DR. TOM MCKASKILL

ULTIMATE GROWTH STRATEGIES

A PRACTICAL GUIDE TO ENGINEER HIGH GROWTH INTO YOUR BUSINESS

High growth successful ventures stand out from the crowd. They win by doing things differently.

Any business can dramatically improve its profitability and growth prospects by moving towards the growth sweet spot.

Successful high growth ventures take a holistic view of the business. Every facet of the business is important. It is not sufficient just to have a great product or service.

Entrepreneurs by themselves don't build successful ventures. They do it in combination with their customers, suppliers, partners and employees.

While luck always plays a part in any success story, attention to detail and a deliberate strategy will greatly improve the probability of success.

"This book fills an important gap - providing clear and helpful guidance to would-be entrepreneurs. It is written in an accessible style, and the key information is supplemented by illuminating examples and questions to keep the reader focussed and interested. It offers an excellent overview and practical framework, and one that makes the size of the entrepreneurial challenge clear, and yet achievable."

Peter Sheldrake
Professor of Business Entrepreneurship
Graduate School of Business
RMIT University

"Do you want the excitement, challenge and rewards of a high growth business? This book is an invaluable, insightful, practical and structured framework for the novice and experienced business owner. Not only will I be using it in my businesses, I actively encourage my clients use the book."

Adam Hodgson
Phigit Consulting

Dr. Tom McKaskill

Global serial entrepreneur, consultant, educator and author, Dr. McKaskill has established a reputation for providing insights into how entrepreneurs start, develop and harvest their ventures. Acknowledged as the world's leading authority on exit strategies for high growth enterprises, Dr. McKaskill provides both real world experience with a professional educator's talent for explaining complex management problems that confront entrepreneurs. His talent for teaching executives and his pragmatic approach to management education has gained him a reputation as a popular speaker at conferences, workshops and seminars. His approaches to building sustainable, profitable ventures and to selling businesses at a significant premium, has gained him considerable respect within the entrepreneurial community.

Upon completing his doctorate at London Business School, Dr. McKaskill worked as a management consultant, later co-founding Pioneer Computer Systems in Northampton, UK. After being its President for 13 years, it was sold to Ross Systems Inc. During his tenure at Pioneer, the company grew from 3 to 160 people with offices in England, New Zealand and USA, raised venture capital, undertook two acquisitions and acquired over 2,000 customers. Following the sale of Pioneer to Ross Systems, Dr. McKaskill stayed with Ross for three years and then left to form another company, Distinction Software Inc. In 1997 Atlanta based Distinction raised $US 2 million in venture capital and after five years, with a staff of 30, a subsidiary in New Zealand and distributors in five countries, was sold to Peoplesoft Inc. In 1994 Dr. McKaskill started a consulting business in Kansas which was successfully sold in the following year.

After a year as visiting Professor of International Business at Georgia State University, Dr. McKaskill was appointed Professor of Entrepreneurship at the Australian Graduate School of Entrepreneurship (AGSE) in June 2001. Professor McKaskill was the Academic Director of the Master of Entrepreneurship and Innovation program at AGSE for the following 5 years. In 2006 Dr. McKaskill was appointed the Richard Pratt Chair in Entrepreneurship at AGSE. Dr. McKaskill retired from Swinburne University in February 2008.

Dr. McKaskill is the author of eight published paperback books for entrepreneurs covering such topics as new venture growth, raising venture capital, selling a business, acquisitions strategy and angel investing. He conducts workshops and seminars on these topics for entrepreneurs around the world. He has conducted workshops and seminars for educational institutions, associations, private firms and public corporations, including KPMG, St George Bank, AMP, AICD and PWC. Dr. McKaskill is a successful columnist and writer for popular business magazines and entrepreneur portals.

To assist Angel and Venture Capital investors create strategic exits for their investee firms, Dr. McKaskill conducts seminars, workshops and individual strategy sessions for the investor and their investee management teams.

Dr. McKaskill completed six e-books for worldwide distribution. He has also produced over 150 YouTube videos to assist entrepreneurs develop and exit their ventures.

Tom McKaskill is a member of the Apollo 13 Angel Group on the Gold Coast, Melbourne Angels and of the Australian Association of Angel Investors.

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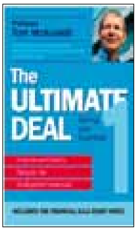

The Ultimate Deal 1 *Selling your business*

This book is aimed at those businesses which need to maximise their profit and growth opportunities in a sale to a financial buyer to leverage the best sales price. It sets out a breakthrough process which includes reducing risk, improving sustainable profits and building growth potential in the business to maximise the sales price. This world first process can increase the value of the business between two and ten times the conventional sales value of a firm.

The Ultimate Deal 2 *Get an unbelievable price*

This book uncovers the secret of how to leverage strategic value in the business to create a large revenue opportunity for a strategic buyer. Dr. McKaskill's is the world's leading authority on selling a business to a strategic buyer and sets out a comprehensive and systematic process for selling a business to a large corporation. Sales values of 40 times EBIT and/or many times revenue are highly probable using his Strategic Sale Strategy for a business with underlying strategic assets or capabilities.

Angel Investing *Wealth creation through investments in entrepreneurial ventures*

Designed to help high net worth individuals become successful Angel Investors. Angel investing involves active mentoring and coaching of an early stage management team towards sustainable profitability or additional funding, probably from a venture capital firm. This book sets out a comprehensive and rigorous process that will help the Angel generate deal flow, evaluate investment proposals and manage the investment and subsequent harvest. The book also provides a useful guide to managing operational risks in the venture.

Get A Life! *An inside view of the life of an entrepreneur - from around the world*

This book is a collection of stories from entrepreneurs around the world where they describe their work and their lives. They explain what it is like to be an entrepreneur, how they got started, the successes and failures of their ventures and the highs and lows of their personal and business lives. The stories are rich in content and provide deep insights into how entrepreneurs think. If you are an entrepreneur this will resonate with your inner being. If you are not, this will provide you with a great understanding of entrepreneurs.

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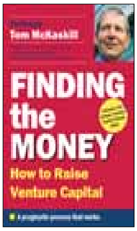
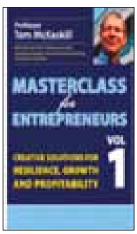


Finding the Money *How to raise venture capital*

The purpose of this book is to educate the entrepreneur on how Venture Capital firms work, what they seek in an investment and how they manage that investment through to an exit transaction. It helps the entrepreneur judge whether they have a venture suitable for VC investment and whether they wish to be part of such an activity. It lays out a comprehensive process that the entrepreneur can follow which will assist them in raising VC funding.

Winning Ventures *14 principals of high growth businesses*

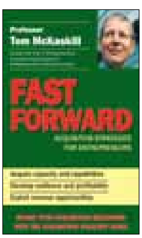
Explains the major contributors to high growth success. Includes a comprehensive Growth Check list for each principle as well as a robust Growth Potential Index to help the reader judge the growth potential of their venture. Based on established theories of growth, venture capital selection criteria and the author's personal experience, this is a must for entrepreneurs.



Masterclass for Entrepreneurs

Creative solutions for resilience, growth and profitability

This book is a collection of published articles by Dr. Tom McKaskill. This volume expands on 30 of those articles to provide a wide-ranging guide for entrepreneurs on how they can mange their businesses more effectively.



Fast Forward

Acquisition strategies for entrepreneurs

In this book, Dr. McKaskill sets out a systematic and pragmatic process for identifying, evaluating, valuing and integrating financial and strategic acquisitions. He draws extensively on his own experiences as a CPA, entrepreneur and academic, as well as his experience with acquiring and selling his own businesses. He brings a systematic and comprehensive approach to growing business through acquisitions.

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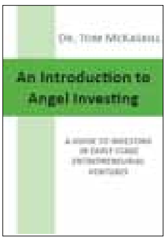
Raising Angel & Venture Capital Finance

An entrepreneur's guide to securing venture finance

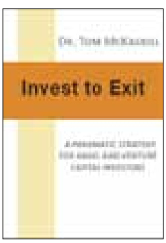
This book is aimed at those entrepreneurs who have high growth potential ventures and seek to raise finance to assist them to develop their business. To secure the finance, the entrepreneur will have to demonstrate that their business is capable of achieving a premium on exit, usually through a strategic sale. The book provides a checklist for the entrepreneur to assist in developing a strategy to raise finance.



An Introduction to Angel Investing

A guide to investing in early stage entrepreneurial ventures

Designed to help high net worth individuals become successful Angel Investors. Angel investing involves active mentoring and coaching of an early stage management team towards sustainable profitability or additional funding, probably from a venture capital firm. This book sets out a comprehensive and rigorous process which will help the Angel generate deal flow, evaluate investment proposals and manage the investment and subsequent harvest. The book also provides a useful guide to managing operational risks in the venture.



Invest to Exit

A pragmatic strategy for Angel and Venture Capital investors

Investors in early stage ventures need to focus on strategic exits if they are to achieve a high return on their investments. This book explains the characteristics of strategic value, how the investor should negotiate the investment and then how they should manage the process to a strategic trade sale. The book includes a very detailed discussion on the problems of high growth ventures, the unrealistic expectations associated with IPOs and the advantages of investing in strategic value ventures.

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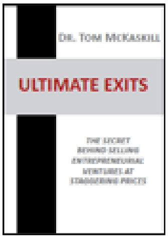

Ultimate Exits

The secret behind selling entrepreneurial ventures at staggering prices

High growth potential ventures have the opportunity to capture a premium on sale if they prepare their business for sale by reducing risk and package their business so that the buyer can readily exploit its potential. The entrepreneur should forget the EBIT multiple and historical performance and concentrate on building potential for the buyer. A financial sale exploits the revenue and profit growth within the business. A strategic sale enables the buyer to exploit an

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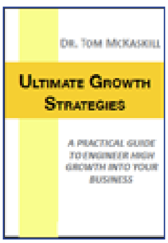

Ultimate Growth Strategies

A practical guide to engineer high growth into your business

underlying asset or capability to counter a threat or exploit a large revenue opportunity through their own organisation. High growth ventures all have a set of underlying principals which drive transaction velocity and operational management. Entrepreneurs who wish to engineer growth into their business need to incorporate these basic principals into their business. This guide steps you through each principal and offers pragmatic ways in which they can be incorporated into your business strategy.

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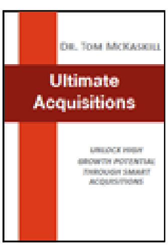

Ultimate Acquisitions

Unlock high growth potential through smart acquisitions

High growth potential ventures are often constrained by a lack of resources or distribution channels. With the right approach to the selection, evaluation, negotiation, integration and post acquisition management, acquisitions can be a very strategic way to overcoming these growth constraints. However, acquisitions need careful planning and management to be successful. This book is a very pragmatic guide to developing a successful acquisition program.

Order from www.ultimateacquisitions.com

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Table of Contents

Preface

Like a lot of entrepreneurs I have a fascination with high growth. I like reading stories of successful entrepreneurs and especially those who change the way whole industries operate. In every story I try to work out how it happened. What did they do which enabled them to get the traction to drive growth? Sometimes it seems obvious until you consider the complex operations they have to put together to maintain high rates of growth. Something more than luck is involved. While luck and timing may help, they do not provide a sustainable growth environment.

My own journey with growth ventures was more of a roller coaster ride than a smooth drive down a freeway. If I simply stated that my first business achieved a 36% compound growth rate over 13 years, it would be a fact. However, I also need to admit that is simply stating an average performance and hides the fact that some years it was over 100% and others it was negative 30%.

We started in 1979 with three people in a dining room in North London programming a system for our first customer. Unfortunately that customer went bankrupt leaving us with a lot of software code and no revenue. Then my partner turned up with an order for a system for an aero club – something none of us knew anything about, but it covered payroll for the next 12 months.

We had decided to get into manufacturing software as we saw an emerging market, especially on the new mini computers. We found a system to suit us in the USA and signed up as a distributor. With the computer manufacturer helping us find prospects, we entered a high growth phase going from the initial three partners to 35 staff in under five years. Along the way we built our own financial and distribution software package and then built another one based on some new software tools from San Diego.

In 1985 the owners of the business in San Diego agreed to sell their business to us. We raised $1.5 million in venture capital and acquired a business of 54 people which we subsequently trimmed back to 35. Our business had doubled. We now had a mixture of products in manufacturing applications and system tools and offices in Northampton and San Diego. Then disaster struck! We found major discrepancies in the accounts and ended up in the Federal Court system for five years litigating against the auditors and previous owners. The business basically stalled and did not recover again until 1990.

However, by 1990 we had produced the world's first enterprise resource planning (ERP) software package for process manufacturing, signed up 16 distributors and merged with a distributor in London, adding a further 25 people to the head count. We were on a roll again.

Our new process manufacturing system proved a winner and we started to win major accounts. However, the UK was moving towards a recession and it looked like we would end up losing our momentum and retrenching staff again. We decided to sell the business. In the middle of 1991, with 160 staff, we sold the business to Ross Systems in Atlanta.

The periods of high growth, in hindsight, started when everything came together. We had outstanding products in emerging markets with little competition and staff who knew exactly how to execute. We had very good strategic partners who enabled us to compete in large deals and we did not have to compromise on price or quality to win the business. We also had great project management systems to ensure we delivered against our commitments.

Our periods of decline occurred mostly when we had the wrong people, lost a major account, were involved in internal turmoil and politics or failed to plan ahead.

Ross Systems Inc., our acquirer, found that they had an unbeatable product and were able to fund a major thrust into the US market. Ross sold more systems in 12 months than we had in the prior five years. However, they failed to understand the complexity of the implementations and did not put the effort into recruiting and training good project managers and implementation consultants. The sales hit a brick wall when salesmen were not able to show prospects successful implementations. Ross never again experienced such a high growth rate.

In 1994 I started a new business, Distinction Software Inc. This was a software development and implementation business in the supply chain optimisation space. This market became a ‘hot’ market about two years later and we found ourselves working long hours just to keep up. We started the business with seven staff and grew to 17 by the start of 1996. We then secured $2 million dollars in venture capital and grew to 30 staff by early 1998. However, the market changed dramatically when the large software application corporations like SAP, JD Edwards, Oracle and Peoplesoft all decided to enter the market. In 1999 we sold the business for 6 times revenue to Peoplesoft.

In hindsight we did some things right and some things wrong. We certainly were in the right market at the right time with a highly differentiated product and little competition. We had a proven management team and had secured the funding to underpin the growth. But the market changed dramatically and the time was right to sell out.

One of the things I now recognise is that I had no framework against which to manage potential growth, despite being very well qualified academically in business. I was simply reacting as best I could to the pressures of the day. Yes, we did strategic planning, but it was based on where we saw the opportunities or threats. What I did not see was the whole picture. I was not sensitive to where things could go wrong along the way.

As they say, ‘If I only knew then what I know now!’

On reflection I recognize that few ventures have high growth potential by chance. You have to engineer growth into your business by having an intimate understanding of what drives growth and how to manage it. Almost without exception, a thorough analysis of the business will identify aspects of the product/market interface which have to change and systems and processes which have to be introduced to support higher growth.

In putting together the Wheel of Success for this book, I have drawn on my own personal experiences but also considerable knowledge which I have gained over the last decade in teaching entrepreneurs how to put together ventures which have high growth potential. Much of the conventional wisdom in the field comes from the venture capital industry. They have a very hardnosed and pragmatic view of where to invest their money. From the anecdotal evidence and my many conversations with venture capital partners and entrepreneurs, I now have a much better view of where and how growth occurs and what you have to do to support it.

More recently I have been involved in angel investing and have been fortunate to sit in on many meetings with investee firms and to have the opportunity of evaluating many investment proposals. It is obvious from those experiences that the 14 Principles of High Growth outlined in this book are very relevant and have allowed me to identify growth impediments in the investee firms and growth opportunities in the investment prospects.

I have spent a lot of time in recent years investigating strategic value investments and strategic exits. Without question, the 14 Principles of High Growth are a very useful tool for identifying strategic value.

I hope this book helps you to understand the growth potential your venture has and the ways in which you can improve the probability of successful and profitable growth.

I wish you every luck in your ventures.

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Acknowledgements

Much of the background for this ebook came from the paperback book which I wrote in 2006 on raising venture capital (*Finding the Money*). Thus for all those that assisted with that book, I would like to thank them for their input.

The stimulus for the earlier version of this material, the paperback book *Winning Ventures*, published in 2006, came from my then publisher Michael Wilkinson who asked me whether it would be possible to develop my ideas on entrepreneurial businesses for a wider audience. Since then I have developed the material further and assisted many entrepreneurs to implement the growth drivers outlined in this book.

My partner, Katalin Johnson, has once again had to struggle through my work, correcting my grammar, finding missing words and asking for clarification where my logic developed faster than the words managed to get through to my fingers. Her contribution is beyond words themselves.

The high growth Wheel of Success

Most businesses never gain the traction to move into the high growth phase. For many, this is a deliberate intention – the owners being quite content to keep the business small and allow it to generate an acceptable income for themselves and perhaps some family members. But others would like to grow but don't know how. High growth can occur by chance but waiting around for it to happen is hardly a proactive strategy. Basically, high growth happens by setting out to create a business which satisfies a number of key principles – fundamental attributes which support high growth successful ventures.

When I walk down most main shopping streets, I am constantly amazed at the number of shops which are closing or opening. I wonder what happened to the ones that failed. However, it isn't hard to guess what went wrong with most of them. They set up the business using the 'hope' strategy. They put a sign up and say:

I hope -

- someone walks past
- they see my sign
- they are interested enough to come inside
- they like something
- they buy
- and more will come

Is it any wonder that so many of them fail?

Restaurants have the highest first year failure rate of any business type. Many are started by chefs who want to move from the kitchen into the office – but they know little about running a business. Failure rates are also very high for tradesmen – just because they are good at what they do, they think this means they can build a business. However, a successful business is more than a good product or service. The successful business is a bit like a jigsaw puzzle, all the bits have to be in place before you can make it work properly. Any missing piece will ultimately create the seeds of failure.

Businesses which have a fundamental flaw will typically only last until the founders' investment is used up. Others with major weak spots may be able to go on for a long time but won't be able to move beyond being a small business and eventually the weak spot may be the cause of their failure if they hit a period of bad luck.

