Managing Growth and Change

Alan S. Gutterman

§1 Introduction

Much time and effort is spent, and rightly so, on the launch phase of a new company and decisions made and actions taken during that phase will impact the future of the business and how the focus of the members of the senior management team will change as the company evolves. The launch phase is dominated by brainstorming about new business ideas, clearing the decks for concentrating on product development and marketing, forming a new entity and finding the funds required to make the dreams of the founders come true. If all goes well the company will transition into a growth phase marked by climbing revenues, an expanding line of products and services and, perhaps most important from a management perspective, an explosion in the size of the organizational structure and the challenges of coordination and communication. Growth is not necessarily constant and the expansion path of the business may include peaks and valleys, with each downturn bringing its own set of issues in terms of diagnosing problems and taking corrective action. At some point the rapid growth generally slows and the company reaches a plateau or even begins to experience signs of decline as customer requirements change and new technologies and competitors emerge. In some cases the symptoms for decline cannot be reversed; however, it most cases the company can stave off extinction by consciously focusing on renewing its business model and, in effect, launching a new business that can succeed in the changed business environment in which the company is operating. However, renewal is not easy since it requires not only new ideas, technologies and capital but also changes in culture and in the ways in which things are done within the company.

This Guide focuses on some of the crucial topics relating to managing growth and change. The Guide begins by describing various issues that companies must address as they seek to identify and manage the inevitable challenges that will arise as they grow and mature and the environment in which they operate changes. The Guide includes an overview of the theory and practice of organizational change including a description of the most common targets for organizational change initiatives—human resources, functional resources, technological capabilities and organizational capabilities—and the factors for, and barriers to, change that companies can expect to confront. The Guide introduces the two major types of organizational change—evolutionary and revolutionary—and lays out basic ideas regarding the development and administration of effective change processes. The Guide then focuses on the dynamics of growth and change experienced by emerging companies including a description of various emerging company growth models, a discussion of the challenges to growth for early-stage firms, a review of strategies for managing growth and change and an examination of diversification strategies used by technology-based small firms to grow their businesses. While the focus of much of this Guide is on managing growth and change in smaller technology-based companies (i.e., emerging companies), larger firms obviously have...
similar challenges and reference should be made to the publications cited in the notes below that accompany the discussion of evolutionary and revolutionary change since many of them were written based on research conducted on large multinational companies.

§2 Targets for organizational change

Companies, like all organizations, must continuously evaluate the need for redesigning their organizational structure to deal with changes in their business environment and ensure that the mechanisms and procedures for coordination and control continue to operate effectively. The process by which companies move from the current state to some desired future state in order to maintain, and hopefully increase, organizational effectiveness is referred to generally as “organizational change.” Companies should create and implement strategies for planned organizational change in order to strengthen and expand the value-creation activities of the firm. For example, even successful companies understand the need to re-align their resources and core competencies in ways that will allow them to continue to grow by introduction of new products and/or entry into new markets. Unplanned organizational change may also be needed in situations where companies have fallen on hard times and need to quickly restructure their organization in order to survive and launch new business initiatives. According to Jones, the most common targets for organizational change initiatives include human resources, functional resources, technological capabilities and organizational capabilities.1

§3 Human resources

The skills and abilities of the managers and employees of the company (i.e., human resources) are essential to the efforts of the company to develop and maintain its core competencies and thus establish a competitive advantage. Accordingly, an important part of continuous organizational change for any company is taking the necessary steps to strengthen its human resources through training and development, socializing new employees into the organizational culture of the company, consciously altering cultural norms and values to keep them consistent with current company strategies and establishing promotion and reward systems that effectively motive personnel and sustain morale. Other human resources issues that arise in the context of a change initiative include adjustment to the management team, leadership and communication styles of the CEO and other senior executives and recognition of the individual-level barrier to changes discussed below.

§4 Functional resources

The ability of functional departments to increase their value-creation capabilities depends on identifying and implementing necessary changes in their organizational structure, culture and technology. As companies grow and competitive conditions change the

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relative importance of functional departments will also change and companies will be forced to realign the resources that are invested in particular functional activities. For example, as the pace of innovation increases in the company’s chosen market the essential focus of organizational change may be in the functional area in the form of a transition from the traditional function-based organization to a product team structure that is more effective in accelerating new product development. Another illustration of function-focused organizational change is the decision to abandon mass production manufacturing in favor of small self-managed work teams that have the autonomy to make decisions about product design and manufacturing processes that will hopefully improve the quality of products and enhance the overall productivity of the workforce in the manufacturing area.

§5 --Technological capabilities

Companies may seek organizational change through strengthening their technologies capabilities in order to improve their ability to rapidly develop and launch new products, reduce manufacturing costs, increase the quality and reliability of products, and create customized versions of products to achieve differentiated advantages. While technological capabilities generally have the strongest impact in product design and development and manufacturing companies may also be able to restructure their organization in way that allow them to turn their technology-based skills and resources into revenue streams. For example, the knowledge created during the process of designing and manufacturing new products can be leveraged into value-added consulting services that can be marketed with the tangible products.

§6 --Organizational capabilities

An important, but often forgotten, source of organizational change is planned changes to the organizational structure and culture of the company in order to enhance the ability of the company’s human and functional resources to create new value. For example, a company can modify its organizational structure to improve communication and coordination between functional departments. Companies may also need to make changes in cultural norms and values if they wish to successfully transition into more dynamic markets that require continuous innovation and rapid new product development.

§7 --Complex process of executing organizational change

While the targets of organizational change can be categorized in the manner described above, it usually necessary to make appropriate changes in several areas at the same time in order for the company to actually achieve the targeted goals and objectives for increased value. For example, assume a company decides to launch a whole line of new products based on technology that the company has not controlled or used in the past. In order to pursue this strategy the company will need to recruit the necessary human resources (e.g., scientists and engineers with training and experience in the relevant technology) and support their activities by investing in the necessary functional resources and technological capabilities. In addition, changes will need to be made in the
organizational structure and culture in order to integrate the new business activities into the company and ensure that other functional departments and business units are willing and able to support the initiative. Among other things this may mean spinning off human and other resources from various functional departments and placing them into a new product team structure that is better suited for the innovative activities necessary for the planned new products to be developed, launched and supported.

§8 Forces triggering the need for organizational change

The need to undertake some form of organizational change can arise from any of the same forces that define the environment in which companies must compete: competitive forces, economic forces, political forces, global forces, demographic forces, social forces and ethical forces. Jones has provided the following examples of how each of these forces can impact organizational design:

- Competitive forces generally require actions that will allow the company to keep up with and surpass the skills of competitors with respect to efficiency (e.g., cost of production), innovation and product quality and reliability.
- Economic and political forces continuously impact the market conditions and rules under which companies produce and sell their goods and services and will cause them to reconsider how and where they engage in production and sales activities. The rise of economic and political unions (e.g. European Union) and increasing use of free trade agreements has changed traditional notions of market entry strategies and provided foreign competitors with new advantages.
- Global forces are clearly important as companies expand into new foreign markets with different languages, cultures and business practices. Changes in the organizational structure will be required in order to allow companies continue to achieve the economies of scale and other advantages associated with global strategies while simultaneously acting like a local firm in foreign markets and satisfying the specific requirements of customers in each country.
- Demographic forces are important internal and external factors for companies. In the workplace companies must address the rising levels of diversity among personnel and must create and effectively administer managerial and reward systems that take into account the needs and expectations of employees drawn from a wide demographic spectrum. In the marketplace companies must be prepared to tailor their products

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4 See also C.W.L. Hill, International Business (Chicago, IL: Irwin, 1994).
and services to the unique demands of specific demographically defined customer groups.

- Social forces have a substantial impact on what employees expect and want out of their careers and the companies they select for employment. Employees have a keener interest in lifestyle balance that employers must consider accommodating and firms must also be prepared to offer employees more opportunities for professional development through training and job rotation.

- Ethical forces are continuously pushing companies to embrace socially responsible business practices and act in an honest and ethical manner. Laws and regulations pertaining to ethical behavior have proliferated in the United States and in many foreign countries and companies must establish and follow internal rules and procedures to ensure that laws are obeyed and ethical problems are brought to light, independently reviewed and positively resolved. Ethical forces are also at work when companies develop strategies to carry out their activities in ways that preserve the environment and respect the human rights of others (e.g., ensuring the foreign suppliers refrain from operating “sweatshops” and otherwise mistreating their workers).  

