. Antonio Dávila challenges this myth by casting light on the importance of building a solid management infrastructure during the transition from a "good business" to a "good company."

LEADERSHIP AND PEOPLE MANAGEMENT • DECISIONS ANALYSIS • STRATEGIC MANAGEMENT • ENTREPRENEURSHIP • INNOVATION AND CHANGE

Setting up new businesses with real opportunities for success is no easy task. But even with an attractive and profitable business already in place, the next step - that of transforming oneself from an entrepreneur into a manager - is just as tough. The transition from a "good business" to a "good company" takes place at some point when it has between 50 and 100 employees. When a business has fewer than 80 employees (to take an intermediary point between 50 and 100) the entrepreneur can handle everything himself. All decisions come through him and he knows what's going on in every corner of the organization. There is no need to know the intricate ins and outs of business management; a good idea, some charisma and a bit of common sense is enough. The big challenge is to grow beyond 80 employees. At this point the company cannot grow based only on good intentions. It needs good managers.

A good example of this is a company set up in June 2003 in Silicon Valley which I have had the opportunity to work with and have followed closely. The basic business idea is great. It wants to be, and is fast on its way to becoming, a leading player within the world of high-tech industry – establishing itself in the meantime as a benchmark for many within the sector, from startups, venture capital and medium capitalization companies to large multinationals. The company has been growing strongly for the last three years but has now reached the transition point. The managing director is a great visionary – the company was his brainchild, after all – and a great salesman – most of the company's sales up to now have been a result of his persistence and hard work. But his big challenge now is to create a team that will allow the company to grow beyond the seventy employees it currently has. For him, growth has always meant more time with clients and more pressure within the organization to sell. And the management team has always consisted of him and three other trusted colleagues.

THE ABILITY TO GROW

The issue of how best to approach this transition is particularly pertinent with respect to European companies. There is a widely-held belief that Europe suffers from a lack of "entrepreneurial spirit," which is nothing more than a reflection of its supposed lack of "innovative spirit." It is true that an excess of red tape and the social stigma of failure, a key risk faced by entrepreneurs, may go some way to explaining the slower rate of new business creation in Europe, especially relative to the U.S. Nonetheless, I often encounter people with ideas who set up new businesses here with the same entrepreneurial zeal I have seen in Silicon Valley. Maybe there aren't as many, but there are still quite a few.

The slower rate of business creation in Europe is often put down to a lesser desire among Europeans to create new enterprises. While there may be an element of truth in this, the real source of the problem has

THE TRANSITION FROM A "GOOD BUSINESS" TO A "GOOD COMPANY" TAKES PLACE AT SOME POINT WHEN IT HAS BETWEEN 50 AND 100 EMPLOYEES.

more to do with the "ability to grow" a business and create a real company, i.e., with managers to manage it. In many businesses, the curb to growth isn't the viability of the business plan, or the lack of funds; it's the inherent shortage of professional management. We are all familiar with companies, in many cases family-run businesses, that reach the magic number of 80 employees and stop growing. There are also countless cases of new, very promising businesses that, once they have reached this ceiling, remain just that: a promising business.

So, what goes wrong? Many entrepreneurs will say that the business is profitable enough so what's the point in growing further? Sometimes entrepreneurs are afraid to leave their region - the environment which they know and in which they feel most comfortable. On other occasions, growth represents more work (which is true since the number of contacts doesn't grow in lineal fashion but exponentially with the rise in the number of employees). The fact is that the management model beyond 80 is different. The "under 80" management model is not "scaleable", that is to say, you can't carry on doing the same thing just on a bigger scale and at a faster rate. If everything that goes on in the organization has to go through the entrepreneur, more growth means more hours of work and more headaches, while expanding to other regions means more travel.

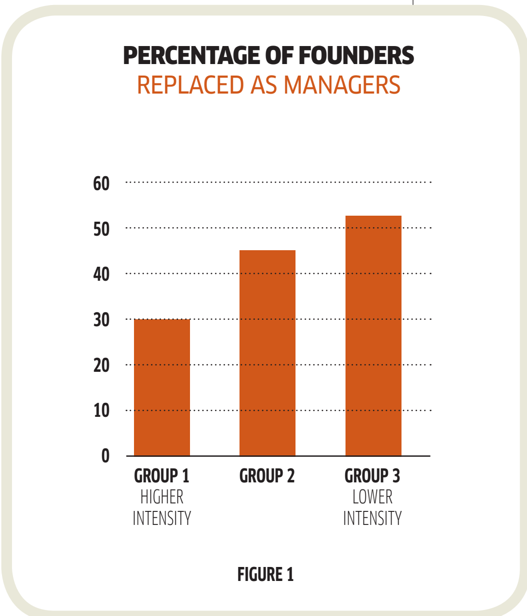

FIGURE 1

As soon as a company's workforce exceeds 80 employees, management must be professionalized. This means that you have to delegate and use management tools. If this isn't done, the company has no means of growing and the "entrepreneurial spirit" remains just that, an allusion to what could have been but isn't. Professionalizing management requires a sea change in attitude and moving from thinking of the company as a personal business to understanding it as an organization. It means hiring people with the skills and experience to "create" an organization. It means hiring specialists – a finance director to set up a finance department, a sales director to set up a sales team, a human resources director who understands the meaning of a person's professional career. And it also means adopting management tools – from setting up a simple budget to the design of the sales process or new product development.