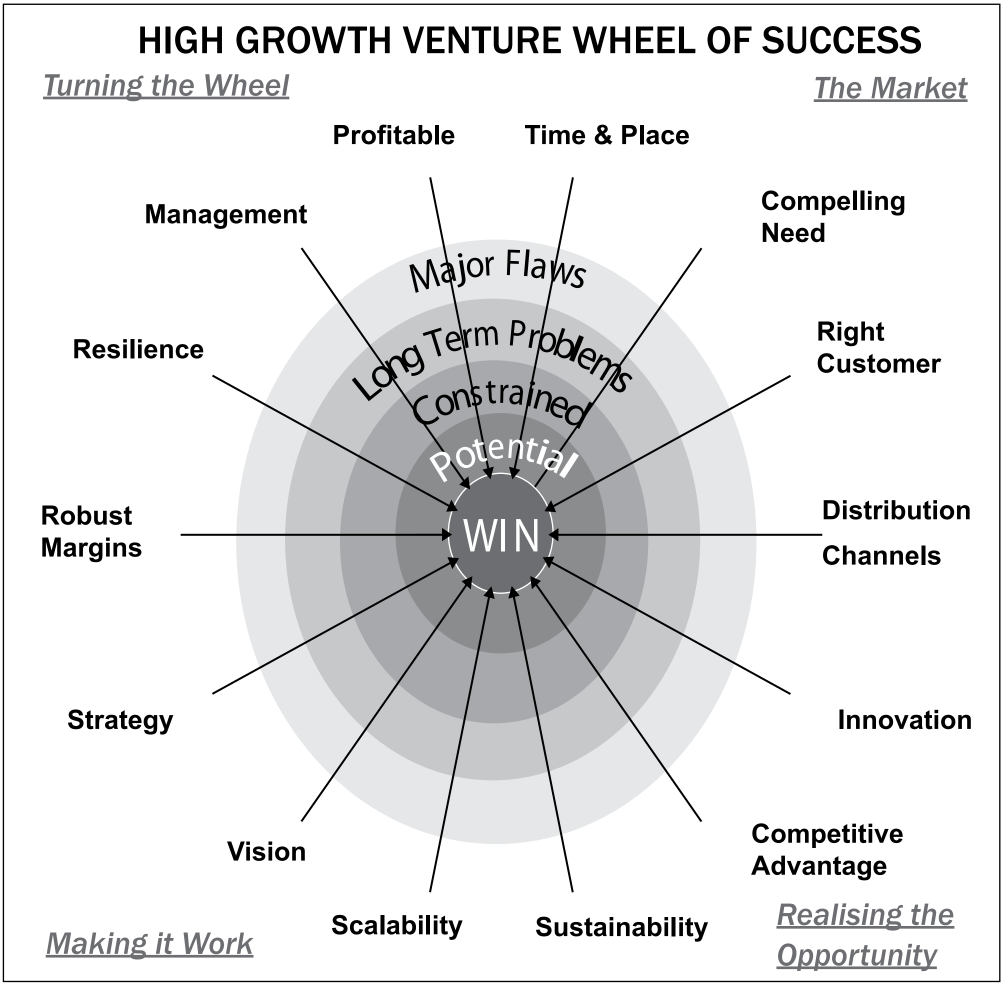
Even relatively large businesses can come unstuck if they fail to maintain the essential pillars of survival. An aggressive competitor, a change in regulations, a man- made or natural disaster or a personal crisis can all have a disruptive effect on the business and it may be sufficient to send it into a downward spiral.

Businesses which are able to maintain relatively high growth, say greater than 20% per annum, over many years are fundamentally different from the vast majority of businesses. They stand above the crowd because they aggressively create a set of conditions which drive and support continued growth and profitability. While they may not be able to keep a high rate of growth going forever, they can maintain it for a sustained period of several years.

What do they look like?

What do they do which drives the growth?

As you would expect, high growth businesses have a lot in common. It is by examining many hundreds of successful high growth businesses that we have come to understand the essential features of such ventures. Over the last 25 years, academic scholars have created a significant body of knowledge about these businesses. Some of this knowledge has been created through systematic enquiry and research but the vast bulk has been accumulated through anecdotal evidence, often from successful entrepreneurs. It is from this body of knowledge and my own personal experience of 20 years as an entrepreneur that I have developed the High Growth Venture Wheel of Success.



Successful high growth ventures are in the sweet spot at the centre of the wheel

There is no doubt that getting your hands dirty in an entrepreneurial venture teaches you a lot. Like a lot of entrepreneurs I find it easier to understand the lessons from my mistakes. Much more difficult is to understand what you did that resulted in success. Luck, good timing and being in the right place can play a significant part in any business venture – even aside from the generally held belief that we can create our own luck.

This is where the accumulated body of knowledge and the established entrepreneurship theory has much to offer. When you have access to the experience of many hundreds, if not thousands, of entrepreneurs you have a better chance of teasing out what works and what doesn't. After all, the purpose of theory is first to explain what happens in the real world. Great theory is robust and can provide predictive power. That is, it can help us predict the outcome if we take certain actions or if certain conditions apply. High growth entrepreneurial ventures all have certain principles in common.

Those fourteen principles are:

The Market

1. Right place, right time

It is not just luck. The best ventures are based on a dramatic change whether it is technology, regulations, the economy or in the way society operates. That change generated an opportunity for a new product or service, a new process or a new way of delivering an existing product or service to meet an unmet need or solve an existing problem in a much more effective manner.

2. The compelling need to buy

Business is driven by transaction revenue. The best high growth businesses solve a problem which has high urgency, high utility or resolves a strong physical or psychological need for the customer. Situations where customers have extensive choice, can delay buying, or are indifferent about buying the product or service are very difficult situations in which to drive a high growth business.

3. The right customer

While it is possible to sell to everyone, the successful high growth business typically has a very tight definition of the ideal customers and knows how to find them. The best customer is easily identified, able to be approached and is willing and able to purchase. Businesses which rely on the potential customer finding them have difficulty proactively influencing their growth.

4. Channels to market

High growth businesses develop and/or secure capacity in the necessary distribution channels which allow it to reach their target customers. This might be through a wholesale or retail distribution system, direct through a sales force or via an e-commerce facility. Without the bandwidth of the distribution channel(s) the enterprise is not able to support its growth plans.

Since many channels have pre-existing agreements, finding ways to access the appropriate channel is an essential key to successful growth.

Realising the Opportunity

5. Innovation as the driver

Innovation is the fuel of the high growth enterprise. This could be an invention, such as a new or enhanced product or service. It might be in a new way of working, such as a new manufacturing process or a different consulting technique. Lastly, it could simply be a new way of delivering an existing product or service into a market – a new business concept. Innovation either creates more value by reducing costs or by enhancing customer utility or experience.

6. A competitive advantage

Obviously the best place to be is to have no competition, however, few businesses have such a luxury and, of itself, it is no guarantee of success. High growth, however, requires that the business is able to carve out a place in the market which allows it to have some freedom around its target market. Along some dimensions of user utility and customer experience, the business needs a superior position which matches the needs of its focal market.

7. Sustainability

While the initial conditions for high growth can be created through innovation, ultimately competitors will chip away at that advantage. Only by establishing long term barriers around the business can the venture hope to secure its existing customers and ward off competitors. Sustainability requires the business to find new ways of protecting its entire supply chain as, over time, competitors will find ways of eroding any single advantage.

8. Scalability

High growth, by its nature, requires the business to solve the problem of scalability. Many businesses are constrained by the shortage of skilled staff or essential ingredients. Only by developing a robust process where the business can be expanded through scalable systems and/or processes, or be readily replicated, can the business grow rapidly over an extended period. This also means that knowledge has to be codified, decisions have to be devolved and organisational structures have to be built that will cope with the demands of such growth.

Making it Work

9. A clear vision

Knowing who you are, what you are doing and where you are going is an essential ingredient to a successful enterprise. Too many businesses fail to have a clear focus which clearly sets out where their position is in the market place. This lack of vision results in many decisions taking them in the wrong direction and away from the conditions which will drive their growth.

10. A long term strategy

Sustained growth requires the business to set out a path of product/market activities over a medium term horizon. High growth firms typically create future scenarios which they want to achieve and then develop the tactical plans to get them there. Constraints to growth then become apparent and investment can be made to overcome them. Often acquisitions are used to underpin the growth. Acquisitions can bring new products, new customers, experienced staff and new competitive advantages.

11. Robust margins

Almost without exception, high growth businesses have above industry average gross margins. This may have come from their product, process or business concept innovation or may simply have come from superior management which has enabled the business to run more effectively and efficiently than it’s competitors. However, where a competitive advantage can be created around a compelling need, especially in a growing market, prices are less sensitive and thus higher prices and better margins can be achieved.

12. Management of risk

There are always going to be bumps in the road, but sustained growth requires the management team anticipate what might go right and what might go wrong and plan for contingencies. Successful ventures mitigate their risks by involving partners, building resilience, putting in place options, shoring up their risk exposures and staying on top of events as they unfold. They undertake continual risk scenario planning so they understand the likely impact of different assumptions on their business and work to reduce the negative impact of things which might go wrong.

Turning the Wheel

13. A capable management team

No one person can do everything and, as the business grows, many specialists will be required to support the operation. Senior management of the business must collectively represent the set of skills, knowledge and experience necessary to carry the business through the growth phases. It also must be able to work as a team rather than a collection of individuals. High growth businesses are driven by entrepreneurial activity – an opportunity focus which stimulates and drives growth.

14. Profitable

Any business which is well funded can sustain a period of losses, but ultimately the business has to make a profit to survive. The basic business concept must generate a healthy return on investment for the shareholders for it to have a future, otherwise the investors would be better off selling out and putting their money somewhere else. Profitable operations over time require the business to have very good performance setting and monitoring systems, clear lines of responsibility, accountability and authority and a proactive attitude to fixing problems. The fundamental economics of the business must be able to support a long term positive cash flow.

An entrepreneur, seeking to create the conditions for high grow in their venture, needs to move along the spokes of the Wheel towards the center. Thus incremental improvements along any attribute will enhance the capacity of the venture to move into high growth.

Changes in one part of a business can have a significant impact on another part. Thus a product can be repositioned to solve a problem for a more select group of customers which has a higher compelling need and this may in turn change the way the product is sold into the market. As a result, the channels of distribution may be changed to provide more targeted positioning and the marketing campaign may be changed to focus advertising and public relations where the target audience can be influenced.

Often better targeting can uncover potential product or service innovations which can not only provide better customer value, but will result in a stronger competitive advantage. This in turn might allow the business to raise prices and generate better margins. Ultimately it leads to higher profitability.

The purpose of the High Growth Wheel of Success is also to show the interconnectedness of the key attributes of the business. A major deficiency in any one attribute will ultimately disrupt the business either through the market place or from internal mismanagement. With these essential drivers in mind, the entrepreneur can examine his or her business and start a review to see which elements need work. Being forewarned of a potential problem is a great place to start. While everything can't be fixed overnight, a plan can be put into place to work on the least desirable features of the business.

A business which cannot be fixed can always be sold. If you know that a business has a fundamental weakness, you might be better off taking what you can get for it now rather than letting it get into a situation where you lose significant value and yet still have to liquidate it or sell it in a fire sale.

High growth ventures are driven by passion and energy

Few entrepreneurs have the skills necessary to fix all the possible problems in their business. The entrepreneur who is open to learning should be prepared to take the time to become better educated in business related subjects and thus be in a better position to undertake improvements. They might also employ a business advisory consulting firm to help them but they should undertake some due diligence on them first to ensure that they have the skills and experience to assist in the areas where help is needed.

The entrepreneur might also recognise that a deficiency comes from not having the right people in the management team. Finding the right person will not only bring the right skills and experience on board but it may be a long-term method of fixing other weaknesses in the business.

Major problems are rarely fixed overnight, however, it is worth developing a plan to systematically examine the business along each of these dimensions. For many entrepreneurs, it is the insight they achieve through seeing this type of model which opens their eyes to new possibilities. Often they are simply too close to the business to see the missing bits of the puzzle. Sometimes just by being taken on the journey is sufficient for them to come up with the ideas necessary to substantially improve their businesses. The High Growth Wheel of Success will certainly do that for many potential high growth ventures.

The Growth Check List

Each Principle has an associated Growth Check List at the end of the principle chapter. This provides a way of auditing what you are doing right now. It provides a list of business attributes which should be present in a firm which is achieving sustainable growth. Not all the items will be relevant to a specific sector, since some are very manufacturing specific and other more appropriate to services business, but similar elements will exist in every business.

Clearly some attributes are more fundamental than others and you will need to prioritise them once you have ticked off the ones which are outstanding. The list is not exhaustive but represents a basic and broad set of activities which the firm should be undertaking, or factors which should be present internally or externally, to support a growth initiative.

However, before you start to invest in your growth plan, check to see if the investment is likely to pay off. While most items will certainly assist you to run a better business and that is worth considering for its own sake, it won’t necessarily guarantee you growth. For that you need to score highly on the Growth Potential Index.

The Growth Potential Index

The Growth Potential Index is a pragmatic method of measuring your potential for growth and especially for sustained growth on each of the 14 principles. At the end of each Principle explanation there is a set of descriptors to help you identify the growth potential in your business. The last chapter provides a way of interpreting the overall Growth Potential of your business. It is certainly not scientific nor has it been validated with any rigorous research methodology. However, it does have considerable real world validity. In other words – it should make sense to the business owner.

The purpose of the Index is to give you a snapshot of where your business is today on a scale of growth potential. The higher the score, the greater the support you have along that characteristic of your internal or external environment for generating growth. A low score does not mean you have no potential at all as you may have never put in any effort into examining this issue in the context of a growth objective. After a careful review, you might quickly see how your business could be changed to improve its chances of growth.

The objective of the Index is to provide a roadmap of where you need to build capability and capacity to drive growth in the business. Many aspects of the business are capable of changing where there is the will to do so and an open mind about how it might be achieved. The descriptors are general and might not be a good match to your type of business but they should provide an indication of where change should be directed.

However, achieving a top score in one attribute may not be sufficient if another attribute completely undermines the business. Regrettably they are not additive, although they do appear to be mutually supportive. Thus improvements across several may well automatically lead to improvement in others.

In the end it may come down to personal aspirations. The entrepreneur who has the desire, energy and natural entrepreneurial ability can take this review and use it to drive change. Out of those changes will come opportunities and those may well lead to the changes in the business which move it to a situation which has greater probability of success and growth.

Avoid the Major Flaws

Established firms have a huge advantage in engineering growth into their business as they usually have the resources to devote to a change project. Even if the early stage entrepreneur knew what to do, they often don't have the management slack or the financial muscle to implement the change. On the other hand, if they did have the resources to implement changes in the business, many entrepreneurs struggle with driving growth because they don't have the theoretical frameworks to know where to start. Few startup entrepreneurs go into business fully trained on business disciplines. For most, however, they are often going forward with a double hurdle, a lack of business knowledge and a lack of resources to refine the business to drive growth.

If these hurdles were not enough to inhibit growth, early stage ventures are also characterized by high levels of uncertainty due to a combination of factors:

- The product is often unproven
- The management team is inexperienced
- There are gaps in the management team
- The market is developing and yet to be established
- Competition is still uncertain with new products emerging

This many early stage ventures start with a lack of business acumen, a shortage of resources to drive change and an internal and external environment which is full of uncertainty. No wonder so many fail to grow. In order to get beyond startup the business has to first survive and secondly, develop the knowledge and resources to implement growth driver attributes. What we know from common observations is that a large number of small ventures fail to develop critical mass to enable them to grow and many fail on route. You only have to visit a shopping mall or walk in a shopping high street to see the number of shops opening and closing to wonder what determines survival. Some industries seem to have higher failure rates than others but without a comprehensive growth framework it is hard to pinpoint why one industry should have higher failure rates than others. Our understanding of growth drivers can learn a lot from what we do wrong. So why do companies fail and why is growth so hard to achieve? Let's start with an understanding of what causes early stage firms to fail. What we want to take away from this discussion is an understanding of the major flaws in business strategy and a knowledge of the major pitfalls to avoid.

Understanding the causes of failure

The major causes of business failure are now well documented and there are modelling techniques which are able to predict with considerable accuracy whether a particular business will fail. While there is no one characteristic of a business that will, by itself, cause a business to fail, a combination of weaknesses can create a situation where failure is highly likely.

Let's start with some data on failures.

Although there are definitional problems in measuring what is meant by 'failure', the data on the rate of failure is open to speculation. Even so, while 'exits' are not the same as failures, the data is enlightening. Most developed market based economies demonstrate similar patterns and so available data from Australia is typical of private enterprise size and life cycle in the major developed economies. The 1997 Australian Bureau of Statistics (ABS) report of business exits in Australia, reported that exits accounted for 8.5% of all businesses per annum (their definition of exits included cessation, liquidation, receivership, change of ownership and mergers). They report a much higher exit rate in new businesses. The ABS data provide the following rate of exits of new ventures; 18% exit after 2 years, 24% after 3 years, 35% after 5 years, 55% after 10 years and 65% after 15 years.

Several Australian and overseas studies have measured start-up failures. David A. Garvin writing in the Harvard Business Review (July 2004) in an article entitled *'What every CEO should know about creating new businesses'* states that, during the 70s and 80s, 60% of small business start-ups failed in their first 6 years. Similar studies over different periods and in different countries have found similar rates of failure. There is, however, some level of disagreement across all these different studies as to the primary causes of failure. It is thus difficult to be definitive and arrive at a simple predictive model which could be universally applied. There also appears to be distinct differences between the causes of start-up failures and failures of established businesses. Even with this reservation, it is instructive to see some of the conclusions.

David A. Garvin stated in his HBR article that start-up failures demonstrated one or more of the following problems:

Early stage ventures have relatively high rates of failure

- Customer failure (unwillingness of customers to pay for product or service, or insufficient demand)
- Technological failures (inability to deliver the promised functionality)
- Operational failures (inability to deliver at the required cost or quality levels)
- Regulatory failures (institutional barriers to doing what's desired), and
- Competitive failures (a competitor's entry changes the rules of the game).

He concluded that success rates rise substantially when a new business targets familiar customers and is staffed by people well acquainted with the market. His test of survival was being able to clearly answer the following question; "What's the pain point for customers and how does our offering overcome that pain?" I will return to this point when I discuss the underlying drivers of high growth, especially an attribute termed 'the compelling need to buy'.

In more established businesses, the consensus of opinion suggests that the primary causes of failure are; a lack of adequate funding, a failure to recruit good quality personnel, the lack of a written business plan and a failure to use professional advice. Characteristics such as being the sole founder, not having parents who own a business, a lack of prior management experience and the younger age of owners have all been found to explain venture failure in some studies but are not supported in others and thus do not seem to have general applicability.

What all these studies do show is that there are some very good predictors of failure. While individual characteristics might not be decisive, there can be no question that the more of these deficiencies a firm has, the higher the likelihood of failure.