§9 Barriers to organizational change

There is no shortage of stories about successful companies that suddenly encounter hard times and one of the main reasons for these difficulties is usually their inability to effectively deal with new developments in their environment and identify and execute the necessary organizational changes. For these companies organizational change is often stymied by various barriers to change that push toward the maintenance of the “status quo,” even though the traditional way of doing things clearly is no longer effective in light of the forces for the change that are overwhelming the firm and its managers. Barriers to organizational change can be found at every level within the company—organizational, group and individual—and efforts to change will inevitably be greeted by skepticism, turf battles, an inability or unwillingness to think “outside the box,” and difficulties in transferring resources from existing uses or obtaining new resources required in order to execute strategies that are fundamental to the desired change. Organizational change may also flounder when managers and employees lack incentives to modify behavior or senior management fails to clearly articulate the reasons for change and actively lead the process. In any event, allowing these barriers to change to restrict the ability of the company to execute necessary modifications to strategy can have disastrous consequences and place the overall survival of the firm at risk.  

§10 --Organizational-level resistance to change

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One of the main impediments to change at the organizational level is the natural interest of people, functions and other business units to protect their “turf” and avoiding ceding actual or perceived power and influence to others as part of a redesign of the organizational structure to address environmental forces. In addition, each functional department has its own way of viewing specific opportunities and problems and will necessarily look to their own interest when an organizational change is proposed rather than considering what might be best for the entire company. For example, senior management may be seriously entertaining a proposal from the materials management department that would significantly reduce the costs on inputs to the product process; however, the managers in the manufacturing department may vigorously oppose the idea based on concerns that the new strategy would make it more difficult for them to control the costs of production and the quality of the finished products that are the outputs of the manufacturing process. Unless senior management can convince the two involved departments to cooperate necessary organizational change may be slowed or prevented altogether and the result will be that the entire company will suffer competitively in relation to other firms that are able to execute the changes necessary to reduce costs and increase profits. The existing organizational structure and culture may also cause problems. The best illustration is when a company with a long-standing mechanistic structure is suddenly forced to engage in complex innovation that calls for extensive collaboration and mutual adjustment. A mechanistic structure is rigid and inflexible and managers and employees used to operating in that structure may find it difficult to transition to an organic structure that is optimal for innovation. Values and norms, which are the foundation of organizational culture, are also challenging to overcome and change since managers and employees must learn, understand and apply a whole new set of informal ways of thinking and carrying out activities and interpersonal relationships.

§11 Group-level resistance to change

Much of the work performed within an organization is carried out by two or more persons collaborating as teams or groups. An obvious example of an organizational group is a department that focuses on a particular functional activity such as research and development, manufacturing or marketing. When organizational change is necessary it can be anticipated that resistance may occur at the group level due to factors such as norms, cohesiveness and “groupthink.” Norms include the strong informal rules that groups develop and internally force regarding appropriate and inappropriate behaviors and these norms, which are generally explicitly passed on to newcomers to the group, form the basis for interactions within the group and between group members and outsiders. To the extent that organizational change disrupts task and role relationships within a group it will be necessary for the group to overcome existing norms and develop a new set of internal rules that fit the new organizational structure of the group—a process that is often difficult for group members to accept and execute.

cohesiveness refers to the attractiveness of a group to its members and often causes group members to resist change in favor of the “status quo” and protect the interests of the group in the midst change even if this causes harm to other groups that would benefit from the change. Groupthink occurs when group members discount negative information—generally some factors that objective observers would agree dictate some level of change within the group—to reach and maintain a consensus that change is not necessary and should be opposed. Resistance to change at the group level becomes more challenging as the importance of the role of the particular group in the overall activities and workflow of the organization increases and senior management must be prepared to discuss proposed change initiatives with group leaders very early in the process.  

§12 Individual-level resistance to change

Change will impact everyone in the organization—executives, managers and employees—and every individual member of the organization will have his or her own concerns about proposed changes in the “way things work” including cognitive biases, uncertainty and insecurity, selective perception and retention and habit. In general, individual-level resistance to change typically flows from natural concerns regarding uncertainty and insecurity about what the new organizational scheme might bring in terms of duties, responsibilities, performance expectations and day-to-day interactions with colleagues and supervisors. While senior management will engage in continuous communications throughout the organization regarding the “benefits” of the proposed to change to “the company” the reality is that most individual members of the organization are most concerned about the impact of the initiative on them and those close to them in the existing organization.  

§13 Types of organizational change—evolutionary and revolutionary

This discussion above of forces for, and barrier to, change dictate that senior management implement an organized approach to change management that includes regular periodic analysis of the organizational environment to identify potential forces for change; analysis of the impact of a proposed change on the organization as a whole, key groups within the organization and individual managers and employees; and development and implementation of “change plans” that recognize impediments to change and include specific strategies for overcoming resistance and executing changes that are tightly aligned with environmental forces. The strategies to be included in any “change plan” depend on the type of change that senior management is pursuing and types of changes have been neatly segmented into two categories—evolutionary change and revolutionary change—that each have their own particular strategies for implementation.  

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Evolutionary change has been described as change that is gradual, incremental and narrowly focused and rather than being an attempt to make drastic and sudden change in the basic nature of an organization the goal is to improve, adapt and adjust strategy incrementally to accommodate to changes taking place in the environment. An important and common example of evolutionary change is the effort of organizations to identify and implement improved methods for operating a technology or organizing the work process and strategies to accomplish this objective include creation of empowered, flexible work groups, total quality management and quality circles.

In contrast to the gradual and incremental nature of evolutionary change, revolutionary change is change that is rapid, dramatic and broadly focused and driven by a perception of senior management that major organizational changes are needed and must be made quickly in order to respond to drastic and unanticipated changes in the organizational environment and/or long periods of neglecting necessary evolutionary changes. Revolutionary change almost certainly touches every group and person in the organization and typically comes with new ideas about organizational design and structure, work processes and strategic goals and objectives. Important and well-known instruments of organizational change include reengineering, restructuring and downsizing. Larger organizations may also attempt revolutionary change by embracing the focus on “innovation” commonly found among smaller emerging companies and marshalling their skills and resources to purposefully execute a radical change in strategic direction based on the creation and commercialization of new technologies and/or goods and services. Revolutionary change generally focuses on drastic alterations to business processes, which are activities that cut across functional boundaries—thus requiring extensive coordination and planning during the change process—and are considered to be vital to competitive delivery of products and services.

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18 Hammer and Champy, who popularized reengineering, one of the major instruments of revolutionary change, defined it as “the fundamental rethink and radical redesign of business processes to achieve dramatic improvements in critical, contemporary measures of performance such as cost, quality, service and speed”. See M. Hammer and J. Champy, Reengineering the Corporation (New York: HarperCollins, 1993).
§14 Development and administration of effective change processes

Successful companies recognize from the beginning that change is inevitable and that it will be necessary for the organizational design and structure and strategy of the company to be adjusted, sometimes radically, as the business evolves and matures. It is therefore essential for senior management to develop and administer effective change processes as part of the company’s overall strategic planning process. As discussed above, even clearly needed changes will encounter resistance and senior management must create and use the appropriate tools for modifying the current state of organizational affairs and driving the organization and its key constituent parts (i.e., groups and individuals) toward the new, desired state of affairs that senior management believes is appropriate for the organizational environment in which the company will be operating.  

An effective change process begins with diagnostic exercises that identify the need for change, specific problems areas and the anticipated barriers to change that will need to be overcome. The diagnostic process requires collection and analysis of information from all parts of the organization—managers and employees—and from key external stakeholders such as customers, vendors and distributors. The output of the diagnostic process should be a revised set of goals and objectives that reflect the desired future state of the organization and remediation of the problems and issues uncovered during the diagnostic phase. Strategic analysis is the key at this point and senior management must decide such issues as whether to try and cope with customer concerns about the “value” of the company’s products by reducing costs and increasing efficiency, thereby providing opportunities to lower prices, or raise quality and responsiveness in order to maintain and perhaps increase prices. Once the strategy has been selected change action must be implemented using one or more of the instruments applicable to the particular type of change that is being pursued. As with any strategic initiative, change plans must include tools for measuring the effectiveness of the change actions and their impact on the performance of the organization. Finally, change processes must be institutionalized so that change is an accepted, and even welcome, part of the organizational culture. This

19 For detailed discussion of the change management processes summarized in this section, see G.R. Jones, Organizational Theory, Design and Change (5th Ed) (Old Tappan N.J.: Prentice Hall, 2007), 288-292. Jones relied heavily on the “action research” ideas presented in K. Lewin, Field-Theory in Social Science (New York: Harper and Row, 1951). Jones explained that Lewin viewed organizational change as a three-step process: (1) unfreezing the organization from its current state; (2) make the desired organizational changes; and (3) refreezing the organization in the desired state with the aforementioned changes in place. See also P.A. Clark, Action Research and Organizational Change (New York: Harper and Row, 1972.

can be accomplished through reward systems that recognize positive change initiatives by groups and individuals and through the implementation of organizational development techniques that increase the adaptability of the organization (e.g., education and communication, participation and empowerment, counseling and process consultation and team building and intergroup training).  