A BIT OF RESEARCH

These thoughts were running round inside our heads for quite a while until we decided to do what academics do best: research. We launched a project to study 78 newly created Silicon Valley companies (with an average age of just over 5 years) that employ more than 50 employees. We devoted a great deal of time to each company, talked to various managers and gathered details of their history, such as the growth in the number of employees, sales, profits, investors and the adoption of professional management tools – from budgeting, sales processes and alliances to product development, financial analysis and people management.

The results were conclusive. The companies which grew most rapidly were those that had devoted time to creating a "management infrastructure," that is to say, management tools. Because of the geographical region and the selection criteria – high-growth companies – many of the companies in the sample were at least partly backed by venture capital. And if there's one thing that venture capital investors prioritize above all else, it's growth.

If an entrepreneur isn't able to make the company grow, the management board (on which the investors sit) will quickly replace the entrepreneur –moving them to another department such as R&D, or otherwise suggesting that they find new ideas and create another company (outside the existing one). As a result, in our sample of companies we see quite a high rate of turnover at the head of the organization. To see if this theory about professionalizing the company made sense, we looked at the level of development of management tools after one year, two years and three years of the company's existence and the probability of the managing director being replaced. Figure 1 shows this probability in relation to the de-

velopment of management tools. The figure suggests (and it's statistically relevant) that the lower the level of management development, the higher the probability of replacement.

We did something similar in Figure 2. We grouped the companies during the second year into three groups based on their level of management development and looked at how they grew. Once again, more development invariably means greater growth.

The conclusion is clear: management does not destroy the entrepreneurial spirit as is so often argued. On the contrary, management enables the entrepreneurial company to grow. Therefore, contrary to popular belief, lack of growth isn't due to a lack of ideas (or a market), but rather to a lack of management know-how. Of course, it is true that too many management tools can lead to increasing bureaucracy and smother innovation. But none of the 78 companies we studied had that problem. The most common problem was the opposite: a lack of management.

ENTREPRENEURS AND MANAGERS

A close look at the level of management turnover at these high-growth companies raises several interesting points. A good entrepreneur is not necessarily a good manager. What is valued in an entrepreneur is the ability to create, to take an idea to market; in a manager, on the other hand, it is the ability to grow, to lead a team to generate ideas. One is a creator of products and markets; the other is a creator of companies. The former enjoys uncertainty, novelty; the manager likes having a platform on which to grow.

Creating companies not only requires entrepreneurs. It also requires managers – people who turn businesses into companies which grow beyond those 80 employees. Such managers are a scarce resource that must be created; they are even harder to find than entrepreneurs. They are people with experience in large companies – which is why one of the functions of large companies in a country is to create managers – and who know how to create a management infrastructure. But they must also have the motivation and desire to work in a "small" company.

These directors know how to "create a company" as well as hire the right people with the necessary management tools. One of the companies in the sample needed to structure its product-development process. Instead of going through the motions and waiting for a fault to occur (as happens more and more frequently as the "team" becomes unmanageable with growth) to force them to restructure the process, the managing director hired someone who had been responsible for product development at Intel. This person brought with them all the necessary experience and expertise to oversee such a crucial area. Something similar happened in other companies with regard to financial management – instead of improving ways of budgeting, measuring profitability and presenting reliable financial data to the board, experienced managing directors hired experienced finance directors who had invaluable knowledge of best accountancy practices.

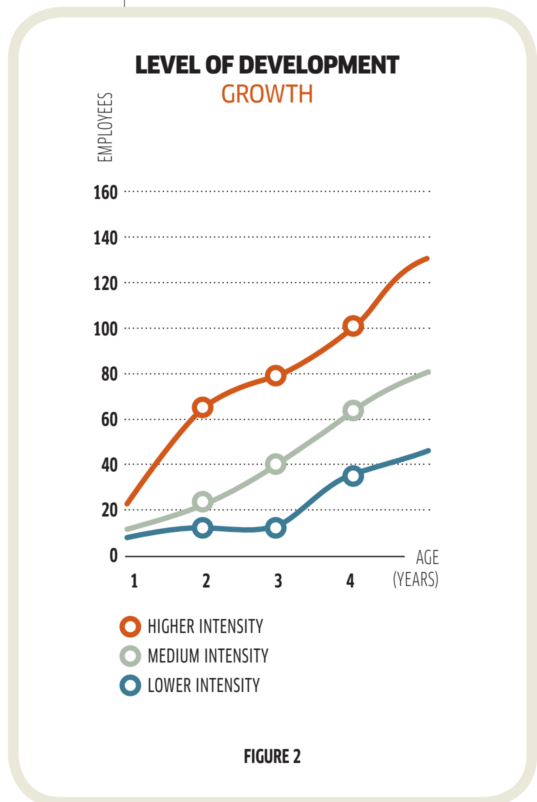

FIGURE 2

Perhaps the company that best understood the need to structure the business in order to grow was Siebel Systems. This company, founded in 1993, reached a billion dollars in sales and 8,000 employees in seven years – something previously unheard of in the software industry. Microsoft took almost 15 years to reach that size and Oracle took 13 years. Tom Siebel, the founder and managing director (an entrepreneur with the skills of a manager), had worked at Oracle for many years before focusing on new companies. Indeed, Siebel Systems was a big company from its very inception – the five employees all wore suits (unusual in Silicon Valley) and behaved as if the company were already a large multinational. Management tools were always ahead of growth. The discipline which led this company to the top (and to leave in the dust many other companies which were set up at the same time but which never grew) was the seed of the problems it would experience ten years later – but that's another story.