The overwhelming evidence does show that it is possible to predict in advance that a specific business idea has a limited chance of success. Thus a market which has too few potential customers, where the customer's don't have any money, where the technology is unproven, where competition is fierce, where costs are highly uncertain or where the entry costs are prohibitive, are situations where the idea should be rejected. Opportunity screening models or 'investor ready' models and checklists used by Angels and VC investors greatly help avoid investment decisions which have low probabilities of success. Even so, market conditions can change, especially in emerging markets and thus failures often cannot be avoided.

To support growth you must build the right foundation

Given our knowledge of business failure, the more knowledgeable entrepreneurs should be able to avoid the obvious mistakes. Even so, some ventures do fall into these traps, perhaps due to unforeseen changes in market conditions. Ventures which fail end up being closed down or the business written off or put into a fire sale where the entrepreneur and founding shareholders lose most of their investment.

Smart entrepreneurs can usually avoid these basic flaws. Their risks are much more to do with aggressive growth. However, as we will see, high rates of growth are difficult to achieve. What is often forgotten in the drive for high rates of growth is that growth itself is a high risk game and is often the cause of business failure.

Achieving high growth is challenging

Private businesses which grow beyond a few employees are in the minority. Achieving a size which can generate a significant sale price is challenging. Just how challenging – check out these statistics from the ABS – similar data would exist for all major developed countries.

> As at June 2007, there were 839,938 (42%) employing businesses and 1,171,832 (58%) non-employing businesses in Australia. Thus over half the registered business had no employees.
>
> Of the employing businesses, 755,758 (90%) employed less than 20 employees. This comprised 527,445 (70%) businesses with 1-4 employees

> and 228,313 (30%) businesses with 5-19 employees. Of the larger business, there were 78,304 (9%) businesses with 20-199 employees and 5,876 (<1%) businesses with 200 or more employees.

If we assume that any reasonable chance of long term growth potential is going to need a business with over 20 employees, you can see from this data that you have a 1 in 10 chance of building a business to this size. Size of business by annual revenue shows a similar challenge.

> As at June 2007, there were 501,467 (25%) businesses with turnover between zero and $50k and 742,288 (37%) businesses with turnover from $50k to less than $200k. This was followed by 646,458 (32%) businesses with turnover from $200k to less than $2m, and 121,557 (6%) businesses with turnover above $2m per annum.

Source: Australian Bureau of Statistics 8165.0 - Counts of Australian Businesses, including Entries and Exits, Jun 2003 to Jun 2007

Growing a business to over $2 million dollars would appear to be beyond the reach of most startup ventures. To be realistic, a $2 million business is still a relatively small business. Clearly if growing a businesses was easy, there would be many more larger businesses. Since the data shows that this is not the case, it begs the question – why is growth so difficult?

If we put aside the product/market issues and just focus on the organisational hurdles to growth we can see that this alone present huge problems for the growth focused entrepreneur. The research shows that the growing business has to go through major changes as it copes with the challenges of increasing size. The business of 2-5 employees will not look the same when it has 5 times the number of employees and/or 5 times the revenue. It is almost inevitable that it will have to change the way it does business in order to manage the increased complexity of a larger business. Different stages of growth will require it to change fundamental aspects of the business. Too many businesses fail to plan for these changes and put the business at risk by trying to make major changes on the fly.

Entrepreneurs who have grown a business from a start-up will tell you of the transitions that they had to go through as the business grew. I discovered major transition points in my own business at 12, 50 and 100 staff. The business also went through a major organisational crisis when it undertook an acquisition 12,000 kilometres away.

Complexity increases dramatically with the volume of staff, customers, products and locations. In order to achieve 5 times the level of the current business, most of these size attributes will increase significantly. What is not so obvious to most entrepreneurs is that the business will need to be managed differently with each additional level of complexity.

Almost without exception, small businesses face a crisis of management as they grow. In the start up phase, the entrepreneur is able to drive the business through sheer energy, passion and vision. He or she knows everyone and the staff are motivated because they are part of the grand adventure.

As the firm adds staff, new people come into the business who were not present when the grand vision was created and their motivations and needs are likely to be different. They may see it more as a job that a mission. They have different needs and thus management styles have to change. At the same time, the growth brings with it specialization of tasks and more formal organisational structures. Reporting lines become more rigid, job descriptions become the norm rather than the exception and performance targets and monitoring is introduced. Soon there is a new layer of management between the CEO and the operations. What was once a project has now turned into a real business.

As the business grows further, communication becomes increasingly formalized as communication lines become longer. The left hand no longer knows what the right hand is doing. Customer service quality may fall as new customers no longer have the advantage of personal links with the founders. Problems escalate with the second location and daily face to face communication is not physically possible. External shareholders and/or external Directors force more transparent decision making and thus the entrepreneur can no longer make decisions on the fly. Larger numbers of staff, customers and other stakeholders now depend on the business for their livelihood.

As the business develops the entrepreneur discovers, often too late, that they have the wrong organisational structure for the more complex, larger business. They will almost always find that some of their best staff are unable to make the transition to the larger enterprise. They may lack the skill, personality, work ethic or experience to work effectively in a more complex situation.

As the business grows, the entrepreneur will also find that the data collection and reporting systems are inadequate for a more complex, larger business. The same may well apply to the distribution channels, alliance partners, manufacturing processes, professional advisors and so on.

Many entrepreneurs simply are not able to make the transition. They may not have the skills, personality, drive and energy, leadership skills, knowledge or business acumen to be effective in the growing firm. Just because a person is a natural entrepreneur does not mean they have any business training or skill. The inventor may be great at the discovery of new products but that does not make them a good business leader. Thus the person in place as the business manager may well be the source of its failure or its lack of capability to grow.

The drive, skill and experience of the CEO is only one of the many elements which have to work effectively for the business to grow successfully. The business still has to deal with getting its products, markets, distribution channels, financing, recruitment and training and many more things right to drive successful growth. Each one of these many facets can undermine growth processes.

We also know from the research into high growth businesses, the 'Gazelles', that very few businesses are able to maintain double digit growth for more than a few years. Even the best companies have difficulty managing the exponential complexity of an integrated growing business.

Let me demonstrate the high growth problem with a simple example:

> *I RECALL REVIEWING a budget projection for one of my businesses where we were examining the cost of recruitment. The recruitment cost seemed somewhat low. When I queried the underlying assumptions, I was told that it represented the cost of recruiting an additional 20 staff, a 40% growth. However, the numbers did not take into account that, of the current 50 staff, we had replaced 12 in the last year. Some had moved interstate with partners, some had gone back to full time education and a couple had taken maternity leave. In fact, we had actually only dismissed two for poor performance. Thus, instead of recruiting 20 new employees, we had to recruit 32, 64% of our current staff.*

When you look at average retention rates, you can expect some percentage of the employees to leave, not because they did not perform well, but because they have personal and family plans that might take them on another path. Thus recruitment and training in a high growth business becomes a real challenge. If you are growing at 100% and replacing 20%, you are recruiting 150% of those who are left at the end of the year. Now, add to that the resources needed for training and the impact on the productivity of the remaining staff who have to work with large numbers of new employees.

If you think that is a daunting task, work out the cost and work involved in putting in place the infrastructure needed to support them. Accommodation comes in discrete sizes, so when you run out of space you can't simply add enough space for one more person, you might only be able to acquire space in blocks able to accommodate 10 or 20 staff.

> *AT ONE STAGE I ended up with three separate offices in Northampton in England as we kept growing out of space. Since I could not predict the growth further than about 6 months ahead, I was not prepared to invest in too much extra space, thus I ended up in a completely sub-optimal spread of staff with people in three separate offices around the town. I had the same problem with the phone system. It came in discrete sizes, up to 12, 64 or 128 extensions. However, when you moved up to the next system, all your investment in the prior system was wasted and you started again. Other infrastructure costs include computers, desks, meeting rooms, storage space and so on.*

When firms grow quickly they have great difficulty managing the basic operations. Quality often suffers as firms grow quickly. Staff are recruited too quickly, job descriptions are loose, reporting lines are blurred, performance metrics are ill conceived and systems for dealing with complaints are poorly established. IT systems take a long time to choose, implement and bed down. People simply haven't the time to figure out how to work together. Often one part of the business does not know what another part is doing.

By far the biggest problem is financing the growth. Very few businesses are able to fund growth through internally generated funds. When you consider the costs which are incurred in recruitment, training, accommodation, computers and supervision, few firms generate the level of profit margins that can cope with more than a 15% growth rate. For most fast growth firms, external funding is an imperative. Even if some of the investment is in equipment, inventory and buildings, only a portion of that investment is going to be covered by traditional asset financing. What can't be covered by internally generated funds has to be sourced from public or private investors. That activity will also take senior executive time away from running the business. Cash management is probably the most critical activity for the high growth emerging firm.

These factors not only make it hard to sustain growth but the constant changes being forced on the organization sow the seeds of failure. Not a lot has to go wrong with such a finely tuned engine for it to collapse or get into serious trouble. Most will recover, but they will lose a lot of the gains made in prior years. Others will not be able to turn the ship around in time and will end up insolvent, unable to raise debt to fund operations or will have lost key customers and employees during the disruption.

What is the probability of success?

I would think there are very few entrepreneurs who would not desire their venture to grow to at least $2 million in revenue and yet we can see from the ABS data that only 6% of all private businesses exceed this threshold. I would also expect that any entrepreneur would want to create a new venture which would generate employment numbers exceeding 20 and yet only 10% of all businesses in Australia in the 2007 ABS report exceeded this number.

We can see from the prior explanation that there are significant challenges in growing the business and no doubt this is the underlying reason for such results. Another way of looking at this problem is to see it from a predictive approach. If we know that there are certain characteristics which have to be present for success, it is possible for us to rate any venture in each of these elements and then calculate the overall chance of success. The venture capital sector has been using this technique for decades to decide when to invest. However, even the best rated ventures are still problematic.

The VC sector has a focus on high growth potential ventures and, over time, has come to identify certain attributes which give rise to higher chances of a successful return on the VC investment. If, however, you need a number of attributes of the venture to be present concurrently and each one has some limited probability chance of being successfully attained, the combined score can be relatively low. Thus even a good venture which scores highly across a number of attributes can still be problematic in terms of its overall chances of success. When we see the probability of success in these terms, we can understand the level of complexity that must be managed in order to achieve success.

You can see in the table below just how difficult success is when you take this combined attribute approach.

Individual Event	Probability
Company has sufficient capital	80%
Management is capable and focused	80%
Product development goes as planned	80%
Competitors behave as expected	80%
Production and component sourcing goes as planned	80%
Customers want product	80%
Pricing is forecast correctly	80%
Patents are issued and are enforceable	80%
Combined probability of success	***17%***

Source: Article published in Harvard Business Review November - December 1998

This specific model was developed to explain VC investments where the investment is typically made when the business has already developed some traction in the market. Most VC investments are at the market expansion stage where products are already proven and a management team substantially in place, thus we would expect these ventures to have lower risks than early stage ventures.

With this insight, I have restated the earlier table but used the 14 principles from the High Growth Wheel of Success as the elements to estimate the probability of growth success. Emerging businesses have to establish many of the attributes which a more established business can take for granted. The early stage venture has more challenges to overcome, setting up a management team, establishing distribution channels, building a stable innovation capability and so on. Thus the number of hurdles to overcome increases and thus the probability of success, or even survival, is much lower.

In this next example, using the 14 principals of high growth, each of the important characteristics had a relatively high score – but look at the combined outcome.

Individual Event	**Probability**
Right place, right time	80%
The compelling need to buy	80%
The right customer	80%
Channels to market	80%
Innovation as the driver	80%
A Competitive advantage	80%
Sustainability	80%
Scalability	80%
A clear vision	80%
A long term strategy	80%
Robust margins	80%
Management of risk	80%
A capable management team	80%
Profitable	80%
Combined probability of success	***4%***

Under this scenario, even if you did everything reasonably well at 80% of excellent, you would only have a 4% chance of achieving high growth. This result lines up well with the earlier data from the ABS on firm size where only 6% of all businesses had revenue exceeding $2 million. At 90% on each of these elements, the success rate jumps to 22%, but for that to occur, the venture would have to be exceptional across a wide range of attributes. You can see from this model that one weakness, say at 40%, can substantially undermine the outcome.

From what we can see from the ABS data, the VC success model and my own 14 principles is that high growth is a challenge and few enterprises will establish the capabilities and capacity to reach reasonable levels of revenue and profit.

Where to From Here?

My own experience over several ventures has shown me that growth can be elusive. My first business, Pioneer Computer Group, grew from 3 partners working in a dining room to 160 employees over three continents 12 years later, a compound growth rate of 36%. However, during the early years, we were close to insolvency several times. This was a classic case of feast or famine due to the size and timing of large deals. During the middle years our business was disrupted by litigation which we brought against the prior owners of our subsidiary in the USA. Just before we sold out, we were faced with a significant decline in revenue and profit as the UK went into recession. Some years we would grow dramatically and in others we would go backwards. But recall that this business was still able to raise US$1.5 million for a 20% stake as it was seen by the investors as a successful business model.

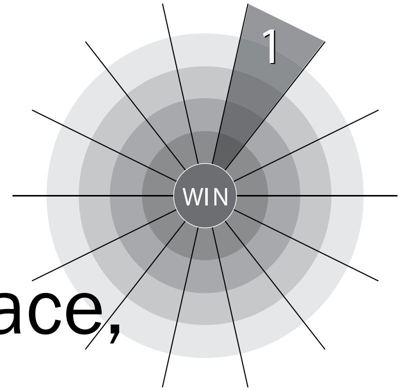
In the case of my last business, Distinction Software, we also raised venture capital. In that case, $2 million for 20% equity. That business seemed to have all the attributes necessary to assure success. The business was staffed by very experienced managers and employees. It sold back into a known niche market. The product suite had a very rapid payback for the customers. Basically, it looked like a very good VC investment. However, sales were slow because customers could do without the product – a low compelling need to buy. In the end, the business went into severe decline when new competitors entered the market.

It is impossible to foresee everything which can go wrong, however, with a better growth framework, we can avoid some of the worst mistakes and hopefully engineer our ventures to give them a greater chance of driving growth in a sustainable manner.

My personal experience suggests that you cannot fix most of the fundamentals of a business. If you have the wrong product or the wrong market it is doubtful that you can fix it later on. However, if the market characteristics are right for growth, a lot of the execution issues can be dramatically improved with good people, good advice and good internal monitoring and governance systems.

Without exception, high exit values and thus significant rewards to the entrepreneur and founding shareholders and investors are created when growth potential is a dominant characteristic of the venture. But as we have seen, ventures which pursue high growth are more likely to fail than succeed and more likely to stall than sustain long term growth. Only the exceptional venture has the characteristics to get to a size which allows an IPO or a good EBIT based trade sale.

From my own observations, entrepreneurs fail to build the solid foundation for growth. What is required is both a comprehensive understanding of growth attributes but also the willingness to change direction to implement the necessary foundation components so that growth has a better chance to develop. The rest of this book sets out the 14 principals of high growth enterprises in a manner which allows the entrepreneur to systematically review their own business and to develop a growth strategy.



Finding the right place, right time

Ventures which succeed in achieving high growth rates are always created and/or supported by a significant environmental change usually soon after the change has occurred or when it has reached critical mass. That is, something has happened in technology, the political environment, consumer values or in the economy which has created a gap or need. High growth businesses are created or changed to satisfy an immediate or emerging need in the community usually at a time when there is an inadequate supply of solutions to meet that need.

Simply put, high growth occurs because there is an emerging need which cannot be satisfied by existing businesses. This gap creates a vacuum which the new or existing firm recognises and they provide a solution quicker than others. As demand outstrips supply, there is less pressure from competitors and some consumer forgiveness around quality and product features. Emerging markets, as they grow, tend to fragment and this gives the emerging business time to carve out and protect a niche in the market. By the time industry generally has caught on to the new market demand, the early entrants have had an opportunity to build scale and put up their own protective barriers.

Thus entering a market at the right time is critical to gaining traction, seizing market share and setting up protection from competitors. Most changes which drive growth activity are external to the business. Changes in legislation, consumer values or in the economy are changes which the business reacts to rather than drives. Changes in technology may be initiated by the firm or be accessed by the firm if developed elsewhere. The smart business is the one which sees the change or recognises the opportunity inherent in the change before others.

Changes in and of themselves do not necessarily lead to growth opportunities. The change needs to be significant enough, or to have a sufficient near term potential, to result in a reasonable market size which can generate enough business activity to justify business investment. The change needs, in most cases, to be disruptive. That is, it needs to have the potential to make existing solutions redundant or to create new problems which have previously not had much attention. The change also needs to be associated with a consumer or commercial need which is sufficiently compelling that enough consumers will be willing to pay to satisfy the new demand.

Changes in legislation or in local, regional, national or international regulations or standards drive considerable business activity. Most often regulations change the status quo and require individuals or companies to behave differently. The change is often associated with compliance and this in turn spawns a need for education, training, monitoring or auditing, new methods, processes or equipment. Compliance situations usually have penalties for failure to comply, such as fines or prison sentences, thus the pressure on consumers and commmercial organisations to buy is high.

Timing is not everything, but it sure helps

Recent changes in international accounting standards have created a high demand for accounting services. This in turn has put pressure on educational institutions to increase the number of graduates. There is a demand for new textbooks as a result of the new standards. Reporting systems have to be changed and that has put more demand on the applications software industry. When you examine the source of this new demand you can see it goes back to changes in global business. Large international corporations have been frustrated with having to comply with multiple reporting standards in different countries resulting in significant duplication of work as they first report locally for a subsidiary and then have to redefine the financial information to report to Head Office. This in turn came about because global commerce had been stimulated by world wide free trade agreements and advances through the international trade treaty agreements. Business growth is stimulated by such changes.

Changes in environmental legislation, especially around chemical usage and disposal, result in current equipment and processes being outdated thus driving new equipment design and sales. Changes in occupational health and safety legislation drive education and auditing activities. Changes in housing and building regulations drive changes in education, equipment, building methods and materials.

While many changes in legislation are announced in advance, few people actively prepare for the change, usually leaving it to the last minute. Thus the business which can foresee the impact of such changes and can develop programs, products or processes to assist companies and consumers meet the new demands are often in a very good position to capture the new market space. If this can be done using protected products or processes, then good luck to them!

Other changes in our economy and our society happen gradually but, over time, can dramatically change our social situation. Thus waves of immigrants into our communities as a result of wars, natural disasters, terrorist activities and disruptive civil unrest gradually change the mix of cultures, religions and values. With these changes come demands for such things as new forms of food, entertainment and travel. Other changes occur through population shifts and population aging. The changing nature of industry through globalisation, technological developments and new discoveries results in the decline of some sectors and the rise of others.