§15 Growth models for emerging companies

Emerging companies, just like any form of organization, progress through various stages of their so-called “life cycle” in much the same way as individuals do as they grow physically and mentally and acquire experience through their activities and the problems that they must overcome. While each case is different it is useful to see emerging companies as going through several identifiable stages of growth, each of which has its own set of "typical" business characteristics and accompanying management issues and problems. While a single model of growth and development certainly cannot explain or predict everything for the management of a particular firm, it can be useful in providing them with a sense of where the company stands and the challenges that are likely to require their immediate attention and in the foreseeable future. Armed with information about the particular life cycle stage that the company is experiencing, management can anticipate problems and make intelligent choices about acquiring the necessary resources for the business, establishing priorities for work activities, and designing and managing the organizational structure of the firm.

There is no single theory regarding the stages of development of a business that is universally accepted; however, there is a significant amount of literature on stages of growth theory which posits that the development of organizations generally follows a predictable path that allows managers to anticipate in advance the challenges that will arise as a firm gets bigger and its activities become more complex:

- Greiner argued that firms can expect to go through five stages of growth, crisis and revolution as the company grows in size and matures. At the earliest stages, the firm begins by growing through “creativity” until it reaches the point where a “crisis of leadership” occurs. In order to continue growing, Greiger’s model suggested that the founders must be prepared to delegate their authority and allow others, including

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22 For detailed discussion of the topics covered in this section, see “Growth Models for Emerging Companies” in “Managing Growth and Change: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

23 The discussion of various stage models below draws from summaries provided in S. Slatter, Gambling on Growth: How to Manage the Small High-Tech Firm (Chichester UK: John Wiley & Sons, 1992), 135-138.
professional managers from outside the original founding team, to assume responsibility for directing the operations of the business.\textsuperscript{24}

- The model created by Churchill and Lewis identified five stages of growth: existence, survival, success, take-off and resource maturity. Movement through each of these stages required confronting and resolving a series of practice problems and issues, such as making initial sales, ensuring timely deliveries, harvesting cash to fund rapid growth and managing consolidation as the firm (or specific product lines) mature.\textsuperscript{25}

- The model developed by Flamholz focused on the transition that must be made between entrepreneurial and professional management for growing businesses. Four stages are identified, including new ventures, expansion, professionalization and consolidation, with emphasis placed on bridging the gap between stages two and three. The need to bring in outside professional managers depends, at least in part, on the skills and experiences of the initial CEO and the remaining members of the management team that joined the firm at or soon after inception.\textsuperscript{26}

- Kazanjian posited four stages of growth based on a survey of technology-based new ventures. During the first stage, “conception and development,” the firm is generally occupied with new product development and technology applications. The second stage, referred to as “commercialization,” calls for acquisition of resources and the completion of activities relating to production startup. The next stage, “growth,” creates pressures on management to develop and maintain an organizational structure that is prepared to complete the complex tasks of establishing sales, manufacturing and distribution strategies to generate high volume sales at suitable levels of profitability. The fourth stage, referred to as “stability,” is defined by profitability, internal controls and the initiation of new projects to push further growth.\textsuperscript{27}

- The metamorphic growth stage model follows a path similar to the one posited by the traditional models of the product life cycle and envisions that firms pass through several different stages from launch through maturity. The first stage, referred to as “start up,” is dominated by entrepreneurial activity. The second stage is marked by organizational growth and maturity and the firm is generally focused on acquiring market share and defending its chosen market niche. The third or final stage is marked by decline and forces the firm to either undergo a major strategic transformation or cease to survive.

- Another way of charting the development of a startup recognizes the following stages: concept, formation and organization, crisis and survival, initial growth, expansion and sustainability. It is possible to identify the key business characteristics associated with each of these stages—immediate business objectives, predominant management style, organizational structure, and the state of the company’s product and market activities—as well as the main managerial challenges that come with

\textsuperscript{26} E.G. Flamholz, How to Make the Transition from an Entrepreneurial to a Professionally Managed Firm (San Francisco, CA: Jossey-Bass, 1986).
graduating into a particular stage (e.g., resource management, sales and marketing, and communications and cooperation within the organization).

- While revenues are an important factor in many of the growth models, and understandably so, there is a case to be made that the number of employees is a better predictor of when a firm is likely to endure a transitional crisis since more people means more complexity for the organization. In general, companies with less than 40 or 50 employees are able to maintain an exciting atmosphere that motivates everyone to perform. As the number of employees exceeds 50, companies begin to encounter more difficult management problems and must begin to wrestle with the challenges of adopting professional management practices and, in most cases, hiring newcomers to take on higher-level managerial and administrative duties. When the size of the company grows to 150 employees or more, the initial intimacy and informality has all but disappeared and the “hands on” management style that was so effective when the business was launched will have passed on in favor of formal structure and systems and a complex set of internal controls.  

There is also real controversy as to whether or not firms really do need to go through a single, predictable path as they grow and mature. Various factors, notably significant advantages in communications technology and rising standards of living in foreign markets, have pushed young businesses into global markets soon after formation and created challenges for their managers that were traditionally deferred until the firm had gone through an extended period of domestic growth and expansion. Companies are also becoming involved in acquisitions and strategic alliances with outside business partners before they have had an opportunity to fully build and stabilize their own internal business infrastructure. As a result, management may be overwhelmed by the size and scope of the human and physical assets that they need to oversee and the challenges of coordinating activities and strategic goals with new stakeholders who were not part of the original team that conceived and launched the company in the first place.

The various growth models and theories discussed above have been supplemented by a growing volume of empirical research. One such comprehensive study of the evolution of emerging companies was conducted by researchers from the University of Chicago Graduate School of Business and focused on how the characteristics of public companies that were launched with venture capital financing evolved from the date of their early business plan through their initial public offering (“IPO”) and on to mature public status with the release of their third annual report following completion of their IPO.  

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28 S. Slatter, Gambling on Growth: How to Manage the Small High-Tech Firm (Chichester UK: John Wiley & Sons, 1992), 147.  
29 The discussion in these sections is derived from S. Kaplan, B. Sensoy and P. Stromberg. “What are Firms? Evolution from Birth to Public Companies”, University of Chicago Graduate School of Business (2005). It is interesting to note that, on average, it took six years for the 49 companies included in the study group to move from their earliest business plan to the date that they released their third annual report following completion of an initial public offering. Other results from the study provided interesting contributions to identifying the characteristics of emerging companies. For discussion, see “Entrepreneurship: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
study compared the firms on a wide array of factors—financial performance, business idea, points of differentiation, non-human capital assets, growth strategy, customers, competitors, alliances, top management, ownership structure and the board of directors—and provided an interest picture of stability and change as the firms evolved. Of particular interest to those seeking parameters for stages of growth was that most common and material changes for the studied companies included production of new or upgraded products; broadening the customer base; implementing external growth strategies such as strategic alliances and acquisitions; delegation of management authority and establishment of dedicated executive positions for finance, sales and marketing, engineering, human resources and technology management; and increased reliance on independent directors at the board level.