Trends over time can identify future problems. Thus an increasing population without a parallel increase in infrastructure spending will gradually create a supply shortage of water, electricity, hospitals, roads, airports and so on. A gradual ageing of the population will result in increasing demand for leisure activities for retired persons, more demand for retirement living facilities and pressure on aged care capacity.

Changing community values will result in new forms of expenditure, often by local and national governments. Thus the increasing risk of terrorism has dramatically increased the expenditure on security. This in turn has led to a burst of R&D activity in security devices and security systems.

One trend by itself can often lead to many products and services looking for new opportunities. However, niche markets are often best discovered where two or more trends converge or separate. Thus increasing demand for housing combined with new regulations on energy efficiency creates demand for materials which are more energy efficient. An ageing population combined with a trend towards fitness creates a demand for personal fitness coaching. Now combine this with increasing litigation and we can see a need for a new set of standards for fitness training for the elderly and thus new educational products.

Changes in technology, the discovery of new knowledge, or the creation of new processes or business models can have a dramatic impact on a marketplace. New technology often solves problems which were previously not able to be addressed or can significantly enhance productivity or reduce costs in solving existing problems. While there is always incremental innovation in products and services, radical innovation can dramatically affect an entire industry.

Radical innovations have one or more of the following features:

- They reduce costs significantly (say 30% or more)
- They significantly enhance a key feature of a product (reduction in size, increase in capacity, improvements in performance)
- They introduce a major new feature (wireless, automatic, portability, etc.)

Radical innovations often replace existing products (DVD for video tapes), create new industries (internet commerce) and decimate existing ones (cars replacing carriages). Such innovations are infrequent but can have major long-term effects on industries, jobs and economies. Look at the impact of computer inventions on the USA economy.

A new business concept can itself have a major impact on an economic sector. This was the case with hub and spoke air travel, shuttle flights, low cost airlines, airline alliances and holiday packages on the travel industry. The planes were the same and the purpose was the same, moving people by air, but these changes dramatically changed the way in which the industry operated. Thus new ways of doing business, often combined with advances in technology, can replace existing suppliers, create new demand and severely disrupt an industry.

Trends over time can identify future problems

When you examine high growth businesses, you can see that they all have their roots in one or more of these changes. Their markets are typically characterised by rapidly expanding demand but lack supply capacity to meet that demand. They are often to be found in new emerging markets based around new technology or new knowledge and they are often providing a solution to a problem which hitherto was not able to be solved effectively or as economically.

Their products or services are typically sold into a global market so that local population size is not a barrier to growth. The growth of the overall market also allows them to readily access either venture capital funding or public funding to fuel the development of their businesses. Most growth businesses are established early in product (or market) lifecycles. At this point the market is still reacting to the emerging product or service and the business is making sales which have the highest need, or are the least resistance, ie. the 'low hanging fruit'. A large potential market where new products and services can find a reasonable size niche market is most often associated with rapid growth firms. This is partly because it is easier for new entrants to find an untapped source of demand but also because early entrants can diversify their products into versions that better fit specialist niche segments, but in doing so can still gain good margins. As markets become more mature, more competitors move into the market, the easy sales are less frequent, it takes more marketing spend to gain marginal sales and markets get fragmented into smaller specialist niches.

Safety features which save lives will find a ready market

With a growing or emerging market there is also less pressure on the firm to operate perfectly. They can afford to make some mistakes and to use some resources working out just how the market will develop. Where demand exceeds supply, prices are not sensitive to competition and each firm can find enough business not to have to fight on price.

Another type of market which can provide significant market potential is the replacement market for existing products where the new firm has a protected product which can significantly improve consumer utility through new features or a dramatic decrease in cost. This type of business relies on consumers turning over existing expired products to the new better one when they come up for replacement. The potential size of the replacement market and the rate of potential sales can be readily estimated in advance making this a very attractive proposition.

There is always a growth market in solving a persistent problem which wastes significant resources, whether public or private. Thus new safety features which save lives or new processes which reduce pollution and so on, will find a ready audience.

Most businesses are based on satisfying conventional demand where the market is saturated and mature. They sell commodity type products or products or services which have little differentiation. Thus they struggle to gain market share. Businesses based on recent technology or recent changes in legislation will generally have better growth results where demand exceeds supply. To the extent they can differentiate themselves from their competitors, they can gain traction and growth. However, most businesses can move into the high growth area by shifting the business into a growth potential strategy. This requires the entrepreneur to identify the current growth drivers in their current operations in order to exploit the underlying potential. Next, the business owners need to uncover those current or potential growth drivers within their industry. Once the future growth drivers are identified, the business needs to construct a plan to transition the business towards those areas where higher growth can be achieved.

Growth Check List

Legislation/Regulations

- What legislation has been enacted or is about to be enacted which will require your customers to make investments to change the way they do business?
- What recent legislation or proposed legislation are you able to leverage to create business opportunities with your current products or services, or with adaptations of your current products or services?
- What recent changes have you made to your own business as a result of recent or proposed legislation using internal skills and resources which you could turn into a product or service to sell?
- What problems do you see having to resolve in your business in the near future which could be the basis of a new avenue of sales?

Technology

- What recent developments in technology have you made which solve an existing problem and could be better exploited?

Trends

- What trends are occurring in your market place which will create a supply shortage? Are you able to provide new products or services to assist resolving the shortage?
- What niche markets are developing in your sector where you might be able to provide products or services?

Personal Insight

When I first went into business, the market for mini computers was just starting to have an impact on the small and medium enterprise market (SME). We now had enough disc capacity to store all the transactions for a small business and there was enough memory and computing power to support the business calculations. Finally multi-user networks were being introduced which allowed the business to link together several parts of the business. An entirely new market had opened up in the SME sector which previously had been denied.

The overall market was huge but uneducated. While large corporations had become used to mainframe computing, the SME market was still using book-keeping ledger machines and local professional bookkeeping services. The user interfaces of the emerging min-computers were decidedly unfriendly and the systems took an excessive amount of training and support to be effective. Even so, these changes spawned hundreds of new companies in the emerging enterprise application software industry.

Growth Potential Index

1. The business is in a mature, stagnant or declining market. There are no current changes or problems that we can identify which will generate growth.

2. The business is in a mature market or emerging but limited market. There are changes that appear to support growth but these are not dramatic. Existing solutions are acceptable. No major changes are anticipated.

3. The business is in a growing market with relatively stable suppliers. There are clear indications of potential changes in technology/regulations/consumer needs and the business will be able to participate in that growth.

4. The business is in a rapidly growing market where changes in technology/regulations and/or consumer demands are obvious. New niche markets are emerging constantly. The business has the capability to participate in such growth but has no active plan to seek out the best opportunities.

5. The current market has high volatility due to constant changes in technology/regulation and/or consumer demands. The business aggressively seeks out opportunities in these changes and develops products and/or services to participate.

Finding the compelling need to buy

Achieving high growth is mostly about gaining momentum in the chosen market. Think of this as a freeway. You are really looking for a smooth uninterrupted path. You either want an empty lane or one where the traffic is travelling at an even pace. You will notice that when traffic is interrupted, it starts to backup and ultimately creates a roadblock, often with no obvious reason. The same thing can happen to growth momentum. If it slows down, resistance builds up along the supply chain which ultimately results in bottle necks and disruptions, which in turn stalls growth.

The greatest source of friction in the growth curve is the decision-making process of the target customer. To the extent that the prospect can choose not to buy, choose to delay the purchase or choose alternative products, the growth rate will be sporadic and slow. Where external events such as economic cycles, man made and natural disasters and business interruptions impact the willingness to proceed to buy, the rate of sales will be unpredictable and the momentum needed to support growth investment will be lost.

When a product or service is being offered for sale, it has a value proposition to the customer. The value proposition can be composed of many elements of which utility is the one most people focus on but this may not be the one which triggers a specific purchase. In the case where there are close alternatives, other factors such as design, smell, taste, image, ease of purchase, risk in use, after sales help, environmental impact, an association with causes or celebrities, availability, warranties and so on, can influence the purchase.

Few people understand just how hard it is to build a value proposition which compels a customer to buy. Most products are chosen on a whim, can be readily deferred or have many alternatives and substitutes.

Think about these questions:

- What problem are you solving? How important is it that the customer solves that problem?
- Are you satisfying a need or a desire?
- What degree of compliance (penalty or cost) results from not buying?
- What happens if the customer does not buy?
- What alternative to your product or service could they buy?
- Who is required to solve the problem? What happens if they don't?

Clearly the most desirable position for any firm to be in is for their product to be needed desperately by a set of customers. This does not mean something they desire or would like to have, or even something they want to have. This refers to something they must have and, better still, must have now! You might well argue that few products can ever be so compelling but, in fact, many basic products would fit that need. Each person has a need for food and water, basic accommodation and security. Without electricity, water and sewage services, life in built up areas would be impossible. This is possibly the major reason why these services were initially provided by state owned enterprises and are often regulated. Food is of course satisfying a basic need although there are many alternatives. But the compelling need is still there.

Some conditions do create compelling needs. Virtually all regulations have compliance requirements and associated penalties for non-compliance. Thus a product or service which stops you from being fined or going to jail has a high compelling need to buy. Products and services which neutralise or reduce physical or psychological pain and suffering easily fall into the class of products which have a compelling need to buy.

Potential customers are not always aware that they have a need for a specific product. Many products come onto the market through the use of fear marketing. For example, they inform you of the millions of bacteria lurking on your tongue or millions of germs hiding in your toilet. Having now made you aware of the danger to your health, they immediately offer to solve the problem with their latest product – which of course will kill all those nasty bugs.

Within the software industry we had the FUD factor (fear, uncertainty and doubt). The sales pitch was to show the customer how much money they were losing by not solving a specific problem and then of course offer the solution. The best products of course uncovered a long forgotten regulation which had severe penalties for non-compliance. My favorite software sector was always payroll as the penalties and disruptions for not getting it right were severe.

It is very difficult to gain growth momentum if the problem you are solving is not serious enough to justify immediate attention. To the extent the customer is willing to live with the problem or is willing to delay solving the problem, the sales pressure is severely weakened. This was the case in the applications software industry. Basically the essential processes were being supported with basic transactions software. However, when value added tax was introduced, these systems all had to be replaced. The customer had no choice but to upgrade or to purchase a new system.

Some conditions do create compelling needs

Products which have many close substitutes have real problems creating sales pressure. Almost all basic food and beverage products exist within this class. There are simply countless products on offer to satisfy basic food and drink needs. In these markets, the sales message has to move beyond utility to appeal to other factors of value creation. Alternatively, the vendors need to package the product for a specific market – non-spill, high energy, lactose free, etc. The marketing objective has to identify a market with a higher need and to move away from markets with alternative or substitute products.

For many businesses, the task is not to drop the product, it is to find the right customer. In many situations you have a product looking for the right problem to solve. The task of the producer is to find the customer with the most compelling need where the product or service will be truly appreciated. The ideal situation is also where there are no alternatives and no close substitutes. With a high compelling need, the decision time is normally greatly reduced, the sale is not sensitive to price and the customer will be willing to refer you to others with the same need.

New technologies often find themselves in a situation where they can be used to develop products to solve serious problems which have not been able to be addressed previously. This is one of the reasons why breakthrough inventions are often found in high growth firms. What you have is pent up demand, no alternatives, a compelling need and short decision times. Many biotechnology discoveries have spawned global products by solving medical problems which have defied medical science for generations. At the time of discovery, they are normally the only solution available. With such a background, high growth rates are almost guaranteed.

What if you have a product which has a low compelling need, how can you change the situation? Basically you need to strengthen the need. Clearly the need is not in the utility or funcionality of the product itself, therefore the value or need has to be built around its intrinsic value. This is the marketplace of designer brands and intangible value creation. With designer brands you create need through an association with an image of self or with high profile celebrities. Need can be associated with self image, ego, peer group pressure, a need to 'belong' or a need to be admired, respected or envied by being in possession of a specific brand. In industrial products or services, the need might be satisfied through an association with an admired and/or leading business customer or through being an 'approved' supplier of choice to a much admired corporation.

INtangible value is associated with elements of customer preferences beyond the functionality of the product or service. This is where companies use smart design, colours, styles, taste, smell, tactile feel and so on. While these are harder to assess, customer feedback can assit to identify those which have greater customer preference.

Multiple products can be pulled into a sale by being complementary to a product which solves a compelling need. The sale opportunity is created by having one component of the sale satisfy a compelling need, but the sale process itself takes the opportunity of presenting other complementary products. Thus an applications software vendor might open the door with a payroll, tax reporting or OH&S reporting system but sell an entire system on the back of it. Consulting firms have compliance audit services which gain them access to clients and then sell general consulting services in cross sell opportunities.

A compelling need reduces the costs of selling as there is little selling effort required. This in turn helps create higher velocity in the business. However, where there are close competitors, this advantage can be readily lost and deals will ultimately be won on lowest price. The ideal position to be in for any business is to have a product which satisfies a compelling need in a medium to large growing market, has no close competitors and is able to protect its competitive advantage for some length of time.

Growth Check List

- How important is it that the target customer solves the problem you have identified?
- How readily is the customer willing to defer the purchase?
- What alternative products or services can the customer purchase to solve the same problem?
- What is the impact on the customer if they don't buy?
- Are there penalties for delay or non-purchase?
- Will the customer suffer mentally or physically by delaying or not purchasing?
- Will the problem get worse during the period of non-purchase?
- How well does the customer understand the impact of non-purchase?
- Can the effect of non-purchase be measured in terms of future expense, lost revenue, penalties or disruption?
- Is there a shortage of supply?
- Is demand increasing relative to available supply?
- Are there local, regional, state or national regulations which are violated through non-purchase?
- How important is image or status in having the product or using the service?
- Can celebrity endorsement increase the value of the product?

Personal Insight

In the first few years after I had developed the strategic sale process, I had been facilitating workshops on how to sell a privately held company to a strategic buyer – usually a large corporation. These workshops had mostly been attended by members of the Young Entrepreneurs Organization. However, even though the workshops were subsidised by a major sponsor, not all members in the local chapter would attend on the day. For many the sale of their business was somewhere in the distant future and they had more pressing problems to attend to. Those who did attend loved the workshop and recognised that selling the business is mostly about preparation – you can't always determine when you might have to sell.

I was somewhat frustrated at the attendance, although with a worldwide market I could certainly keep busy. However, I recognised that the problem was that the need was not compelling enough. What I needed to do was to find a customer who had an acknowledged and strong need to achieve a high value exit. My work with venture capital firms finally led me to the right customer – the venture capital firm themselves and their investee firms. An exit is a critical objective of the investment. Generally a VC wants to exit within three to five years of the investment. So now I have a clearly identified customer with a compelling need to buy.

Growth Potential Index

1. The product or service has many competitive and substitute offerings and is highly discretionary or optional. Customers regard the purchase as a nice to have rather than a must have.
2. The product satisfies a clear customer desire but it is neither urgent nor pressing and can be satisfied by a large number of alternative solutions or products. Customers can decide not to buy without being overly concerned.
3. There is a clear need but satisfying the need can be deferred as it is not an urgent need to satisfy. Customers have a strong preference to purchase and would be concerned if they were not able to. There are some near acceptable alternatives.
4. The need is obvious and of high value to the customer but may be temporarily deferred or can be partly satisfied by poor alternatives. Customers have a strong desire to purchase and would be seriously concerned by deferring the purchase.
5. There is a compelling need to purchase either to avoid high physical or psychological pain or to avoid severe penalties or costs or, in the case of corporate purchases, to obtain/maintain a competitive advantage. Deferment is not really an option, nor are there any substitute solutions.

Personal Insight

At Distinction Software Inc. a business we started in Atlanta in 1996, we developed a sales forecasting and inventory planning system for high volume, low cost consumer packaged goods. Using prospect data, the software could show a 15 – 30% reduction in safety stock over a three month period providing an investment payback of three to six months on the software cost. Even though many corporations expressed interest, few made the investment. Why?

After five years it became apparent that only corporations which had deep seated inventory problems were willing to make the organisational and system changes to implement the software. For the others, their profitability was high enough that the changes required to implement the software was simply 'too hard'. For the software to work effectively, the customer needed to change job responsibilities, reporting lines and data ownership. The 'compelling need to buy' only existed in a few corporations. For the others, it was a desirable, but not a necessary, thing to do.

Targeting the right customer

Successful high growth businesses have a very clear definition of their target customer. They know exactly what problem they are solving and they know how and where to deliver a sales message to the customer in a way which will create a positive situation for closing a sale. Above all else, the sales process is proactive. They go out and touch the target customer; they don't wait for them to find out about the firm and its products or to come and find them to buy the product. They provide a solution to a job which the customer wants done.

You see businesses all the time which reach out to the general public in the hope they will buy. A retail store, a restaurant and the internet marketing firm are all hoping they can attract customers. But they have little influence over the buying cycle. When I walk down most main shopping streets I am constantly amazed at the number of shops which are closing or opening. I wonder what happened to the ones that failed? However it isn't hard to guess what went wrong with most of them. They set up the business using the 'hope' strategy.

They put up a sign or develop a web site and then think:

'I hope people bother to stop and read about my products. I hope they are interested enough to enquire and I hope that they have enough money and are willing to do so. Then I hope they will tell all their friends.'

This does not create a high growth business. The high growth business targets a specific customer who has a problem which they can solve. The customer is either publicly identified by name and address, such as a corporation, a professional service provider, is available through a mailing list or is a member of a club or association which is willing to support a marketing approach to its members. The size of the market that is being addressed is sufficient to provide the growth projections of the firm for some years to come.

Alternatively, the customer can be readily reached through an established, or readily built, distribution channel. This might be through a subscription magazine, a credit card member directory, a specific specialty store or a web site targeted at a very specific group. The aim of the firm is to gain easy access to the specific customer who has a high likelihood of having the problem that is being addressed by the firm's products or services.

In order to generate the growth rate needed, the firm must be able to project the rate of sales of its product or services. To the extent that it can estimate the number of potential customers it can reach with its sales message, it has a much better chance of estimating its sales closure rate. The marketing program needs to have a very good estimate of the number of potential customers hearing its message in order to be able to estimate potential customers. With a tight customer profile, a readily identified method of reaching them individually and a clear understanding of the sales triggers, a proactive approach can be mounted to generate the level of sales activity the firm can support.

In a room of sleeping people, pick the ones who are left-handed

The more successful firms solve a very specific problem which has a compelling need to be resolved. Where these problems are owned by highly targeted and readily identified customers who are able and willing to pay a reasonable price to satisfy the need, the firm has a much easier marketing problem. Highly specific problems also normally have readily obvious decision processes which the firm can work with. Thus specific information can be provided which can demonstrate how the product or service can readily solve the problem.