Reference to growth stages should not imply that all emerging companies will ultimately be successful. In fact, this is almost impossible to expect given the substantial risks and uncertainties associated with launching and growing a firm based on the viability of unproven technologies and other innovations. One study of companies in high technology industries in the United States found that 80% of the new start-up firms exited the market after one year and that among firms that actually survived until the fourth year, the exit rate within the following year remained over 60%. In fact, it was not until the seventh or eighth year that firms could anticipate more than a 50% survival rate into the future, which means that it generally takes that long for the company to establish sufficient credibility in the marketplace and build an inventory of resources that can be used for sustainable growth.30 For those firms that are able to survive long enough to establish a foothold in the target market, there is a strong likelihood that they will eventually be integrated into the operations of another company. For example, a study of technology-based firms organized in the 1960s indicated that a third of those firms had been acquired, including by merger, by 1980. In that survey, the mean age of the acquired firms was 6.4 years when the deal was completed.31

§16 Challenges to growth for early-stage firms

In many ways the first exposure of founders and other senior managers of early-stage firms to the issues associated with organizational change will occur soon after the company is launched as they struggle to quickly transform their ideas and dreams into a viable business model. Launching a new business is a complex and demanding process that generally focuses on product development and commercialization activities yet must also include business planning, technology management, organizational design, recruitment and oversight of human resources, pursuit of capital, development of internal recordkeeping systems and constant attempts to interact with outside business partners such as customers, vendors and distributors. The issues that firms must address in order to realize growth-oriented objectives have been categorized into resource acquisition and

allocation, organizational structure and design (“work flow”), human resources, technology management, sales and marketing, communications and public relations and, of course, financial viability. The challenge for management is not only finding the time and talent to devote attention to each of these areas from the very outset of the venture but also to identify the changes that must be made as the company develops and grows. For example, as the firm grows, resource acquisition priorities shift from capital to recruiting qualified and experienced managerial and technical employees—a transition that also impacts the organizational structure of the firm, reporting channels and the use of internal controls.\textsuperscript{32}

Several of the key issues that jeopardize the progression of rapid-growth firms are discussed below; however, at a basic list of challenges that would normally be expected would include the need for a transition in the roles of the founders and other members of the senior management team, particularly the CEO; the need to provide support to middle managers and functional specialists pressed to engage in activities beyond their skills and experience; averting communications problems that will likely arise as the organization grows and becomes more complex; clarifying the roles and responsibilities of the members of a continuously expanding management group; and identifying and executing the projects necessary to improve the infrastructure of the company in order to support the pursuit of growth:

- The CEO must eventually accept the fact that he or she must begin to delegate tasks and activities that the CEO had previously handled directly in order to free more time for new activities that arise due to the growth of the firm, notably planning and development and monitoring of controls.
- As the firm grows, managers may be asked to take on challenges that are beyond their skills and experience. For example, a sales director that handles the company’s first four or five customer accounts directly may have a hard time recruiting and supervising a growing sales team needed to handle a sudden surge in the volume of customers. Another problem in this area arises when technical specialists look to take on management responsibilities to additional compensation and prestige, only to find that they are ill-suited for the job.
- A breakdown in communications can be caused by a number of factors, most of which generally all crop up at the same time. Adding more people means that the informal style of communication that predominated when the firm is smaller is replaced by written reports. Growth generally means more departmentalization, which tends to create barriers to the flow of information. Other contributing factors include multiple locations and even just larger facilities that make it harder for working groups to intermingle on a regular basis.
- Confusion about roles and responsibility within the management group means that it takes longer to make decisions. In addition, poor role definition means the employees

\textsuperscript{32} For further discussion of the challenges of launching a new business and the specific issues that management must address in order to realize growth-oriented objectives, see “Entrepreneurship: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
throughout the organization will not know who to go in order to bring up a new idea or resolve a problem or issue that may have come up with a customer, vendor or other business partner. Finally, uncertainty in this area means that it will be more difficult to establish and enforce internal controls.

- Infrastructure issues are critical and general arise without warning even though they should have been expected. For example, growing firms can expect to be faced with major challenges, and substantial capital outlays, in diverse areas such as telecommunications, MIS, human resources and customer service and support. Even the most experienced manager is not qualified to handle the myriad technical and business issues that arise when purchasing or leasing new systems, establishing formal training programs or establishing a relationship with outside service providers to support the firm’s products.

§17  **Allocation of scarce resources**

At their earliest stages, technology-based companies, like many small businesses, are inevitably challenged by limited resources. Even if the company is able to garner outside funding, such as venture capital, the amount of money raised will only be sufficient to take the company to the point where the investors reasonably believe that the business should be able to generate revenues from its own activities. As a result, the company is under significant pressure to perform and ill-suited to absorb any unforeseen delays in product development, regarding of whether the delay could have been predicted or anticipated. Moreover, the scarcity of financial resources means that the company cannot afford to make the wrong decision regarding the products or projects to be pursued, nor can the company have the luxury of hiring the people and procuring the resources to pursue alternative solutions at the same time. Managers of small technology-based companies also bemoan the fact that they feel that they lack the financial resources necessary to recruit the necessary human resources in the technology and marketing areas to increase the possibility that the company’s products and services will be developed and marketed successfully.

Research shortages, and the need for careful allocation of scarce resources, is a constant challenge for emerging companies in their earliest stages regardless of the enthusiasm and financial support that a venture receives from the investment community. Accordingly, the senior executives of a firm in this situation should be mindful of the following guidelines for effective allocation of resources developed from researched conducted by Hendrickson and Psarouthakis:

- Implement a formal planning and budgeting system; however, make sure that the categories are customized to the specific way in which the company actually operates;

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• Invest in hardware and software that can enhance the effectiveness of the planning and budgeting process;
• Consult with managers before establishing goals, priorities and budgets, but remain mindful of the need to give priority to overall strategic needs over the parochial desires of any one manager;
• Develop training procedures and incentives for managers to make sure that they understand, and adhere to, the planning and budgeting system; and
• Establish procedures for regular monitoring of key indicators of performance, such as profits, expenses, sales, inventory, productivity and quality.

§18 — Developing effective management skills and practices

While resource shortage is a term generally applied to capital and “headcount”, it has also been suggested that management experience and skill is often a crucial limited resource for many technology-based companies in their early stages. As such companies begin to grow quickly, the founders, who may be skilled technologists but novices when it comes to management, may be unable to respond to developments that create new management activities. The founders of many technology-based companies are often more interested in pursuing novel and complex technological opportunities than in maximizing the returns on capital that may have been invested in the enterprise. In fact, founders with a strong science or engineering background may be unwilling or, at best, reluctant to direct development activities toward technology and markets that are attractive from a business and marketing perspective if they believe that such a strategy will derail or delay their efforts to achieve other technological milestones that have less practical commercial application. Studies have also shown that entrepreneurs exhibit distinctively different psychological traits with regard to their propensity for, and willing acceptance of, growth and change within the firm. Taking all these factors together it is apparent that emerging companies often find that the overall development of their businesses may be hampered by delays and mistakes caused by a lack of management ability.

Overcoming resource shortages with respect to management skills is essential to the success of an emerging company given that the empirical evidence appears overwhelming that high performance among those types of companies is firmly linked to the skills and abilities of the management team. Since it is rare to find persons that can combine the outstanding technical skills often found among entrepreneurs who start a new technology-based business with the leadership and management skills necessary to achieve continuous growth, it is not surprising that these companies must inevitably confront the need to replace the founders with professional managers. The founders may not only lack the requisite management and administration background, they may also be unable to act quickly with imperfect information in order to respond to changes in market and technological conditions. This transition is obviously a sensitive issue and the founder may still be able to exert control through his or her ownership interest and the

influence that the founder has already had in setting the initial direction of the business and recruiting other key staff members.

Transitioning to professional management is just one step in overcoming managerial problems for emerging companies as they begin to develop and mature. Another important piece of the puzzle is implementing management practices that are best suited to the dynamic environment in which fast growth companies will operate. Guidance on this point has been provided by research undertaken by Ernst & Young LLP and The Kauffman Center for Entrepreneurial Leadership:

- Use a collaborative decision-making style with the top management team;
- Accelerate organizational development by assembling a balanced top management team with and without prior experience of working together;
- Develop a top management team of three to six individuals with the capacity to become the entrepreneur’s entrepreneurs;
- Align the number of management levels with the number of individuals in top management;
- Establish entrepreneurial competency first in the functional areas of finance, marketing and operations;
- Assemble a balanced board of directors composed of both internal and external directors;
- Calibrate strategies constantly with regular board of directors meetings; and
- Involve the board of directors heavily at strategic inflection points.

§19 Organizational structure and managerial processes

Organizational structure and managerial processes are often ignored during the early stages of development of a new business venture for the simple reason that there simply are not enough people or projects involved to warrant a significant investment of effort in those areas. Not surprisingly, the recommended approach for companies during the earliest stages of a new venture is to attempt to operate “leaner and meaner” to achieve initial growth, including few managers and physical assets and reduced rates of compensation. As the business grows, the investment priority turns to technology and equipment that can improve the production process and these need to be supported by work flow systems that generate the highest growth rates including delegation of authority to free senior managers to concentrate on other activities, functionally balanced teams of managers and the use of work standards and monitoring systems.

Not surprisingly, Hendrickson and Psarouthakis found that the top performing firms in their survey of small to medium-sized growing firms were those companies that were able to do the best job of addressing structural and administrative processes challenges by developing operational and management systems that can help the company deal effectively with increased complexity and scope of activities. On the operations side, these systems are intended to reduce the time, effort and costs associated with what are becoming relatively routine and repetitive activities or transactions. Thus, for example,
Operational systems should be considered to address such things as sales, order processing, inventory, purchasing, production, delivery, billing, collections, accounting, and finance. Management systems are needed for those activities necessary to plan, organize, and control the growth and development of the firm and should address things such as strategic and operational planning, appraisal, and management development, budgets, and controls and coordination of activities across the organization. Examples of techniques included an effort by the CEO to remain directly involved in communications, greater use of meetings and teams to review plans and engage in problem-solving activities, and establishment of work standards and use of monitoring systems to track results in relation to goals. As the firm grows, both operational and management systems will be needed; however, at the earliest stages of expansion, it is best to focus on operational systems and defer, or at least slow, the introduction of management systems that may have a crippling effect on pursuit of the “high risk and high return” projects that is so necessary for innovation. 

While “professional” managers should add value and experience to the growing technology-based firm, the track record of hiring and retaining persons who can successfully fit into the organization and culture of the business is problematic. Among the guidelines that should be taken into account to maximize the chances of success are the following:

- Make sure that the job and related responsibilities are fully defined and understood before the recruiting process begins. This causes the firm to resolve at an earlier stage any potential problems with existing managers and also forces the company to create a profile of the ideal candidate for the new position.
- Whenever possible, seek to recruit persons that have actually worked and managed in a rapid growth environment. Professional management does not mean the person must come from a large organization and, in fact, persons with a “large firm” background generally have a very difficult time fitting in at a small growing business.
- Make a concerted effort to assess whether the candidate is willing and able to accept the need of technology and marketing specialists to retain some degree of autonomy and independence. Also, evaluate whether the candidate will be able to make immediate “concrete” contributions to the firm, even though resources may still be in short supply.

As the firm grows and the demands on the time of senior management increase, there is a tendency to address the problem by creating additional levels of management personnel. While supplementing the management group is an almost unavoidable consequence of growth, caution should be used before creating too many new positions. In addition to the problems of integration that apply to any professional manager, regardless of where

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36 L. Hendrickson and J. Psarouthakis, Dynamic Management of Growing Firms: A Strategic Approach (Second Edition) (Ann Arbor, MI: University of Michigan Press, 1998). The cautious approach to introducing too much formality with respect to management systems in innovation-based firms is illustrated by the finding of the researchers that successful companies actually tended not to rely heavily on written job descriptions or the use of written policies to coordinate activities.
they are placed in the organizational hierarchy, the founders and senior managers need to carefully evaluate the impact that a mid-level management position might have on overall communications within the firm. For example, the founders and other senior managers will need to determine whether they will honor the position and delegated authority of the mid-level managers or simply bypass them and continue to deal directly with employees who are nominally supposed to be subordinates of, and reporting to, the mid-level managers. The founders need to take the time to train the new managers and establish realistic and objective expectations about their roles and responsibilities. Another factor that needs to be considered is the reaction of those employees who are suddenly told that they need to report to a new mid-level manager from outside the company when they have been working directly with the founders from the beginning of the firm’s activities.

In all but the most exceptional cases, a good deal of the initial growth spurt on the payroll can be attributed to hiring additional functional specialists outside of the core activities of research and development, engineering, manufacturing and marketing. For example, the firm may bring in professionals to handle human resources issues and information technology and may also bolster the activities in the core activity areas by hiring specialists to handle such things as marketing planning and advertising. Risks associated with this trend include the real possibility of clashes and misunderstandings between the “veterans” and the new specialists, many of which are eager to impose their own stamp on the way things are done, reduction of speed with respect to decision making and a general diversion of resources away from activities that directly impact customers.

§20 Strategic planning

Strategic planning is, at some point, an essential element for every business enterprise regarding of size or stage of development; however, when emerging companies are launched they typically lack the resources and discipline to design and implement the sophisticated planning systems generally found in larger organizations. A number of researchers have explored possible relationships between rapid growth and the business strategies deployed by managers. Available materials include a combination of case studies, which generally lack statistically analyzed data, and empirical-based research. In most cases, the studies used “sales” as the dependent factor for measuring growth, as opposed to profitability and changes in the number of employees. The samples used for these studies are normally relatively small, no more than a few hundred companies, and often are based on firms from a non-random sample (e.g., “Inc. 500” companies). Hendrickson and Psarouthakis reviewed a significant amount of published empirical evidence on the relationship between management actions and sales growth and presented their results in the form of issues confronting growing businesses—resource acquisition and allocation, organizational design (i.e., “work flow”), human resources, technology management, marketing and communications and finance—that presumably

For discussion of the role of strategic planning and the steps that should be taken to implement a comprehensive planning system, see “Strategic Planning” in “Managing Growth and Change: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

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should be addressed through strategic planning at some point during the early evolution of the business.38

While development and use of a formal business plan is commonly suggested in articles, books and classes on entrepreneurship, informal studies that only a relatively small number of small- to medium sized businesses actually engage in formal planning. However, a business plan is much more common among those firms, such as Inc. 500 companies, that have achieved above-average growth in sales performance. Among the key factors in the use and success of a formal business plan is the background of the persons involved in the planning process and the intensity of the effort expended on the project. For example, companies that involve professionals in the development of a formal business plan achieve faster growth rates than companies that do not. The formal planning process is also more effective when the CEO and other members of the management team have more formal management training and experience and are more flexible and aware and oriented to the future. Finally, those companies willing to devote more time and other resources to formal business planning, and involve all parts of the firm in the planning process, exhibit higher growth rates.

Even if a business plan has not been formalized fledgling companies should consciously engage in certain activities that will inform their decisions regarding the direction of the business, the types of resources to pursue and allocation of the scarce resources that the firm is able to attract. For example, companies should establish systems and procedures for obtaining external information that can be used in various business functions, notably marketing strategy, personnel, public relations and advertising. Other strategic activities consistently emphasized by companies that enjoyed above-average growth in revenues include increasing profits, as opposed to increasing revenues, number of employees or the amount of assets deployed in the business; increasing profit margins; emphasizing marketing initiatives as the primary focus of overall firm strategy; and improving the firm’s production processes. As to specific strategies deployed to achieve these objectives, the following were identified: active engagement in market research; emphasis on selling directly to customers, as opposed to using distributors and other agents; product innovation; active attempts to obtain capital from outside sources, regardless of whether the efforts were successful; concentration on a few main products, as opposed to a diverse line of products that might cause the firm to lose focus and squander resources; and investment in new machinery as a way of obtaining the desired improvements in production. In summarizing their conclusions, the researchers emphasized the importance of using all, or most of these strategies, as opposed to simply relying on any one of them. For example, while much attention is placed on encouraging companies to be “innovative,” and governments often provide support for research and

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development, growth does not automatically follow unless the firm supports new products with solid marketing and sales strategies.\textsuperscript{39}

Strategic planning, in whatever form it occurs, is not totally effectiveness unless it includes processes for monitoring the progress of the company with respect to pursuit and achievement of the specific goals and objectives established by the senior management. The principals of a “start-up” business need to identify quantitative measures that can be used to gauge their success in implementing strategies that are appropriate to overcome the various challenges that confront growing businesses such as acquiring and effectively allocating crucial resources, establishing an efficient organizational structure, recruiting and retaining the necessary human resources and managing the acquisition, protection and use of technology. The challenges identified by Hendrickson and Psarouthakis suggest some basic measurement tools such as adequate cash flow; minimal or non-existent delays in production processes; low absenteeism and turnover; total sales and rate and steadiness of sales growth; and low incidence of litigation, regulatory problems and bad publicity.