A great number of businesses target 16 – 25 year olds, time poor executives, free thinkers or people with a desire to feel young at heart. The problem with this type of approach is that it is difficult to be proactive, to actually reach out and connect directly with your target customer. These businesses are highly dependent on the passing traffic for business. They typically advertise to the general public through newspapers, popular journals and TV. But they can't be sure they are getting to their intended audience. They are reliant on their target customers seeing them in passing. Since most of us are now highly resistant to advertising, much of the marketing spend is wasted.

Alternatively, highly targeted marketing to a named individual or to a tightly defined readership of a specialty journal or to a mailing list of a special interest group, is going to have a higher rate of contact. The marketing spend per contact is likely to be much lower and the conversion rate higher, especially if the problem being addressed has a high compelling need. Thus marketing productivity in high growth firms tends to be much higher.

Often the product or service can be aligned to a problem which is already the focus of attention of an interested group. Thus providing a solution to a new tax compliance issue may find receptive clients through an accountancy journal which has been addressing the need for some time. A plant soil additive which absorbs and slowly releases water which can be spread in a field in climates with erratic rainfall might be of interest to a farmers association or be picked up in a farming journal or TV program.

Sometimes a firm can use an existing distribution channel to gain access to a target audience. Thus an existing supplier might be willing to bring a new product to the notice of their own customers if they see that it might enhance their own customer relationships. This is often the case with strategic partnerships. Multiple businesses might agree to work together to promote each other's products to the ultimate benefit of a joint customer. This was often the case in the computer hardware industry. The marketing challenge of the computer hardware manufacturer was that they did not directly solve business problems. These were solved by software vendors and implementation consultants. Thus in order to sell the hardware, they would identify the problem to be solved, find the right software solution and then present the prospect with a package of products and services from multiple strategic partners. The strategic partners would spend much less on marketing as the hardware vendor was searching out the right prospects for them.

The potential customer needs to be reachable for the firm to proactively impact the sale.

A reachable customer is one you can get in front of with your product or service message. Potential customers must be identified with a location or place where you can deliver your message. This also needs to be cost effective, thus a TV advertisement aimed at registered dentists does not make a lot of sense when a trade journal, a dentist conference or direct sales visit to a registered dental surgery, would have a higher conversion rate.

For business-to-business sales, the sales process also needs to deal with complex multi-tiered decision processes. The person with the problem may not be the person making the buy recommendation or the person with the power to make the purchase. Sales processes need to understand the level of influence, the authority and the politics of the customer environment, to close a sale. An important attribute of the target market must be that they have the willingness and the ability to spend on the product or service. A potential user who has no budget or authority may only be able to recommend the product or service, but the criteria for the buy decision may be made on other attributes of the product or vendor. The marketing and sales process needs to take these aspects into account when marketing and selling the product or service.

Clearly a high growth venture also needs to have prospective customers in sufficient numbers so the business can make enough revenue and profit to be a viable and growing entity. Many businesses limit themselves to one segment, geography or channel. For adequate growth to be achieved, the firm needs to project revenue over a number of years in its selected market segments. If these markets do not generate the necessary transaction volumes to support a target growth rate, the business needs to look at new geographies, new channels and/or new markets for growth.

They set up the business using the 'hope' strategy

Instead of seeking out or developing new products for new customers, the firm should first see if it can find more of the same customers which brought it success. A product which has a clear competitive advantage, solves a compelling need and has a well-defined target customer, should be readily accepted in other geographies. Even if the firm is unwilling or unable to set up its own operations in those new territories, it may be able to find distributors which have the capacity, knowledge and distribution channels to handle the product or service. This way the firm can continue to benefit from its existing capabilities before it needs to spread its resources across other products.

Growth Check List

- Does the firm have a well-defined description of the prospective customer?
- Are there sufficient numbers of the target customers to create a high growth market?
- Is the firm able to obtain names and addresses of target customers in a manner which would allow personal approaches?
- Do the target customers belong to a specific association or well-defined entity which would allow targeted marketing?
- Is there a well-defined buying process which is used by the target customers which can be incorporated into the sales process?
- Is the firm able to create a sales proposition which can be put in front of the intended customer which the customer is likely to notice and act upon?
- Are the targeted customers willing and able to buy the product or service at the price offered?
- Is the problem or need being addressed obvious to the intended customer?
- What other businesses are already servicing the target customer which might be interested in working with the firm?
- Are there other products or services which complement those of the firm which can create a better overall solution for the target customer?

Personal Insight

In my last business, Distinction Software, we specialised in process manufacturing companies which had a large investment in inventory of high volume, low value consumer packaged goods. A significant portion of that inventory is held for safety stock to cater for inaccuracies in their sales forecasts. By improving their forecast accuracy by several percentage points, we could reduce their overall inventory by, often, tens of millions of dollars, in just a few months. Our task therefore was to find the right customer.

Getting lists of manufacturing companies by industry code is not that difficult. After reducing the list by size of firm, we had a manageable number to work with. By identifying their products we would know with some reasonable degree of probability whether they were likely to have a large investment in safety stock. From that point on we could tele-market to get our sales staff an interview with the person who had the most to gain by reducing inventory.

Other places we could market to were trade magazines, trade exhibitions and industry events.

Growth Potential Index

1. The firm does not know the size of its potential market. It has no clear definition of the ideal customer, the places where they might be contacted nor whether they are willing and able to buy.

2. Customer definition is reasonably clear but no attempt has been made to establish whether they can be approached proactively, are willing to purchase or are in sufficient numbers to make the venture attractive.

3. A clear definition of the customer exists, intention to purchase has been established but the size of the market has not been established nor has a program been developed to proactively reach them.

4. The size and location of a clearly defined existing and/or potential customer market has been established. The size of the market has been established and the level of buying intention has been estimated.

5. A clearly identified and reachable existing and/or potential customer market has been defined and validated. The purchase intentions show a clear intention to purchase the specific product of the firm. The size of the market would support the projected revenue of the venture.

Developing channels to market

No matter how good the product or service is, without being able to place them where customers can see them, try them and buy them, the firm is simply not going to generate revenue in any volume. A business which has an intention to grow, especially one that wishes to grow aggressively, has to find channels to market which will put their products in front of the intended target customers in sufficient numbers that the growth objectives can be achieved. There are many possible channels to market and the business needs to choose those which are most appropriate for the type of product or service being offered as well as the type and purchase preferences of the target customer.

The channel to market is most often determined by the price of the product or service. Thus a low priced product must achieve significant volumes to generate growth of any magnitude. On the other hand, higher priced items or services need less capacity in the channel but are often more complex to sell.

With low priced products or services, few companies develop their own distribution networks, instead they distribute through existing channels such as retail stores. Servicing the retail stores will be a network of high volume delivery routes, lower volume wholesalers and a network of agents and distributors. In order for the firm to achieve significant volumes, it must be able to gain access to this vast network of distribution services. Access will need to account for any pre-existing agreements which exist with competitors, the profitability of the product or service to the channel and whether the owners are willing to set aside capacity and space for the new product.

In some markets multiple channels for low value products can exist. Thus some products may be sold through supermarkets, pharmacies and department stores. Each is likely to have its own feeder systems. A lack of access to one may not prohibit the firm from securing sufficient sales through others. However, some markets, such as consumer packaged food products, are mainly sold through supermarkets. Without adequate access to that channel, the growth of the firm is limited. If the firm is up against strong incumbent competitors, it may not have the bargaining power to gain the shelf space needed to generate the level of growth it desires.

Products which compete closely with others will have difficulty gaining attention in an existing channel which is operated by a few large retail corporations. They will have existing agreements with the large product suppliers and may not wish to upset those relationships. On the other hand, a product with very distinctive characteristics which has no close competitor and fills a compelling need for customers, will find a ready acceptance within such channels. This would be particularly so if the margins offered to the distribution channel were generous.

Lower priced products with a higher service component or higher knowledge requirement of sales staff often utilise a franchise/agent/distributor model. The problem they are solving is one of replication to achieve scale. To achieve replication and scale they need to move the product or service delivery to a highly standardised offering. This form of delivery ideally suits a franchise operation. The problem of funding growth is also partly alleviated with franchise sign up fees. Providing the product or service can establish some unique selling proposition, rapid growth within this type of channel is possible. If a strong brand can be quickly established, a leadership position can often be secured. Even if new entrants come into the market to copy the offering, the brand is often sufficient to ensure additional margins and continued growth.

Higher priced products generally require exclusive outlets or a direct sales force. Most products sold through retail outlets which carry high prices are normally well established brands. To establish a new retail channel requires considerable funding and a product with very high customer pulling power. Very few products can ever achieve such success. Products which have been successful in this regard have normally come from very large corporations that can fund the roll-out and trade on their corporate identity to give them credibility with potential customers.

The normal channel for high priced items is via a direct sales force. In the case of consumer products, this would be through established channels which deal with like products and services, such as professional practices, real estate firms and dedicated outlets. Business to business products are normally sold via agents, distributors and a direct sales force. The limit to growth is usually the speed with which such agents or distributors can be recruited and trained and/or the pace at which direct sales staff can be recruited and trained. The more complex the product, the more specialised knowledge required to sell it, the more difficult it is to find appropriate sales staff.

If you are not in front of the customer, you never get the opportunity to sell

Many firms have turned to agents and distributors to create greater capacity in their channels to market. The most appropriate distributors are those which already deal with the target customer and offer a complementary product or service. The firm thus rides in on an existing channel with sales staff who already understand similar product and service purchasing processes. But in this situation, the firm has to generate enough commitment from the distributor to have them devote the necessary resources to train their own staff to handle the new product or service. The greater the investment required and the longer it takes to gain a return on the investment, the fewer potential distributors the firm will be able to attract. Clearly then, a product or service which has a high margin, a well defined target customer and a compelling need to buy, will be able to attract distributors more easily. If the level of investment can be reduced, the amount of training reduced through simplification and standardisation and the value proposition made easier to deliver, potential distributors are more likely to sign up.

Growth is both a factor of capacity and velocity. Thus a firm will limit its growth if it cannot establish sufficient band-width within its outbound distribution channels. At the same time, growth will be limited if the sales cycle is long. To the extent the product or service can be simplified, standardised and packaged, both the capacity and the velocity can be increased.

When it comes to distribution channels, many entrepreneurs believe more is better. In fact, the reverse is true; having fewer channels helps avoid some serious problems with channel conflict.

Getting to market is a challenge for any business and choosing the right channel is an important strategic decision. Adding extra channels may be the right thing to do, but only if the firm has worked through how it is going to manage any overlap and deal with any conflict which arises. When the firm has wholesale, retail and internet distribution channels, its own staff and alliance partners may not be overjoyed.

Channel conflict occurs when two or more channels of distribution promote products to the same customer. For example, the consumer who can buy from a retail shop or over the internet may be able to work out which is the cheaper, thus cutting out one party. The conflict occurs where the consumer uses the resources of one channel to evaluate a product or service and then buys from another. The firm is then competing with itself and potentially wasting resources. Even where the firm owns both channels, it may have sales incentives which are being compromised. It is difficult to motivate staff if you are undermining them.

Growth is both a factor of capacity and velocity

A company which seeks to 'go direct' and yet wants to retain its existing marketing channel partners can create a conflict of interest with its existing channels. The partners see the company's actions as a threat to their commercial existence. The commercial world is full of examples. As airlines, for example, compete more aggressively in the packaged holiday market, their channel partners – the travel agents – need to find new ways to attract business.

How do you avoid channel conflict? You have to design a channel strategy which clearly matches a specific type of customer with a chosen distribution channel. Your marketing strategy should direct the right prospects to the right channel. The various channels also need to clearly understand which prospects they are pursuing, so that their sales efforts will not be undermined by another channel.

Markets can be divided up by territory, type, vertical market, products offered and so on. The level of achievable business needs to reflect the size of the potential market and the resources available to secure the business. The sales commissions and other incentives need to be aligned to achievable targets.

Conflicts between channels may still arise, so rules of engagement need to be established which are fair, objective and equitable. If necessary, engage an external arbitrator acceptable to both parties.

Where the same products are offered in overlapping channels, consider using different brands and perhaps packaging the products with slightly different features or accessories. Consumers may compare the two, but you do not want them to be able to shop around for an identical product looking for the cheapest price. For example, you can use an internet site solely to promote products and direct sales to your retail channel, but if selling online care needs to be taken with internet discounts, as these will be seen by your other channels as undermining their sales efforts.

Smart firms involve their channel partners and staff in developing the marketing strategy. The partners may be able to see areas where they can be more successful and where a new channel will supplement their own efforts. By being actively involved in the design, they may come up with some creative suggestions. They also have a chance to voice their own concerns and could help to create a channel design which is acceptable to all parties. It can work effectively – it just needs some careful planning up front.

Personal Insight

When I started my first business we had very few staff and very little money to throw at marketing. However, our software operated on computer hardware which was sold by large corporations. Hardware by itself solves very few problems; generally you need to invest heavily in software engineers to do something with it. But the SME market did not have the knowledge nor funds to develop their own solutions like the major corporations, they wanted off the shelf packaged systems. Thus in order to sell hardware, the computer manufacturers would market solutions written by their software development partners. Instead of having just two salesmen, we had ten times that many looking for prospects for us.

Growth Check List

- Does the firm have the capacity to produce the volumes necessary to meet its projected demand?
- For each product or service, has the firm identified and prioritised the different points of purchase?
- For each point of purchase, has the firm identified the most appropriate channel to present the buying opportunity to the customer?
- For each buying opportunity has the firm identified how the product is best delivered to that point of purchase?
- Has the firm identified the capacity it would need within each channel to take the required volumes to the point of purchase?
- Has the firm identified how it will secure/acquire the necessary capacity over time to deliver the products or services to the customers?
- In order for the firm to achieve the level of sales it projects, has it identified the level of marketing expenditure and the form of marketing needed?
- How will the firm generate the level of enquiries and leads needed to fuel the order pipeline?
- What partnerships and strategic relationships can be utilised to generate the level of prospects needed?
- To what extent can other parties (agents, distributors, joint ventures) be used to increase capacity within the distribution channels?
- Where multiple channels are being used? How does the firm propose to handle channel conflict?
- If distributors are to be used, how can they best be motivated to invest in the opportunity and be motivated to give it priority attention?

Growth Potential Index

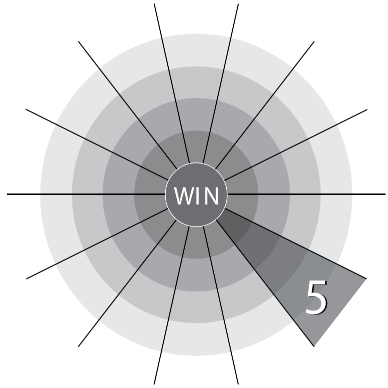
1. The firm has limited opportunities to utilise existing channels to market as these are locked up with competitors. The nature of the market does not support alternative channels.

2. The firm has limited access to existing distribution channels and has to compete for capacity with many other competitors. The firm has some capacity within its own resources to access customers directly but is limited in the extent to which it can fund growth in this channel.

3. The firm has a well-defined distribution strategy but lacks an exclusive presence, a lack of incentives on the part of distribution channels to put above average effort into the products or a lack of capacity within that channel to handle significant volumes.

4. A single distribution strategy is well defined, is effective in reaching most of the target customers and can handle the volume of sales anticipated but lacks robustness to be able to adapt to disruptive events. Other channels have proved difficult to develop.

5. The distribution strategy has multiple paths, is able to directly connect with the target market in an arrangement which provides the firm with excellent and timely exposure to the customer. The channel(s) are highly motivated and incentivised and have the depth and scope to cater for changed circumstances and can readily support the volumes required to meet financial objectives.



Innovation as the driver

Innovation, whether it is in product, process or business concept, enables the firm to step away from the pack and secure a greater level of control over the business outcomes. A business which does the same as every other business in the sector will ultimately be forced to compete on price. Sooner or later, one of those businesses will develop a way of cutting expenses and thus be able to lower the price to the consumer. At that time the game is lost and the business, without the cost advantage, will fail.

To avoid this situation, a business needs to establish a basis of competition which can sustain it. This often means a focus on a niche market where some element of the business provides a meaningful added value to the target customer. This is normally achieved through an innovation in the product or process (invention), or in the way the business operates (business concept). A significant innovation which can be protected over some length of time can often be the basis for a premium price and a sustainable foundation for a business.

Most new businesses are copies of similar businesses. They use the same products and services and compete along the same dimensions as their market counterparts. Therefore, they divide up a limited market between them. Where there are low barriers to entry into the target market, more and more firms will start up thus ensuring that most firms will fail to gain the traction needed to grow. In the end, they must compete on price to distinguish themselves and this ultimately brings them to a mere survival level of business.

Firms which have low growth generally have captured a leading position in a small stagnant market and secured it through customer loyalty, thus effectively denying critical mass to the next entrant. Alternatively, they have developed some level of differentiation and /or specialisation to gain a market share of a larger stable market and are able to continue to service that market with that advantage. However, they fail to generate growth traction beyond a certain point because the overall market is too small or their differentiation only covers part of the potential market.

High growth comes from a significant innovation which either captures market share readily from existing firms or takes a significant share of the market growth. The innovation is either very well protected or the firm has the ability to bring new innovations into the market at a rate which maintains its leading position.

Venture capital firms use innovation as a criterion for funding. They seek an innovation which has high value to customers, no close alternatives and a high degree of protection from copying or eroding. They are looking for a base from which an advantage can be generated and exploited.

Don't settle for mediocre, be the leader

Most high growth firms are formed around new knowledge, that is, inventions. Inventions provide a good basis for growth, especially when the distribution channels are in place and can take up increasing volumes of product quickly. However, new business concepts can also provide a good basis for growth, providing the new method of doing business can be scaled quickly. That is why internet businesses had an advantage as they needed little back-end capacity to scale quickly.

The size or impact of the innovation is a metric which conveys information about the likely competitive advantage. A substantial innovation which significantly changes the cost structure of an industry, greatly improves customer value or opens up solutions to previously unsolved problems, provides the underpinning for high rates of growth. Obviously, the more unique the innovation and the more customers value the impact, the more it adds to the potential competitive advantage of the venture.

Few businesses can achieve sustainable growth on the back of a single innovation. Generally it requires a process of continual innovation to generate growth over a longer period of time. Some inventions will naturally spin out multiple products. Thus a breakthrough process might be used to create many end user products. However these situations are relatively rare. Most firms will need to develop new improved products over time to keep their competitive edge.

Innovation need not be limited to product or service utility or functionality. New revenue can be gained in a number of different ways, each providing the firm with growth potential. Innovations in product, process or business concept can be used to further each of these revenue paths.

- Repeat purchases. How can you be assured that customer will buy your product next time?
- Shorter time between purchases. How can you get the customer to use more of the product or use it more often?
- Accessories and supplements. How can additional value be generated for the existing customers which will increase the price paid at each purchase.
- Additional non-utility value. Can additional value be created around the product through the buying cycle or in the product experience which will increase loyalty, referrals or additional purchases?
- Complementary products. What other related products might the existing customer buy which could be leveraged from the positive experience of the initial purchase?
- Additional uses. What other ways could the product be used which could generate new purchases or introduce a new customer segment?
- What other territories could the product be marketed into which could drive new revenue?
- What extension to the product performance or utility might open up new markets?
- What strategic relationships could be developed which could generate new customer leads?
- What other firms might resell your products into their customer base or into other distribution channels which could generate new revenue?

Innovation is not limited to invention, it can simply be developing a new way of adding value to the potential customer through the way the product is sold, used, serviced, replaced or disposed of after use.

High growth firms stay close to their customers. They seek to add value to the entire life cycle of the product or service experience. They are interested in many aspects of the sale:

- How do they make the decision to buy easier?
- Are they able to make it possible for the customer to try the product before they buy it?
- What information does the customer need to make the buy decision?
- How can the customer get a faster return on their investment in the product?
- Are they able to make the buying experience more effective, less time consuming, less risky, less stressful, more positive and/or more enjoyable?
- What other dimensions of the customer value are they able to tap into? Perhaps an environmental or social attribute?
- What do they need to do to have the customer recommend the product to a potential customer?
- How are they able to make the product more effective in use?
- What ways could the product be developed or enhanced to increase its value to the customer?

At the same time that the firm is developing customer value, they are also putting effort into streamlining their own operations. In order to grow, the business needs to bring more units of output to market within the same unit of time or with the same unit of resource. Thus effort is put into design, assembly, packaging, shipping, installation and after sales support to gain increased productivity.

One of the hardest lessons of continual growth is that the business needs to cannibalise its own products. New technologies, new information, new customer needs and new regulations gradually undermine old products. While incremental innovation will provide medium term support for the business, ultimately a competitor, often a new entrant, will undermine the market with a new product or business concept which captures the mindshare of the target market. Often this inroad starts in a fringe market where it gains credibility, stabilises its offerings and then gradually eats away at the market share of the established firms.

The successful high growth firm recognises that new product life cycles start as poor cousins to the established products. In their early stages, they offer fewer features and are less robust. However they often offer a product dimension which the established products do not and thus are able to capture a new market poorly served by existing products or are able to segment out a customer set which has a poor experience or fit with established products. This would have been the case with early portable disc drives, digital cameras and relational databases. But these products grew in functionality, reliability and value to undermine the mainstream markets.

Thus the high growth firm watches developments at the edge of their market and invests in emerging technologies and business concepts so that it is on the ground floor when the take-off happens.

Personal Insight

The problem in software development was always software reliability. It must be the only business in the world where you ship a product which you know has errors to a customer who acknowledges you have problems by paying an additional annual fee for you to fix errors when they find them. But finding and fixing errors exhausts your staff, is stressful and frustrating and greatly reduces your productivity. To reduce the size of the problem we developed a software tool that allowed us to write software in English- like statements, moved regular functions into routine libraries so each programmer would not be reinventing the wheel and introduced a data definition system to remove a lot of data validation to a central library.

The overall result was a 30-fold increase in productivity. When we sold the business, we had eight programmers developing and supporting a system of about 14 modules. The corporation which acquired us had over 70 programmers working on applications equivalent to four of those modules. Our technology became the standard for the corporation and is still being used around the world 20 years later.

Growth Check List

Products/Services

- What new technologies are coming onto the market which you could incorporate into your own products?
- What strategic partnerships do you have which enable you to access new developments which could be used in your marketplace?
- What research and development capability do you have?
- What access does your R&D team have to current and prospective customers?
- What training are you giving your R&D team on the industry, the marketplace and how customers are using your products?

General

- Who are your toughest customers? Are you using them to set the benchmark for where you should be delivering solutions?
- Are you tracking competitor developments?
- What problems do you see your customers having to resolve in their businesses in the near future which could be the basis of a new avenue of business?
- Are you receiving feedback from your customers to evaluate the quality of your products?
- Are you examining customer complaints to assess how you could do better?
- Are you tracking lost sales to see if you could improve your success rate?
- Have you asked ‘why?’ lots of times to see if you could do business a different way?

Growth Potential Index

1. The products or services are the same as many others in the market. The firm has no investment in any development.
2. The products offered have minor differences to the competition. The firm invests little in product development or new product introduction. The firm is a follower rather than a leader in working with customers.
3. The products have clear differentiation from others in the market place but the differences are not necessarily sufficient to capture customers from competitive offerings. The firm does however take note of customers' requirements and complaints and seeks to provide new and improved products to meet those needs. The firm does invest in finding and developing products and services for its target market.
4. The products have major differences from competitive offerings and customers value those differences. Products have a strong competitive advantage. The firm proactively works with customers to identify new features and new products. The firm spends significantly on research and development within its target markets.
5. The product has breakthrough product and/or business advantages which clearly separate it from competitors. Customers highly value the advantages and this has/will create a leadership position. Products are the only offering in a new emerging market or are the only products able to solve the target problem. The firm spends significantly on research and development in its current markets and in potential markets.

6

Achieving a clear competitive advantage

While it would be an advantage to have a rapidly growing market in which even the poorest of the competitors could find space to grow, few markets offer this situation. Most businesses compete in either mature markets or markets with slow growth. Yet, even within mature markets, some companies manage to carve out a place and grow rapidly. This was certainly the case with Starbucks, Office Depot, Walmart, Aussie Home Loans, Virgin Records, Virgin Blue, and Bendigo Community banks. They all found a way to compete which resulted in a significant shift in market share. Yet look at the products they sold; all well-established products which had been around for some time. All these companies found a new business concept or process which dramatically increased customer value compared to their competitors.

It is easy to see how an invention can provide a competitive advantage. A major change in functionality, a new attribute of performance or a major reduction in cost, will clearly unseat established firms. Innovation in product characteristics which taps into an unmet need can provide massive growth opportunities. At the same time, a major development in process innovation can lead to a raft of new products which can provide a first mover advantage which might give the business time to seize a leadership position in an emerging market.

However, if you have a product or service in a marketplace which is simply littered with comparable offerings, you have very little hope that your venture is going to gain the traction needed to support any significant level of growth. The market place is crowded with 'me-too' products. With little to differentiate them, customers will buy on a whim or simply treat them as a commodity and buy the one which is the most convenient or the cheapest. In these markets, shelf space and price are the dominant competitive dimensions. However, unless you can control the shelf space or ensure you offer the lowest price, your ability to forecast and control sales is limited.

Your way out of this trap is to identify a niche market and develop products and services which better match the needs of the target market. However, if everything you do to be different can be readily copied with little effort, then clearly you are in a business which has little chance of any substantial growth.

Competitive advantage arises from having a superior position on one or more attributes which your target market values. In the case of customer value attributes, that superior position needs to be not only obvious to the prospective customer, but they must value it to the point where it is the major factor in their choice between competitive offerings. If the difference is strong enough and important enough for the customer, it is also the attribute which can drive a premium price position. In the case of internal operations, the attribute must result in a significant cost advantage which results in superior profit performance.

Few markets have customer utility and customer buying experience around a single dimension. Consider these aspects of the customer interface:

Product Utility

- *Functionality* How well does it do the job (specifications)?
- *Safety* Some products are safer to use than others
- *Fun and Image* Interesting colours, design, style and brand
- *Environmental* Does it impact the environment and has this been taken into account in the design?
- *Convenience* How easy is it to put away, carry and use?
- *Simplicity* How simple is it to operate?

Purchase Experience

- *Availability* How easy is it to find and buy?
- *Information* How easy is to find out about the product and have questions answered?
- *Delivery* What is involved in getting it delivered and picked up?
- *Supplements* What after sales help, warranty, training etc can you access?
- *Ease of use* How easy is the product to use?

- *Disposal* How do you dispose of it when you don't want it any more?
- *Maintenance* How easy and expensive is it to get maintenance?
- *Divisibility* How easy is it to try before you buy?

You can either be cheap or different — I would rather be different and expensive

While many of these attributes refer to physical products, equivalent attributes exist with service offerings. Thus the quality of the experience itself is a dimension of many participant services. Customer service in terms of quality, consistency, friendliness, level of helpfulness, knowledge, and so on, can be used to differentiate different types of experiences. Atmosphere, ambience, noise level, security, the type of other participants, duration and mementoes, all alter the feeling during and after an experience. The key to service experiences is to work out how the customer expects to react and then to offer an exceptional experience along a dimension which the customer values and remembers.

Within any market there will be sets of customers who place different weights on the various attributes of the utility and the buying experience. In the end, you may have to make a choice between different attributes which are mutually exclusive or compromise each other. Thus portability may have to be sacrificed for greater productivity.

One dimension may be sufficient for you to create a niche market. Thus vibrant colors may not appeal to mainstream buyers but a fringe market may exist who appreciates unusual style and color. There may be a niche market in a rugged version of the product for use in difficult environmental situations like building sites or uninhabited regions.

Another dimension of competitive advantage can come from specialist information. Thus many firms have developed expertise in bidding on government contracts or in consortium tenders. Others have developed deep expertise in a specific application. Some recruitment firms specialise in one type of business or one type of professional executive. Packaged travel providers often specialise in one region or one type of experience.

Many businesses have grown substantial market presence by solving an especially difficult problem. For example, this could be in servicing jet engines or putting safety systems into mines. The key to this advantage is to solve a complex problem which requires unusual expertise and perhaps specialised equipment.

Often these markets are not large enough to attract large corporations. Also the expertise gained in such environments often cannot be used elsewhere.

There have been many situations in the past where competitors have fought for market share along a single dimension. This has normally been in product specifications. Such things as capacity, power consumption, weight, pixels, size, accessories, or speed. In their race to be first to market on the next dimension of competition, they often forget that customers have many other attributes of value and that substantial niche markets evolve around those. Thus a product which has average performance but has unbeatable customer service will gather loyal customers and grow market share providing enough customers value customer service over other product attributes.

Only by finding a strong point of difference along an attribute which the target customer values, will your own products or services carve out a segment of the market. Clearly the most desirable position to be in is to have a product which not only fully meets the needs of the target customers, but has no competitor or near substitute.

Unless the business has a strong cost advantage, growth will only be generated by products or services which are differentiated from the competitors. Typically this differentiation will be based on some level of innovation in product, process or business concept. The innovation itself needs to be difficult to match over a reasonable period of time for the business to gain a leadership position within its target market.

Growth businesses only maintain their position by staying ahead of their competitors. Thus they are very sensitive to what their competitors are doing and how they are positioning themselves within the market. A superior position can be readily lost if a competitor is able to match or exceed your position on the attribute you have chosen to compete on.

The smart business is proactive in delivering increasing value to customers. Within their chosen market sectors, the most successful firms seek out the most demanding customers and work closely with them to provide an on-going stream of added value. These key accounts are often the reference point for other customers within the sector and their purchase decisions will highly influence others in the same market. By staying close to the key customers and by working with them to establish where products and services need to evolve, the firm has a direct connection to value leadership. The market notes the buying preferences of the leaders and thus marketing is more by referral than persuasive marketing. This in turn can lead to greater marketing budget productivity.

Growth businesses carry out continual competitive analysis to ensure their market is not being eroded by developments in other firms. This analysis needs to be matched with the target segment needs to ensure the firm's products and services continue to provide better value than the competitors. The competitive analysis needs to be able to show very clearly why the firm's products are preferred in some market segments to other offerings and to be able to offer reasonable proof of that assertion.

For a competitive advantage to be meaningful, it needs to be periodically validated by actual or potential customers. The difference must be meaningful and sufficiently important to the target customers that they have a clearly expressed preference for the product or service you are offering. Validation is also needed to ensure that the other companies that do have product offerings in the general market in which you are dealing do not have a close alternative.

Growth Check List

- What need does your product or service meet?
- Why does your product or service meet this need better than what competitors offer right now?
- What are your strengths and weaknesses vs. your competition?
- What are the attributes of your product or service that your customers like most?
- What are the attributes of your competitors' products or services that their customers like most?
- What aspects of your product or service do your customers complain about most?
- What aspects of your competitors' products or service do their customers complain about most?
- What aspects of your competitors' products or services do your customers like least?
- What do your employees like most and least about your business, products, services and customers?
- What do your suppliers like most about you and least about you?
- What features and functions are your customers requesting that you could add for the least effort?
- What is the biggest problem your customers have that you could resolve?
- Where is your market likely to develop and how well will you be positioned to take advantage of these changes and trends?
- What words do your customers use to describe your company, products and services?
- How would your customers describe your closest competitor?

Personal Insight

In the late 1980s I was involved in the development of an enterprise wide solution for process manufacturers. Up to that point, manufacturing specifications were defined using a Bill of Materials, basically a list of components and assembly instructions. The key difference between discrete and process manufacturing was that you could disassemble a single manufactured product. In process, once the ingredients had been mixed it was normally impossible to go backwards. Thus a pizza once cooked cannot be uncooked.

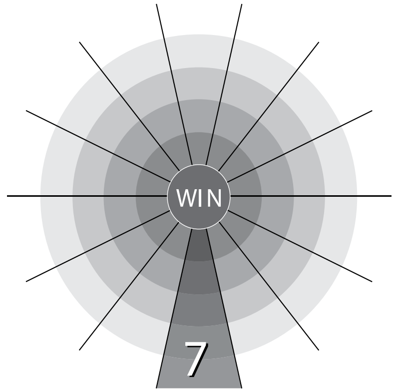
By 1990 we had developed the world's first integrated solution for process manufacturers based on a recipe specification. This also allowed for modifications in the ingredient quantities due to potency and for the output to have varying quality characteristics due to minor differences in external and internal characteristics of the process and the environment. This product enabled us to secure the largest ever process manufacturing software contract that year.

By 1994 many large software vendors had entered the market and our competitive advantage was being quickly eroded. However we had identified a specific problem which specialty chemical manufacturers had that required them to be able to break product inventory into lots, each of which had to have a number of quality attributes identified and measured with the lot. This feature had to be integrated into purchasing, receiving, inventory, recipes and sales order processing. Because of the complex nature of the integration and the smallness of the niche market, we were the only software vendor to specialise in that segment.

Over ten years later, this software still leads the market within that segment. The corporation which now owns the product has established a highly loyal customer base that works with it to define new features.

Growth Potential Index

1. The products and services sold by the company are the same as other companies in the sector
2. The firm has a number of competitors which offer similar products or services. The firm has no plans to differentiate their products or services further.
3. The firm actively seeks to differentiate its products and services from its competitors. The extent of differentiation is, however, not significant. Few opportunities exist within the market for major differentiation.
4. The firm has been proactive in seeking out underserved markets and in identifying significant ways of differentiating its products and services. The sector offers major opportunities for leadership in large niche markets.
5. The firm has significant and well-protected product and service differentiation. It has established a leadership position within a large and growing niche market. The firm continues to expend significant resources to improve its product and service offerings and find new ways of extending its competitive difference.



Building in sustainability

Many entrepreneurs think that their business is sufficiently protected by having a superior product or service or by making the product or services offering different in some way from their competitors. This is often achieved through a combination of features and functions which customers value or through superior customer service, availability, after sales support and so on. It is highly likely that a winning combination can help secure the initial sale, however, this does not stop the competitor from copying what you do, maybe doing it better and then chipping away at your customer base and reducing your future market share.

A competitive advantage will gain you business at a point in time. The real challenge for any business is to build a platform which will protect that competitive advantage but also adapt it to ensure the firm retains its leadership position as the market evolves. The key objective is simply about protecting the business from erosion from an existing or new competitor. What is to stop a much better funded, larger, more aggressive competitor from duplicating what you have done and offering greater incentives for your prospects to buy from them? This gets down to: how are you going to protect your business?

Protecting the business is most often seen as erecting barriers to entry. That is, what protection can you put in place to protect your competitive advantage, your distribution channel, your on-going customer revenue and your source of supply.

The more conventional barriers to entry have one, or several, of the following attributes:

- High start-up costs
- Expensive to acquire
- Take a long time to acquire
- Protected by patent, trademark or copyright

- Restricted under license, rights or agreements
- Require specialised knowledge which itself is in limited supply
- Highly innovative and not capable of reverse engineering
- On-going customer revenue is protected with high switching costs or is contracted
- Distribution channel is owned or restricted under contract
- Source of supply is restricted or locked in under contract.

Strong barriers to entry usually create the basis for a sustainable competitive advantage and this in turn is a pre-condition to high growth. While you may have established a competitive advantage with your product or service, this is really only beneficial if you can sustain and/or protect it over the long term.

Protection can be legal rights which attach to patents or licenses or they can be protected by being difficult, expensive or time consuming to copy. A business may protect itself by controlling elements of the market such as preferred outlets, distribution channels or essential components. Other firms may be effectively locked out of a market through customer or supplier agreements or by controlling the source of an essential resource input. The ability to defend encroachment is an essential factor in maintaining protection. The firm which cannot defend a patent infringement, for example, has little protection against a large well-funded predator.

Competitive advantages are transient. There are numerous forces acting within markets which will undermine competitive positions. These include such factors as:

- Expiration of patents, licences and copyrights
- New inventions which provide better, cheaper and/or more effective solutions
- New processes which increase productivity or provide new benefits
- New ways of doing business which customers prefer
- Competition arising from more open trade agreements.

Thus a strong position at one point in time may be eroded either by the passage of time or by new products and/or new competitors coming into the market. Competing in the market with a constant stream of new products and penetrating new markets is hard work and fighting it out prospect by prospect puts a considerable strain on the business and it's staff. In the absence of some overpowering long-term competitive advantage which allows the business some margin for error, you are going to have to battle for each new customer.

You have to plan to win the business every day — forever!

Some entrepreneurs are mesmerised by the size of a potential market. They take comfort in the fact that there will always be new customers to sell to. They seem to think that because there are large numbers of potential customers, they have some divine right to get their share as they pass by. However, the rate of company failures would suggest otherwise. It is not just the competitors you can see which should give you cause for concern, it is new entrants which come into your market with a different business model that can turn an industry on its head. The firm which has not bothered to block off the competitors will be the most vulnerable to such changes.

Many entrepreneurs search for the holy grail of 'first mover advantage'. Being first to market can often provide a business with an opportunity to gain premium prices. For example, new markets can sometimes be readily harvested if the new business solves an important problem. Early demand often allows 'cherry picking' – taking those with the highest needs or those who are the most innovative as early customers. First mover advantages are most often associated with new inventions but can also be associated with new ways of doing business. However, there is nothing in this strategy which suggests you can sustain the initial advantage. Once competitors imitate your product or service, they can attack your customer base.