\textbf{§21 --Financing and control}

Finance issues quickly become among the most important concerns for the founders and other senior managers of an emerging company. While it is now possible, albeit often difficult, to get through the initial stages of concept development while operating on a “shoe string” and sacrificing salaries and other resources that would require an investment of capital there comes a time when some level of funding is necessary to properly launch new products and services so that revenues from those activities can be generated to push the business toward sustainability and further growth. Evidence indicates the senior managers of the most successful high growth businesses work hard to develop good relationships with outside funding sources, including banks and private investors, even before the company begins serious capital-raising activities. Beyond that, however, consideration should be to the following financial and strategic planning practices of fast growth companies identified in the course of research undertaken by Ernst & Young LLP and The Kauffman Center for Entrepreneurial Leadership:

\begin{itemize}
  \item Anticipate the need for multiple rounds of financing (on average every 2.5 years);
  \item Secure funding sources capable of significantly expanding their participation amounts;
  \item Utilize financing vehicles that retain the entrepreneur’s voting control;
  \item Maintain control of the firm by selectively granting employee stock ownership;
  \item Link the entrepreneur’s long-term objectives to a defined exit strategy in the business plan;
  \item Prepare detailed written monthly plans for each of the next 12 to 24 months and annual plans for three or more years;
\end{itemize}

• Establish functional planning and control systems that tie planned to actual performance and adjust management compensation accordingly;
• Share with employees periodic planned versus actual performance data that is directly linked to the business plan;
• Link job performance measures that have been jointly set by management and employees to the business plan; and
• Prospectively model the future growth of the company based on benchmarks that exceed industry norms, competitors, and the industry leader.

Especially during the early stages of the emerging company’s existence, management must keep costs variable and avoid taking on excessive debt coupled with high fixed interest costs. Debt management is no easy task, particularly when the founders are unwilling to accept equity financing out of concerns regarding loss of control or erosion of the future value of their ownership stake in the business.

§22 Strategies for managing growth and change

A good deal of research has been conducted on the challenges confronting emerging companies as they attempt to make the transition from the “start-up” stage to a maturing and expanding enterprise. The results of the research, as well as anecdotal evidence, indicates that some of the principal growth problems for small technology-based businesses include the following:

• Inability of the CEO to change his or her role;
• Inability of employees to change to meet the new demands of their jobs;
• Communications problems caused by an increasing number of inter-company relationships and accompanying complexity;
• Inability to maintain “team spirit” and the close cohesiveness of a small company;
• Breakdown in decision-making processes, which erodes the ability of the company to respond quickly to changes and opportunities that inevitably arise in a rapidly-growing environment;
• Role confusion among top management due to creating new positions, authority levels, reporting channels and areas of responsibility; and
• Resource shortages, including shortage of qualified technical and managerial staff and the necessary infrastructure tools to support rapid growth.

The consequences of these problems, if not addressed, are easy to foresee, including conflict between functional groups, job stress and absenteeism, turnover at the managerial level, and low morale. As a result, performance deteriorates rapidly and the company becomes less productive and more vulnerable to crisis.

40 A fuller description of the research relating to the challenges confronting emerging companies as they grow appears in “Entrepreneurship: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
Probably the greatest management challenge for a small, yet growing, technology-based firm is achieving the appropriate balance between the flexibility and informality that is so necessary for innovation on the one hand and the stability and formality that is required in order for the business to create and take advantage of an institutional memory and capacity to efficiently complete repetitive activities.\(^{41}\) Many different forces converge to push small firms toward stability, including introduction of outside professional managers, adoption of formal operational and managerial systems, the need to cope with constant change, hiring of new employees who are not familiar with the original way of doing business within the firm and pressure from outside advisors and investors. In order to cope with these forces, founders of emerging companies have tended to adopt one of several approaches to the balancing problem:

- Gradual introduction of professional management skills and practices throughout the organization while making a concerted effort to retain flexibility. This approach often fails due to the inability of the founders to grasp how quickly change occurs in a growing firm.
- A “see-saw” approach that contemplates alternating periods of flexibility and stability, with the flexible approach being used to effect dramatic changes in strategy and direction.
- Simultaneous expression of stable and flexible practices in different parts of the organization, such as establishing professional management practices with respect to operations and marketing while retaining a flexible approach in the product development area.

Other companies are able to achieve the necessary balance through careful construction of their management team. One common variation of this approach is to allow the more entrepreneurial founder to retain primary responsibility for product development while assigning authority for operational functions to managers with a more professional orientation. A similar strategy is to provide that responsibility for various functions will be shared by two persons with different skills, experience and philosophy.

While each of these approaches is commendable for their recognition of the basic problem, the firms that are most successful in managing the change and growth process are those that are prepared to continuously evaluate and redesign the organizational structure under the direction of a strong CEO. This process should begin on the day the company is launched through the establishment of performance standards for each area within the organization. These standards will then become a part of the culture of the firm that will guide the actions and expectations of all employees as the business grows.

§23  --Strong CEO leadership

Effective change and growth requires that the company have a CEO, or other principal executive officer, who can and does exercise strong leadership and demonstrate a clear

vision regarding the direction and objectives of the company. Leadership in this context goes beyond entrepreneurial and technical talents and requires an ability to recognize and manage the key transitions that the company must make in order to grow successfully. In addition, the leader must be able to effectively communicate the vision for the company throughout the organization and define a set of core values relating to that vision that can be used to guide the actions of managers and employees in their day-to-day activities.

Research confirms that the most successful firms appear to be those where the leadership style of the senior executive is strong, yet democratic. The most effective CEOs allocate time and effort to face-to-face communications with employees at all levels of the organization. In so doing, the CEO is not only building team spirit, he or she is also collecting the information necessary to make rapid decisions based on the most information available from the activities within the company. The CEO should also have access to advice from an independent group of experience advisors. For example, the CEO may rely on the support of non-management directors, venture capitalists, specialist consultants, legal and accounting professionals or senior executives not associated with the firm that have been through the decision-making process before. The group can be used to brainstorm ideas and focus the CEO on the key factors that need to be considered in selecting from among various alternatives. The result, generally, is a quicker decision made with a higher degree of confidence and enthusiasm.

§24 — Strong and balanced management team

Strong leadership by a single individual should be tempered, yet supported, by a balanced and experienced team of other senior managers. Research indicates that the more successful companies are those that have put together a strong top management team and delegated primary responsibility for key functional strategic decisions to the relevant functional executive. In addition, successful companies have readily and easily adopted a team-oriented approach to major decisions regarding the strategy of the firm and key projects and initiatives. A strong management team also assures that the leader will not act in an autocratic manner or that key functional areas are ignored or denied access to their fair share of resources in order to make the necessary contribution to the firm.

§25 — Defining the roles of the founders and other early technical specialists

The company must be prepared to make quick, and difficult, decisions regarding the ability of members of the founding team and other early technical specialists to perform managerial functions. As discussed above, many growing companies run into problems during the growth stage when founders are unwilling to move aside for more experienced managers or talented scientists or engineers attempt to take on managerial responsibilities that are beyond their skills, experience and interest. One solution to this dilemma is establishing clearly defined director and manager positions within each of the key

43 Id.
functions and allowing directors to take the lead on defining an overall strategic plan for the function while the manager assumes operational responsibility for making sure that the plan is realistic and effectively implemented.

§26 Changes in organizational design and structure

Maturation and development of the firm inevitably leads to consideration and implementation of changes in the areas of organizational design and structure. The traditional organizational form, generally suitable for a simple and stable environment, is typically based on specialization of activities and features the use of functional departments or units. As companies grow, multiple divisions or subsidiaries may be created; however, each of them generally follows the functional alignment with respect to their internal organization. As technology has become more important to the business models of a broader range of companies firms have begun to recognize the need to integrate greater flexibility into their organizational structures in order to remain competitive and survive in increasingly turbulent market conditions. For example, in industries where the technology is evolving rapidly, engineers and new product development specialists soon realize that it is necessary to look outside the firm for new ideas and for collaborative activities. As such, relationships with external technology sources (e.g., strategic alliance partners engaged in research and development and other firms willing and able to enter into licensing arrangements) begin to break down the rigid organizational walls found in the traditional structure. Even more important has been the need to improve production processes to reduce costs and meet the requirements of customers for “just-in-time” delivery of high quality products. Companies have discovered that the best way to accomplish these objectives is to shift from a functional- to a product-based focus, which means relying on an organizational structure that follows the flow of production and which therefore requires extensive collaboration among several departments, thereby further eroding the historical separation of the engineering, manufacturing and marketing functions.