High growth firms not only ensure they have a leadership in gaining initial sales but they put strategies in place to also reap the rewards of additional sales of the same product, cross selling complimentary products and gaining referrals to new customers.

Most firms have repeat sales to their existing customers. Once the initial sale is made, you need to move immediately to close the door behind you against competitors. You need to construct a situation which will ensure that future purchases are sent your way and not to your competitors. If you can prevent your competitors from selling to your customers, you have effectively protected that part of your income stream. Your objective is to lock down your customer so they prefer to buy from you even when your competitor introduces a better product or service which could more effectively satisfy the customer's needs.

Clearly the most effective way to secure the long-term business of the customer is through an exclusive purchase agreement. This need not be to the customer's detriment however.

There are some very good reasons why the customer may allow, or even encourage, this arrangement:

- Reduction in costs of preparing procurement agreements
- Economies of scale in ordering, freight, receiving and storage
- High learning curve costs in understanding the complexities of each organisation, their ordering and fulfilment processes
- Time and resources required in building relationships at multiple layers in each firm
- High start up costs in bringing on a new technology or process. This could involve organisational changes, data conversion and training costs
- Committed capacity to customers' business

Many companies have implemented single source procurement agreements to provide stability with their suppliers and to show that long-term relationships are more important than short term cost savings. It is very common for this structure to be used to implement the exchange of intellectual property, joint design teams and sharing of cost savings. Once the relationship is in place, not only will it protect repeat purchases of the same products or service, but it can result in lower cost of sales for cross selling products and services.

Complex products which require considerable up front installation and on-going support are also effective ways of capturing customers over a long period. The 'switching costs', which includes costs, time and stress of moving to another product, can often be very high, thus once sold, customers tend to stay with the initial supplier for a long time. This relationship can be used to leverage cross selling opportunities, especially where additional products can be easily integrated into systems or products already in place. Many software products fit this category.

Some products have a lock in feature due to the conditions under which they are acquired. Life insurance and health insurance, for example, can be prohibitive to change if personal circumstances change and a new policy would be difficult and/or costly to acquire. To retain the benefits, the customer has to stay with their existing policy.

Competitive advantages are transient

While not 100% perfect, many membership programs create a form of lock-in of the customer. Airline frequent flyer programs or store frequent purchaser programs attempt to create loyalty and to provide the customer with additional benefits which only accrue with frequent or volume purchases.

Gaining control over the point of sale to the customer is an effective way of controlling the customer purchase. While the customer might have a range of choices in theory, they might be willing to limit their choice through a preference for a particular method or place of purchasing. Gaining access to a preferred channel, or owning or controlling a preferred channel, gives you effective control over the final purchase. The question which the seller needs to ask is, 'Where does my customer buy?' If you are the only product in your category at Office Works or Toys R Us, then you have greater influence over the ultimate customer purchase.

You might be able to use the synergies of an existing preferred channel to reduce costs and gain premium profits or lower your price and undercut competitors. Some firms are able to significantly reduce their costs by using distribution channels which already serve the desired customer. Thus a firm which introduces a new product to an existing distribution channel need only recoup the marginal costs of using that channel. Excess capacity in the channel can be used to cross sell additional products thus achieving deeper account penetration.

Owning, controlling or being able to influence the availability of a limited, unique or rare input can give you effective control over the entire supply chain. Companies which have integrated backwards to own specialist components or rare commodities have greater control than their competitors who must work with less favourable inputs.

Inputs can be physical, like a commodity or a component, or it can be information or expertise. For example, specialist staff with deep expertise who are in limited supply can be an effective blocking factor if you can develop some form of exclusive supply arrangements. Many situations require an accredited specialist or highly trained or experienced or knowledgeable expert, the firm which has long-term access to them through their supplier has a sustainable advantage.

> **Some entrepreneurs are mesmerised by the size of a potential market**

Another form of exclusivity exists where specialist stores and wholesalers have an arrangement with their suppliers where the supplier will not place another store or use another distributor in their immediate vicinity or region. This protects their immediate market and should assure them of limited competition. This is especially effective where the supplier provides brand name products which have high customer loyalty.

Another effective way of controlling the supply chain is to limit the access of other competitors to the point of supply. Owning or controlling the inbound delivery channel can provide this level of protection. The most obvious example of this type of control is a unique distribution agreement with an overseas supplier. Where the distributor has an exclusive distribution agreement, they have effectively locked out their competitors. This is especially effective where the product solves a unique or difficult problem and satisfies a compelling need.

The last point of protection is with the business itself. There are two layers of protection, stopping someone coming into the industry and stopping a competitor from copying your product or service. Industry barriers are those things which build a wall around the industry which excludes potential new entrants or requires considerable cost or time to overcome. The number of ways in which this type of protection can be achieved is extensive but would include such things as:

- Licences, accreditations, registered rights
- Regulations which limit new entrants
- High cost of set up
- Extensive network of outlets or contact points
- Deep expertise of a situation, process or market
- High economies of scale or high learning curve effects
- Ability and capacity to retaliate
- Protection through subsidies, trade barriers or quotas

If you are already in the industry, you want as many of these as possible. If you are entering a market or trying to grow the business, these can be serious impediments. They can also have negative consequences. For example, high costs of set-up might limit the number of effective competitors in a market but the same high costs may lead to intense price discounting when business levels decline. It may deter others from coming into the market but it may not be sufficient to protect the profits of those which are already there. Within their market sector, the firm needs to make it difficult, stressful, time consuming and/or expensive for anyone to copy or negate their competitive advantage.

Many companies see their relationships with their customers as an important blocking factor to new entrants. Some firms have nothing else going for them other than strong customer loyalty, but this can be sufficient to protect their business over a long period of time. Their level of customer service, customer empathy and willingness to go the extra mile to delight their customers is their strength.

Employees can themselves be a major competitive strength. In many businesses recruiting and retaining the best people is the key to long-term success. Retaining the best people for research and development may give a firm the ability to bring great products to market quicker and cheaper than competitors. Other blocking techniques are needed to fence off your customers. Such things as:

- Patents, trademarks and copyrights
- Highly prized locations
- Well established brand
- High customer loyalty
- A way of doing business which is highly valued by your customers but is not understood by others
- Secret formulae or processes

A patent which solves a unique problem can be a powerful blocking strategy. The other techniques may be more or less effective but are not guaranteed and may only work in some circumstances. They are, however, all factors which can impede the effectiveness of a competitor. The greater the time and/or cost to duplicate or overcome, the greater the level of protection.

Few of these barriers are, however, permanent or 100% effective. Many people believe that patents and other registered intellectual property rights provide the ultimate protection. In truth, these rights are only effective if you have the money to defend them. Many patent holders have been worn down by the time, stress and expense of litigation. A large corporation might be willing to take the risk of infringement litigation or be willing to spend a large amount of resources finding a way around the patent.

Few companies can achieve long-term sustainability without re-inventing themselves and developing new innovative products or services. In the short to medium term, the best approach is to develop a combination of strategy, protection and employee and customer relationships that can best meet the business needs. Implementing an integrated solution of blocking techniques or factors across the entire supply chain will be the strongest mechanism you can have to ensure protection of future revenue from existing customers. One hundred percent protection is an ideal but that should not stop you from implementing a range of blocking techniques to give you the strongest position.

Personal Insight

The applications software industry was a wonderful environment in which to build sustainability. First you had the protection of copyright although that was probably marginal. Next you had the high cost of development of large scale software systems. Not only were they expensive to develop but you needed a lot of computing and functional expertise to get it right. Then of course there was the large internal cost to the customer for implementation. This would cover data conversion, training, new equipment, project management and so on. Once a system was purchased customers, were highly unlikely to want to go through that exercise for some years.

Then of course we had the maintenance and support contracts. If they wanted help, error correction and software updates, they had to pay the annual support fee. Just like an insurance policy for fire and theft, few would take the risk of doing without it.

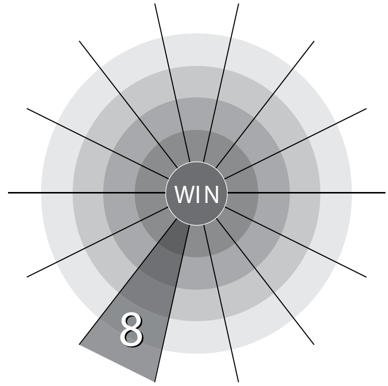
From 1985 to 1999, I was fortunate enough to have an outstanding team of software developers who moved with me from Northampton in the UK, to San Diego in California and then to Atlanta in Georgia. During that time I was involved in three separate businesses and this team came with me each time. Many companies tried to recruit individual members of the team but they stayed together, not because of the salaries, but because we offered an interesting and challenging environment in which they were respected and treated well. I ended up with a real star team which was incredibly knowledgeable and productive.

Growth Check List

- Are you taking advantage of legal protection methods such as patents, copyright, brands, trademarks, licenses and rights to protect your business?
- Are you working with your customers to establish how you can be the supplier of choice?
- Have you developed connections with your customers that integrate their business with yours?
- Have you made it difficult, time consuming, stressful, risky or expensive for your customer to move to a competitor?
- Do you have relationships with customers which are personal and social?
- Have you offered your customers incentives to buy from you over a longer period of time, either quantity price discount, loyalty schemes or special service arrangements?
- Are you working with your customers to help them build better businesses?
- Do your customers come to you to help resolve their own strategic problems?
- Are you working with the customer's point of purchase to gain preferred treatment?
- Are you accumulating hard to acquire, special and unique knowledge and skills which can benefit your customer?
- Have you investigated where economies of scale might give you a competitive cost or service advantage?
- Have you created a business environment where the best people in your sector want to work?
- Are you providing the right personal challenges and rewards for the best employees so that you keep them?
- Are you securing the rights to new products and technologies which will allow you to create and maintain product leadership?

Growth Potential Index

1. The business offers products and services which can be readily copied by others.
2. Products or services have short-term protection, but this is expected to be eroded by a determined competitor or anticipated new products in the market.
3. Products have some level of long-term protection but only through an aggressive product development process, strong customer service and/or features which appeal to a niche market.
4. The firm has strong intellectual property protection through patents, copyright, or registration rights but these may be overcome or eroded by a determined and well-funded competitor although this would take some years to be effective.
5. The firm has very strong intellectual property protection through patents, strong branding, high customer loyalty or highly specialised and difficult to acquire knowledge. Significant funding and/or strong alliance partnerships are present to defend IP which can be expected to deter copying.



Engineering scalability

Many product or service businesses look great when the volumes are small, when the founders take special care over the development and delivery of the customer solution and where the customer is given additional assistance to ensure a favorable customer experience. However, when the business grows, volume production requires a level of planning and control that is not required or needed when volumes or outputs are small. Logistics needs to be much better integrated, quality needs to be controlled through the entire value chain and the business needs to have purchasing, human resources, marketing, administrative and IT infrastructure to support the ongoing operations.

Businesses which can handle 10 or 100 transactions need to be massively redesigned when volumes reach hundreds and thousands. How will the business cope if it needs to manage multiple locations? Does the business have the right people, structure and resources to build a larger, higher volume business?

The business of today will not look like the business which has five times the number of employees and/or five times the revenue. It is almost inevitable that the firm will have to change the way it does business to manage the increased complexity of a larger business.

Entrepreneurs who have grown a business from a start-up will tell you of the transitions they had to go through as the business grew.

Almost without exception, small businesses face a crisis of management as they grow. The entrepreneur in the early days is able to drive the business through sheer energy, passion and vision. He or she knows everyone and staff are motivated because they are part of the grand adventure. As the firm adds staff, new people come into the business who were not part of the grand vision and their motivations and needs are likely to be different. They may see it more as a job than a mission. They have different needs and thus management styles have to change. At the same time, the growth brings with it specialisation of tasks and more formal organisational structures. Reporting lines become clearer, job descriptions become the norm rather than the exception and performance targets and monitoring is introduced. Soon there is a new layer of management between the CEO and the operations. What was a project has now turned into a business.

When you grow fast, you need to build growth capability and capacity

As the business grows further, communication becomes increasingly formalised as communication lines become longer. The left hand no longer knows what the right hand is doing. Customer service quality falls as new customers don't have the advantage of personal links with the founders. Problems escalate with the second location and daily face to face communication is not physically possible. External shareholders and/or external Directors force more transparent decision-making and thus the entrepreneur can no longer make decisions on the fly. Larger numbers of staff, customers and other stakeholders now depend on the business for their livelihood. Many entrepreneurs simply are not able to make the transition or don't want to.

Capacity within all aspects of the business will be limited by some attribute of the assets or capabilities employed. Equipment will have a limit on throughput, people are limited by the hours they can work effectively, warehouse space and plant floor space is limited by the existing structure or the land available for expansion. Ultimately the growth in the business will require every element of the business to be replaced or modified.

Growth requires that more and more people be employed to take on both specialised and general tasks. These new people need to be integrated into the business, taught the activities they need to undertake and shown how their operations link in with the rest of the business. To the extent that knowledge is undocumented and systems are ill defined, this process will inhibit the rate at which new people can be introduced and made effective.

Some firms can best grow through replication. In this situation, a business unit is duplicated and then controlled and monitored though a network of controls. The extent to which such replication is documented, standardised and supported will greatly influence the speed at which the business can scale. Franchised operations use this as their underlying business model. They rely much less on the initiative of the individual manager, instead they prescribe how the operations will be undertaken, provide extensive documentation in systems, policies and procedures and put in place monitoring systems to enable early intervention when things go wrong.

Other growth business models use distributors. The advantage of using distributors is usually that they bring much needed talent to bear on the sales and support activities at a much faster rate than the firm can fund or support. But for a business to support distributor operations, it also needs to have considerable standardisation, set expectations clearly and deliver against its promises. Distributors are themselves independent businesses who can decide not to put the energy and investment into the operation if they do not foresee an adequate return for their time and effort or if they feel that they won't get the support needed to make them successful.

Reasonably high growth requires that all aspects of the firm work in harmony as the business scales. However, not all parts of the business have linear growth characteristics. Many parts of the business will have step changes in capacity and these will need to be planned ahead of time. Some changes require greater lead times than others. Thus a new factory on a green field site may require three years to plan and build but a new office might be able to be accessed and used within 6 months. A change in the underlying IT business transactions support system may take a year just to evaluate prior to purchase and then several years to implement.

There are important strategic insights which can be gained from undertaking a scalability exercise. It is almost certain that the business will have to change organisational structure as it grows. At the same time, it is almost certain that the IT systems which support the business will also have to change. What can be more surprising is that the firm will discover that some of their best staff are unlikely to make the transition. They may lack the skill, personality, work ethic or experience to work effectively in a more complex situation. This is very confronting for senior management but it is better to discover it early than have the disruption of having to replace loyal staff when it is really too late. With enough notice of the impending change, however, staff can undertake retraining or change job responsibilities. In some cases, the only solution might be to transition them out of the business.

The firm can simulate activities at different levels of operation and, in doing so, the various constraints on the business will be uncovered and a plan for dealing with these can be constructed. At the same time, this exercise will uncover spare capacity which may be able to be used in the short term to solve problems, improve productivity or enhance customer operations.

Many firms put their businesses at risk by discovering constraints and bottlenecks as they expand. By planning what the business will look like in the future and working backwards to the business of today, the firm can see where the step increases are and take appropriate action to plan properly for them. At the same time, being confronted with future limitations along the path they are on might prompt management to seek new avenues for growth that they had not considered previously.

Complexity comes from dealing with more and more differing elements in the business. Thus the business which increases the number of locations will experience a step jump in complexity. The business which introduces new products into new markets will take on a host of new information which has to be dealt with. The biggest impediment to growth ultimately is the ability of management to cope. Thus linear expansion of the business, that is, 'more of the same', is going to be much easier to cope with than expansion into new products and new markets.

When considering expansion, many entrepreneurs leap after new opportunities without considering the impact on their own time or the capacity of their firm to absorb new activities. Perhaps this is why high growth firms put so much effort into selling more of the same products to existing customers or in finding additional products which they can sell to existing markets. Rather than grow by increasing the number of markets they chase after, they concentrate first on the markets where they already have an advantage and where their existing systems are established to support them. Thus geographical expansion of existing products into the same markets would seem to have less complexity than to expand locally into new markets.

While diversity has the advantage of spreading the risks and increasing expansion opportunities, it comes with a complexity cost. To the extent the firm has a centralised management culture, this will place a severe limitation on the ability of the firm to aggressively expand.

Growth Check List

- What are the constraints to expansion of your business?
- How much control rests with the CEO? Is this a bottleneck in the business?
- How easy would it be to double capacity and then double it again?
- If you had to start operating another location, how well would the internal systems cope with the added location?
- If you had to support a distant location, how easily could that be done?
- How well documented are polices, procedures and guidelines used within the business and how easily can this information be imparted to new employees?
- If you lost key staff, how well would the business cope?
- If the business is growing rapidly and the best people are promoted to new responsibilities, how well could those under them pick up the tasks?
- If you were faced with doubling the business within 12 months, how easily would you be able to find new staff, train them and manage them?
- Can the firm grow through replication of an operating unit rather than by linear growth?
- If 30% of the senior management team were suddenly required to be devoted to a distant opportunity, how well could the business operate in their absence?
- To what extent is the firm micro managed? Are individuals given latitude to find solutions to their own business problems or must everything be approved before action can take place?
- What capacity exists within each department to substantially increase throughput?
- Does the firm know what additional throughput could be achieved in the various plant and equipment it uses?
- Where are the bottle necks in the in-bound and out-bound supply chains that would constrain the firm in the event of a major growth thrust?

Personal Insight

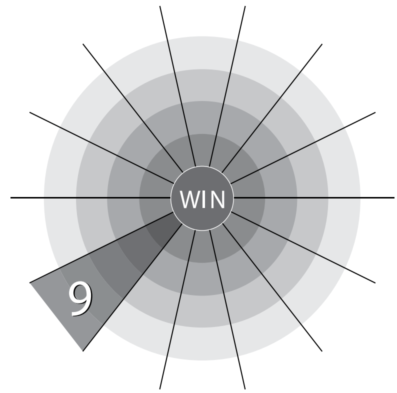
In 2005 I was interested in taking my workshop on 'Selling your Business to a Strategic Buyer' to both the USA and the UK. But as a full time employee of the University I obviously had limited time to market and facilitate workshops. Instead, I decided to license the workshop to a limited number of distributors. To support this activity, I documented how the workshop was administered, wrote a script for the instructor and video taped the presentation component. In addition, I video taped a live case study session with some of my students to show how that activity would be conducted live.