As growth continues, consideration should be given to creating discrete divisions or other business units when necessary to build accountability and provide motivation to managers and employees deployed on a distinguishable project. As the firm grows, areas of responsibility become more difficult to define and even the simplest issues take longer to resolve within an increasingly complex structure. In response, management may create divisions or business units with clear marching orders as to their goals and objectives. In so doing, the larger company has, in effect, launched a new entrepreneurial venture that can hopefully benefit from the flexibility and excitement of a small firm. However, before this strategy is used, the responsible managers must be given guidelines regarding the available resources and they must be required to create a formal plan of action that can be vetted by senior managers.

44 For detailed discussion of various topics relating to organizational design and structure, see “Organizational Design: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
§27 --Employee relations

The CEO and the other members of the senior management team with responsibility for functional activities should deliberately allocate a minimum amount of their time and resources to staying in touch with their employees. This is a critical step in navigating the growth process, which necessarily builds distance in relationships within the organization. By maintaining a “hands on” approach, the senior managers can continue to communicate their overall vision for the business and elicit information from all parts of the company. This style of interaction need not undermine development managerial and reporting channels as long as employees understand that such channels need to be respected. Of all the areas in the firm, the most important thing is for management to remain continuously involved in all aspects of the innovation process.

Another aspect of employee communications is making sure that turnover among managers and other key personnel is handled to carefully and that staffing decisions are made in a manner that recognizes the talents and contributions of early joiners and the sometimes harsh reality that new blood will be needed in order for the company to continue advancing forward. While the company must always be alert to the problems that may be caused by promoting employees into positions for which they are not qualified, many successful firms report that a substantial percentage of their senior managers rose up through the ranks. In those cases where it is necessary to recruit from outside the firm, every effort should be made to encourage friendly communication and interaction between the newcomers and those employees who have been with the company for a significant period of time.

Finally, senior management must implement programs and systems that can build and maintain organizational cohesion in the face of rapid growth. For example, training programs can be used to enhance the skills of old and new employees and communicate the vision and direction that management has set for the firm. Also, managers should be encouraged to use various methods to be sure that old and new employees, as well employees from different departments and locations, are fully integrated. Possible strategies include matrix-like organizational structures and creating project teams that are consciously staffed by representatives from several different departments or functions.

§28 --Early planning for change and growth

Planning for growth and becoming a big company should begin from the day that the firm is launched, however ridiculous that might seem at the time. This does not mean that the company should abandon its entrepreneurial instincts—it simply means that certain standards and systems should be introduced as soon as possible so that they become second nature as the company grows and operations become more complex. Examples include implementation of strict financial controls and forecasting procedures; installation of systems that can scale easily to handle growth to significant, yet reasonably attainable, levels; and engagement of outside professional advisors with experience in handling and counseling high-growth businesses. The initial systems should focus on
those areas considered to be critical to the success of the firm and management of growth, such as product planning, capital spending and expense systems.\textsuperscript{45}

\section{Improving and deepening customer relationships}

During rapid growth companies should make a concerted effort to remain in touch with their customer base and continuously elicit feedback from key customers regarding product performance, the quality of support and service and ideas that the company might use in developing new products or enhancements to existing products. The goal of this process is to improve and deepen important customer relationships to build loyalty and tap into valuable information that customers are uniquely positioned to transmit regarding the markets and technologies that are of greatest strategic significance to the company.

\section{Monitoring}

Successful managers continuously invest the time and effort required to monitor and control those activities and issues that are the most crucial to the health of the business. For the technology-based firm, this generally means establishment of comprehensive measures of product quality. In addition, systems must be created to generate real-time information regarding the operations of the firm and activities throughout the competitive environment in which the firm is operating. The necessary information goes beyond the traditional accounting data and should include qualitative assessments of key operational factors such as orders, inventories, cash flow and product returns. Careful analysis should also be made of comparable measures for competitors, as well as any material changes in their strategic plans. Monitoring is not an easy process for small technology-based firms, particularly those involved in emerging markets; however, senior management must create a roadmap that can be used to gauge the progress of the company as it begins to speed forward and this means establishing performance standards that are based, at least in part, on external benchmarks.

\section{Multiple management approach}

Carroll made an interesting argument for the use of multiple management systems by high technology firms.\textsuperscript{46} In general, such a system is based on the formation of a group of mid-level managers who are “specialized generalists” taken from all departments and functions throughout the company. The primary goal of this group is to analyze and question the systems and procedures of the firm and make recommendations for changes that will hopefully contribute to the long term growth and development of the company. The group would operate alongside, yet somewhat independent of, the firm’s regular management structure; however, the activities of the group would be taken seriously in virtue of the formal recognition and supported provided by the senior management of the firm.

company. Use of such scheme is not intended to undermine the authority of general managers but instead recognizes that they are so involved with day-to-day operations and problems that they have little time to spend on long-term planning, nor are there incentive packages designed to measure and reward their contributions to performance that may not come to fruition for a year or more.

Carroll pointed to the McCormick Company as an excellent example of some of the best features of successful use of the multiple management system. At McCormick, the size of each group, referred to as “boards,” ranged from five to 20 members and the company had a number of boards operating at any one point in time. The list of potential projects for study by the board was created from suggestions made by the members themselves or from other managers and employees of the firm; however, the boards were generally free to study anything that they wished and it was expected that all departments and functions within the firm would cooperate with any study and provide requested information. The boards meet on a regular basis, typically bi-weekly, and members work on group projects as time permits in addition to their regular jobs with the company. Boards have full support and sponsorship from top management, which receives and acts upon all recommendations made by the boards. The term of service on a board is limited in duration and vacancies are usually filled through recommendations made by current board members. The performance of board members is regularly evaluated and low performing members will be dropped prior to the end of their term.

McCormick found the recommendations of the boards to be highly useful and, in fact, most of them were accepted, approved and implemented by top management. The most successful projects tended to be those in which both the company and the project team has the greatest interest and which were most relevant to current organizational issues. The technical and problem solving skills of the team members, and their ability to sell their recommendations to top management, also had a positive contribution. In addition, the multiple management system achieved several other important objectives that were perceived to be important to the firm and its organization, notably refinement of management skills among board members, exposure of board members to personalities and organizations in other parts of the firm, and development of cooperative relationships that ultimately will enhance the performance of day-to-day operational duties. Boards were often used in divisions and subsidiaries that were acquired, since they proved to be useful in dealing with issues that might arise in the course of attempting to integrate these businesses into the different culture and operating methods of the parent company.

§32 Diversification strategies for small company growth

As the revenues and rate of growth from a company’s initial selection of products and markets begin to level off, consideration may be given to one or more diversification strategies as a way for the company to continue to evolve and perhaps transform itself into a different type of business. Several of the most commonly used diversification strategies are described below; however, there are certain conditions and risks common to any diversification attempt that should be borne in mind during the earliest stages of consideration. First of all, as a general matter a diversification strategy should be
launched with a relatively modest attempt to work with closely related products and markets, since these strategies allow the company to leverage its existing resources, knowledge and experience and reduce the risk of pursuing such a strategy. A careful and thorough analysis should be conducted to understand and properly define any supposedly closely related product or market. A critical mistake made by many companies is simply assuming, without objective justification, that their existing capabilities can be easily transferred and that the market will be easy to enter and provide sufficient opportunities to attain a competitive advantage. One or more senior managers must be identified and given the authority to lead the diversification effort. Dealing with new products and markets, regardless of how closely related they might be to existing business, is akin to launching a new business and requires attention to all of the tasks and operational challenges that arise with any start-up. Finally, diversification should not be attempted without a thorough and candid assessment of the impact that the new strategy is likely to have on the company’s existing businesses. Factors to consider are the inevitable reduction in attention to current products and markets, particularly at the senior management level, and the need to divert financial and human resources into new areas.

§33 --Product diversification

A product-based diversification strategy focuses on the development of related products that can be marketed to the company’s existing customer base. Product diversification appears to be the most commonly pursued growth strategy among small technology-based firms. When a company attempts to transition from its initial core products to a new class of products, it must be prepared to expend the time and resources necessary to establish credibility with the customers in the target area. A firm is most likely to have success with a product diversification strategy if it has developed its own proprietary core technology that can be adapted for use in multiple product areas. Accordingly, it is not surprising that product diversification is a favored strategy of companies that fit the profile of a technology specialist. A dominant sector player is also able to execute a product diversification strategy due to its resource advantages in all of the areas necessary for success, including technology, capital and marketing. Market specialists should also be able to use their knowledge and experience, and close working relationships with, a defined group of customers to identify new products that will suit their requirements.

§34 --Market diversification

A market-based diversification strategy is based on attempts by the company to sell its existing products to a new group of customers. In this context, market diversification does not include expansion into new foreign markets where the customer base has substantially the same characteristics as the company’s domestic customers. Instead, the skill set required includes the ability to learn about the specific requirements of a new group of customers and then develop new products, or adapt existing products, to meet

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their needs. The barriers to successfully implementing a market diversification strategy are substantial and go beyond product design issues to include the possibility that the company will need to radically restructure its sales and distribution methods. However, many small technology-based firms are able, because of their size and flexibility, to adapt quickly to new market segments and do well at quickly establishing strong relationships and communications with their customers in each segment. In spite of this, companies do often underestimate the advantages held by incumbents that already have substantial knowledge about the market and experience in anticipating and dealing with the problems that will be encountered by new entrants.

While market diversification can be pursued in the same geographic market in which the company is currently active, growth-oriented companies inevitably reach the point where they seriously assess new opportunities in foreign markets. Companies that have initially pursued development and supply of customized products or services to complex vertical markets are most likely to encounter difficulties in attempting to move its existing product portfolio into new geographic markets. Optimally, the new technology-based company will defer geographic expansion until it has had an opportunity to build its resource base and generate sufficient cash flow to fund the initiative. However, many companies based in the smaller European countries have little choice but to look internationally for sales at a very early stage since opportunities in their domestic market are necessarily limited. Studies done during the 1980’s indicate that small technology-based firms in the United States tended to look to Europe as their initial target for foreign expansion and that many European companies took a corresponding interest in the American market. However, there are also indications that European firms often found other parts of Europe to be more promising than the US for several reasons, notably a lower level of competition and the fact that the products were more likely to have a technical advantage in Europe than in the US.

§35 --Vertical integration

A growth strategy based on vertical integration involves taking on one or more new activities along the “value added” chain. For example, it is common for companies to take on service and support for their products, rather than contract out those activities, as a way to gain better control over communications with the customer base. Going in the opposite direction, a company may take on manufacturing of parts and components in order to protect proprietary aspects of its core technology and ensure a secure source for those items. Also, the relatively rare firm that launches as a distribution company may ultimately integrate backwards in the value chain by developing, either alone or in conjunction with other, new products that fit customer needs that may be identified in executing the core distribution business. In all cases, vertical integration should be approached with substantial caution by smaller companies since the firm is typically

For detailed discussion of the globalization process including entry into foreign markets, see “Globalization: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
embarking into functional, technical and business areas that are completely new and which may be well outside the experience and competence of the management team.

§36 --Unrelated product markets

Companies may also look to grow by both taking on new products and entering into new markets in order to exploit those new products. Realistically, this strategy makes no sense for almost all small technology-based businesses with the possible exception of technology specialists that have developed an innovative core technology with potential applications across a diverse range of product and customer markets. A company with any interest in this type of strategy is probably best advised to seek out strategic alliance partners that can shoulder some of the risks and costs and provide the company with relatively easy access to the new set of resources that will be needed in order for the desired diversification to be achieved.49

§37 --Acquisitions

Negotiated acquisitions are an accepted and common part of the diversification and change strategies of larger, well-established companies.50 In rare cases, smaller companies will also consider acquiring another company, or a significant portion of its assets, as part of a plan for implementing a growth strategy. Unfortunately, anecdotal evidence indicates that acquisitions by smaller firms are rarely successful for some or all of the following reasons:

- The target business is itself in a weak competitive position and significant management time may be needed to orchestrate a turnaround at the same time attempts are being made to integrate the target into the acquiring company’s business and culture.
- For various reasons, the acquiring company overpaid for the acquisition, generally based on unrealistic assumptions about the maturity and future profitability of the target company. As a result, significant, and often radical, changes must be made to the target’s business plan in order to generate sufficient revenues to justify the original investment.
- Senior managers and other key employees of the target company that continue with the business after the acquisition may lose their motivation if their incentives have changed as a result of the terms of the transaction.
- Serious attention may be needed to evaluating and upgrading the financial and other internal controls systems of the target business and making sure that accounting procedures in the new business are fully integrated with those used throughout the acquiring company.

49 For detailed discussion of the role and structure of strategic alliances, see “Strategic Alliances” in “Managing Growth and Change: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

50 For detailed discussion of the role and structure of negotiated acquisitions, see “Negotiated Acquisitions” in “Managing Growth and Change: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
• Steps will need to be taken to reassure, and integrate, any employees of the target company that are taking on as a result of the acquisition. In particular, these employees need to understand the purpose of the transaction, the vision for the two businesses together going forward and the role that they are expected to play in that progress. A related, but not unimportant, issue is the impact of the acquisition of existing employees of the acquiring company.

• Personality clashes may arise between the senior managers of the parties to transaction, particularly disputes over the roles of the founders and top executives of the target in the post-deal organizational structure. In addition, middle managers from both parties may run into problems due to different operating styles in addressing similar business activities, such as sales and service.

The best way to avoid, or at least minimize the impact of, most of the problems listed above is to have a management team on the acquirer side that is experienced with these types of transactions and the due diligence process that needs to be undertaken prior to consummation of the deal to be sure that the acquisition flows smoothly. In addition, resources must be set aside to work on the deal after it is done, including gathering and absorbing all the relevant knowledge regarding the target’s technology, products, markets and other resources. If this is not done, and the target is essentially left on its own to pursue its prior strategies, serious problems may quickly arise.
About the Author

This chapter was written by Alan S. Gutterman, whose prolific output of practical guidance and tools for legal and financial professionals, managers, entrepreneurs and investors has made him one of the best-selling individual authors in the global legal publishing marketplace. His cornerstone work, *Business Transactions Solution*, is an online-only product available and featured on Thomson Reuters’ Westlaw, the world’s largest legal content platform, which includes almost 200 book-length modules covering the entire lifecycle of a business. Alan has also authored or edited over 90 books on sustainable entrepreneurship, leadership and management, business law and transactions, international law and business and technology management for a number of publishers including Thomson Reuters, Practical Law, Kluwer, Aspatore, Oxford, Quorum, ABA Press, Aspen, Sweet & Maxwell, Euromoney, Business Expert Press, Harvard Business Publishing, CCH and BNA. Alan is currently a partner of GCA Law Partners LLP in Mountain View CA (www.gcalaw.com) and has extensive experience as a partner and senior counsel with internationally recognized law firms counseling small and large business enterprises in the areas of general corporate and securities matters, venture capital, mergers and acquisitions, international law and transactions, strategic business alliances, technology transfers and intellectual property, and has also held senior management positions with several technology-based businesses including service as the chief legal officer of a leading international distributor of IT products headquartered in Silicon Valley and as the chief operating officer of an emerging broadband media company. He has been an adjunct faculty member at several colleges and universities, including Berkeley Law, Golden Gate University, Hastings College of Law, Santa Clara University and the University of San Francisco, teaching classes on corporate finance, venture capital, corporate governance, Japanese business law and law and economic development. He has also launched and oversees projects relating to sustainable entrepreneurship and ageism. He received his A.B., M.B.A., and J.D. from the University of California at Berkeley, a D.B.A. from Golden Gate University, and a Ph. D. from the University of Cambridge. For more information about Alan and his activities, and the services he provides through GCA Law Partners LLP, please contact him directly at alangutterman@gmail.com, follow him on LinkedIn (https://www.linkedin.com/in/alangutterman/) and visit his website at alangutterman.com.

About the Project

The Sustainable Entrepreneurship Project (www.seproject.org) was launched by Alan Gutterman to teach and support individuals and companies, both startups and mature firms, seeking to create and build sustainable businesses based on purpose, innovation, shared value and respect for people and planet. The Project is a California nonprofit public benefit corporation with tax exempt status under section 501(c)(3) of the Internal Revenue Code dedicated to furthering and promoting sustainable entrepreneurship through education and awareness and supporting entrepreneurs in their efforts to launch and scale innovative sustainable enterprises that will have a material positive environmental or social impact on society as a whole.

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