A potential distributor now has a textbook, a workbook and instructor training material to enable an instructor to learn how to deliver the content. Providing the instructor has some experience working with entrepreneurs in an executive education setting and has some personal experience selling a business, there is no reason to think that they could not deliver an excellent experience to the attendees.

The first distributor in the USA has now run several workshops and has generated very positive feedback and recommendations for others to attend. The method clearly works. From this point on there is no reason to assume that this delivery model cannot be used many times over.

Growth Potential Index

1. No assessment of volume operations has been undertaken.
2. An operations plan for growth has been produced but the level of aggregation is too high to establish if the plan is achievable.
3. The operations plan for growth has been established at a low level of aggregation but supporting detail of resources required, staffing skills required and infrastructure is lacking.
4. A detailed operation plan has been compiled which fully supports the growth plans of the venture. Supporting detail shows infrastructure, staff and resource requirements, however, no sensitivity analysis has been undertaken in areas where delays, variations in productivity or shortages might occur.
5. A detailed, integrated, robust operational plan has been prepared which includes all support operations. The plan has been reviewed under various risk conditions and contingency plans are available to mitigate or negate likely risk situations.



Developing a clear vision

More successful ventures have focus. High growth ventures typically are developed around multiple products and services where synergies abound. Developments in one part of the business are readily imported to other parts of the business. New products are able to be cross sold or readily adapted to serve multiple markets.

A focused business clearly knows what problems it is solving; it has well defined markets and a very good description of its customers. Thus it is able to articulate why it exists, often in very simple terms. It is able to provide a short, focused vision of the venture which shows that all parts of the business are heading in the same direction and are mutually supporting and not undermining it. In such an environment, decision-making is easier, actions are more targeted and results can be measured in terms of where the business should be heading.

There are two parts to the clear vision which high growth ventures are noted for. The first is focus and the second is a view of where they are heading – the vision of the future they wish to build.

While many businesses would claim they are opportunity focused, you sometimes wonder whether they ever stopped to evaluate which opportunities they should pursue and if the combination they have makes sense. In emerging markets, it is very easy to see new business opportunities in every conversation and every customer contact. Most of them seem to be related to other things you are doing; maybe it is the same customer or the same underlying technology or another use of company resources. Of course each one takes a little investment and then it needs some specialised staff to develop the idea and bring it to life. Once developed, you find out that it actually needs different people to agree to buy it and the process of selling it is a little different to the last item you sold.

Then you discover that it has slightly different risks to the products and services you already have in the market and you need to modify your sales process, agreements and after sales support to manage the new risks. Before you know it, you are actually running a different business.

Many firms fall into this trap. They start in one product or service and then see extensions which take them into other markets. Or they start in one market and then find they have an internal problem they need to solve and decide to make a business out of it. So a software business becomes a product business, a recruiting business and then a training business. Or a manufacturing business becomes a trucking business and a maintenance engineering business.

You end up anywhere and everywhere without a map

High growth businesses look for synergies across their business. Thus a new product should not only be able to be developed within existing research and development capabilities but it should be sold into markets where similar buying processes are utilised and where current staff can be readily deployed. Market growth comes from finding comparable markets which will buy the same product or market or product extensions which can be serviced using the same product/market approach.

Different products are developed or acquired if they have the ability to leverage existing products. Thus platform products might be developed which can support multiple applications. Common components might be developed which can be utilised across multiple end products. Processes might be developed which can be used in many parts of the business.

Every business sector has its own risks, idiosyncrasies, networks and opportunities. But knowledge of these takes time. During the learning time mistakes will be made, resources will be wasted in false starts and competition will erode opportunities. However, once the learning has been done, risks understood and networks established, risks are more readily identified and mitigated, opportunities are spotted earlier and networks provide sources of leads, recruits and synergies.

Few people are able to build up knowledge across multiple markets and stay up to date. Thus the more markets in which a business operates, the higher the chances of making mistakes or missing opportunities. High growth businesses tend to be relatively tightly focused around some common underlying asset or capability. They specialise in one major dimension of their business and other parts of their business hang off it. They typically have an underlying capability which unifies all their products and services. This could be a technology which they apply in multiple situations, a type of customer they specialise in or a capability they are able to apply to multiple situations.

In a high growth venture, the senior management team is able to deal readily with situations which are brought to them from different parts of the business. Each member has the experience and knowledge to apply their specialist knowledge to help arrive at a solution to a problem or opportunity. This does not mean that the business has to operate around a single customer type or single market, but it does assume that the markets are sufficiently similar that the combined knowledge of the senior management team in that market or similar markets makes them effective at making decisions.

The best high growth businesses have very simple visions around a major capability or a single objective. That vision often capitalises on their most important competitive advantage. It usually has a clear definition of a common customer or customer type and often states what problem they are solving.

A good test of focus is to answer the following questions

- *What business are we in?*
- *What market do we serve?*
- *What problem do we solve?*
- *How would we define our customer?*
- *Where do we derive our competitive advantage from?*
- *What do we do better than everyone else?*

High growth businesses usually have very simple answers to these questions. Their focus helps them identify how best to grow their business as they are able to test new ideas against a set of criteria which represents why they were successful in the first place.

The second part of the clear vision is having a well-defined goal in mind for the whole business some years out in the future. This vision should encompass the whole enterprise and not be an overly convoluted general statement. Thus an enterprise which does everything has clearly lost its way. A business which provides multiple disparate products and services, even if to a single focused market, is highly likely to get into trouble.

If you were to project the growth of your business out five years – what would it look like? Would you see a business which worked closely together, where synergies existed between the different parts of the business?

What if your business was to grow by a multiple of ten over the next three years with each part of the existing business growing at that rate. What would the business look like? Would it be a business which made sense from a market and management perspective?

High growth businesses tend to hang together – they make sense. The various parts of the business seem to complement each other. The core parts of the business support all the extensions. While any part could be split off, it would not be as attractive to the buyer as it is to the original business.

If your business was to grow by a multiple of ten – is it a business which you would be comfortable managing? Will you end up with one business or several separate and distinct businesses? If it is the latter, then you have a lack of focus and it would be difficult to develop a clear vision for the business.

Personal Insight

In the early days in my first business, we chased after everything. We were in financial systems, manufacturing systems, PC sales, training and even customer programming. It wasn't until we had been in business for about eight years that we really understood what we were good at. We had a superb software development team and we really understood enterprise wide systems for manufacturing. We decided to focus our talents and energies into developing a system for process manufacturing – the first company ever to do so. The resulting system was world class and enabled us to sell the business to a US listed company for a healthy premium.

Growth Check List

Product/market

- How many different market sectors are you currently servicing?
- To what extent can you use knowledge gained in one market to enhance your capability in another?
- How much cross selling of products and services are you able to achieve once you have established a new customer?
- To what extent are the buyer behaviors similar in each of your markets?
- To what extent are the product and service risks comparable in each of your markets?

People

- To what extent are you able to utilise your staff across your multiple business areas?
- If you provide staff development training – to what extent does this enhance their ability to work more effectively in different areas in the business?

Image

- Do people outside the business have a clear understanding of what your business does?
- Are your staff able to provide a concise meaningful description of what your business does, its customers and the value it provides to those customers?

Growth Potential Index

1. The business has a number of disparate products and services operating across substantially different markets. Developments in one part of the business have little potential to improve other parts of the business. The business is unlikely to change in the future.

2. The business operates in a number of different markets which are somewhat related although specialist knowledge is not able to be used across different segments. Some staff could be cross-trained to some advantage. Some parts of the business could be closed or sold off to provide more focus. Major changes are, however, not possible even in the medium term.

3. The business operates across a number of different markets with different customers. Processes within the business sectors are partly comparable but major differences still apply. Some changes could be made in the medium term to reduce the effort in those parts of the business which have the least synergy with other parts of the business. New investments could be made in those parts of the business where synergies in market approaches, buyer processes and service support methods are compatible.

4. The business operates across a number of different markets with some level of commonality. Most employees are able to provide input into most of the market sectors the business currently operates in. Minor changes to the way the business operates and some pruning of existing products or services and/or changes to the markets the business focuses on could be undertaken in the short term to improve the business.

5. The current business is highly focused, or could be readily modified to create a situation where products and services sell into highly comparable markets using similar processes and knowledge. Developments in one sector are, or could be, used in other sectors in which the business operates.

10

Pulling it all together in a plan

Most business plans are simply projections of the past. It is simply Excel madness. It is almost as if, by putting the data into Excel and projecting it forward for three years, it will happen. Of course it might. But that would be more hope than strategy. Forecasts need to be based on a set of realistic and defensible assumptions.

For others, the business plan is an expression of what they would like to happen. They know what outcomes they desire and work backwards until they establish the growth rate which will get them there. Alternatively, they use a set of assumptions which seem reasonable and build their business plan from there. This is often expressed as the classic "percentage of the market" plan.

"The market is huge and we only need 2% of the market to be a $100 million business."

However, this is often not supported by any validation that the customers will buy the firm's products or they will buy in the volumes asserted.

The growth business plan has a very specific purpose. It is to ensure that the business is capable of delivering on the specific goals and objectives the business has committed itself to.

The purpose of the business plan is to show that those objectives can be met.

To reach the destination you have to know which path to take and how each step will be undertaken. Day to day control of the business is an essential characteristic of a well-run firm. This means knowing where you are going, what you need to get done and having the systems, policies and procedures in place to monitor and correct deficiencies. The reason why VC firms prefer to work with experienced executives, especially those with start-up and high growth revenue experience, is that these people have learned the importance of being well informed and taking remedial action early.

Operational systems include all the budgeting, financial and operational reporting systems, performance setting and monitoring processes and systems and reward systems to encourage the right behaviour. High growth businesses are very finely tuned because they consume cash in building capacity. They have little room for mistakes and therefore early warning systems and quick response systems are very important.

The general view is that, if you cannot put together a good business plan explaining every aspect of your business, you probably don't understand it well enough to manage significant growth. The major benefit of the business plan process is to be able to communicate the complex nature of the business to everyone involved in achieving the targets. It has to explain every aspect of the business in sufficient detail that you clearly identify how each part of the business interacts and supports every other part. It needs to show how all the parts have to work together at a point in time and over a period of time.

The business plan really has three components:

- Where are you now?
- What are the goals you want to achieve?
- How are you going to get there?

The existing business provides the platform for growth and should be able to demonstrate the operational aspects of the business model. This should validate the product/market information, the financial aspects of the business and the capabilities and capacity of the existing business. It should also be able to identify where resources, capabilities and untapped skills can be utilised to support the growth plans. Plans need to show how the growth opportunities the business intends to pursue are translated into such things as new products, geographic expansion and acquisition opportunities.

The firm should develop a comprehensive roadmap showing how the plan will be achieved. This should include the identification of specific milestones, the tactics which will be employed to reach each milestone and the manner in which the firm will adapt its structure to move to the next milestone.

The business plan is simply about execution. You are at point A (now) and you need to get to point B (the agreed goals). Simply put, what are you going to do to get there? You need to show exactly how you are going to put the strategy in place over a three to five year timescale.

To arrive at your intended destination, you need to work out how to get there

Say you are a $5 million revenue business. To get to your defined goals, let's say you need to grow the business to $20 million, how are you going to do it? It is simply not an extrapolation of the numbers. Few high growth businesses develop in a linear manner. They typically extend their capabilities into adjacent areas of business. Since new business areas often consume current resources and impact existing business units, the growth strategy must contain operational plans for every part of the business, both the new and the old. The plan should contain considerable detail about the operational areas of the business. For example:

A detailed marketing plan

- Size, growth , customer profile, competition
- Promotion, advertising, PR plans
- Proof of effectiveness

A sales plan

- Closure rates, remuneration plan
- Recurring business revenue and targeted prospects
- Sales targets and recruitment and training plan

An R&D Plan

- Product development and release milestones
- Quality assurance, recruitment and training plan
- Equipment plan

And so on.

Senior management should be able to investigate any part of the plan to see exactly what each business unit and each manager will be doing to contribute to the overall plan. This is then all brought together as an organisational plan, including recruitment and training, office accommodation, manufacturing and warehousing space, infrastructure planning, a finance plan and a set of resulting financial statements and so on.

The CEO should be able to say, ‘Show me exactly how these revenue numbers are going to be made.’ This might require a breakdown into recurring revenue and new business. The recurring revenue might be supported by actual contracts with customers. The new business should be supported by a prospect generation and sales closure plan which targets specific customers or specific channels and so on. The more the managers within the business can show they really understand how to make the numbers and have the people, systems and processes in place to do so, the more convincing the plan is.

At the same time, the growth plans may call for new management positions to be filled, new departments to be created and/or new business units to be acquired or developed. An executive recruitment plan, a succession plan and a staff development plan therefore needs to be included in the overall plan. Finding the right people, moving existing staff into new functions and back filling jobs is a critical activity for businesses which experience high growth. A serious limitation to growth potential is the ability of the business to find and train quality staff.

The plan should be very specific about the strategy to create demand for existing and new products since this is probably the greatest area of exposure in the plan. The plan must be able to show how that will be supported through the operations and development parts of the business to show that the business can deliver on its sales.

At the same time, the business must manage its risks. Contractual risks are an area of great concern to fast growth companies. Having done the business, they don’t want to be looking over their shoulder to see if it needs to be done again. Thus well written contracts with customers and suppliers, well designed contracts of employment and well documented intellectual property ownership and assignment are all components of good management of risks. Other risks need to be identified through a risk analysis exercise and simulation exercises. Some risks might be regarded as acceptable due to their low potential impact, while others need to be addressed so that plans are put in place to minimise, contain or avoid them.

Few plans are ever realised as written. Not that they were bad plans at the time of their creation, but circumstances change. However, by having a clear understanding of how the business works, new opportunities can be better addressed, the impact of setbacks and problems can be better analysed and corrective action can be taken in the context of everything else that is going on. The impact of new growth opportunities on the existing business can be more easily defined and the chances of finding the necessary resources to pursue an opportunity can be better assessed with a comprehensive planning process.

Personal Insight

By 1990 my first business, Pioneer Computer Group, had grown to three offices in two countries and 16 distributors over 12 countries. We had two main manufacturing application products and two system software products. We were concurrently developing software versions for release within one year, for the subsequent year and for the one after that. There were typically about 50 implementation projects being undertaken at any one time, many of them lasting over several years before they would be completed.

Our staff retention fortunately was very good but even so we were recruiting several people in each office at any point in time. Externally there were companies creeping into our market space and more were likely to do so. The whole business was simply too complex to leave it to just-in-time decision-making. Detailed plans had to be put together for every aspect of the business to ensure we could clearly identify what needed to be done, co-ordinate all the various projects which were in play and adequately staff for vacations, sickness, resignations and growth.

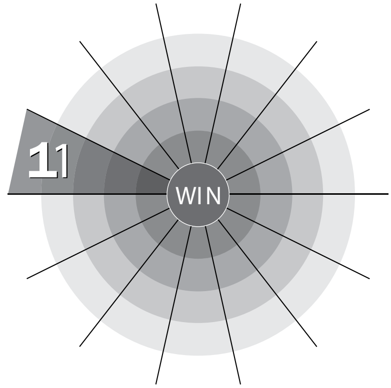
Growth Check List

- Are clearly defined targets set for each area of the business for the next few quarters and for the next three to five years?
- Is there a development strategy in place for enhancing the current products?
- Are customers and suppliers involved in defining new needs and capabilities for current markets?
- Are new opportunities for growing the business being investigated?
- Does the senior management team have some slack time to enable them to pursue new opportunities?
- Has the company mapped out what can be achieved organically and what needs to be acquired through acquisitions?
- Are plans built using both bottom-up and top-down methodologies?
- Are the growth plans realistic and achievable without putting the business at high risk?
- Has the senior management tapped into personal and professional networks to validate their projections of how their markets will develop?
- Do people at all levels inside the organization have incentives to put the time and energy into meeting growth targets?
- Are the performance setting processes aligned to the performance monitoring and exception reporting systems to ensure problems are quickly identified and actioned across the entire organization?
- Have the operations of the business been simulated through the planned growth period to ensure that adequate capacity and funding has been planned for?
- Has a risk analysis been undertaken to test the sensitivity of the plan to delays, disruptions, loss of key customers, suppliers and personnel?

- Does every person in the firm understand how the business is going to develop and what their contribution is to its ultimate success?
- Are employees excited by the plans for the development of the business?
- Are plans updated as circumstances change?

Growth Potential Index

1. No long-term growth strategy exists for the business.
2. The business plan is mostly an extrapolation of existing trends of the business. No serious attention has been given to developing the business into different products, markets or new avenues of business.
3. The strategy of the business is to grow and avenues for growth have been identified. Some of these are extensions to existing business and others are new areas of business. Realistic plans for new areas of growth have not been created.
4. A clearly defined strategy is in place for developing the current business and for extending the business into new areas of growth. Detailed plans exist for all areas of the business which are realistic and achievable. However, there are still areas of concern around access to funding and whether acquisitions objectives can be met.
5. A detailed and realistic growth plan has been developed for the existing business and new areas of growth including highly specific and targeted acquisitions. The plan has undergone risk analysis and actions have been taken to minimise risk exposure. Senior management appreciate the effort involved in building new growth capabilities and have created a business environment which will allow them to devote considerable effort to new areas of interest.



Creating robust margins

One of the biggest impediments to growth is access to finance to fuel the investments needed to support growth. A business which is in a steady state and makes a reasonable profit will have set aside a certain amount to fund its working capital requirements. The fortunate business which is able to obtain credit terms from its suppliers longer than the credit terms (if any) it offers to its customers may be able to have a zero working capital position. However, once the firm has to invest in growth infrastructure, the only firms which can do this from internally generated activities are those with high contribution margins. The rest have to raise the funds through the sale of equity and/or borrow funds.

A simple example can highlight the financing problem:

Attribute	Year 1	Year 2	Year 3	Year 4
Revenue $M	2.0	4.0	8.0	16.0
Customers	100	200	400	800
Employees	50	100	200	400
Products	2	2	4	6
Locations	1	1	2	3
Executives	3	6	10	12
New Employees	12	75	150	300

This is a simplistic view of growth as there are normally some economies of scale in staff numbers as the firm engages specialists and the span of control increases. Also firms spend progressively more on productivity assets and processes to gain better use of staff time. However, leaving those considerations aside for the moment, the example demonstrates some significant aspects of growth.

- The amount of data the firm has to process goes up considerably with the number of transactions, often requiring investments in new support systems (financial, logistics, quality control, human resources, customer relationship management, asset tracking, complaints handling and so on). Not only is the firm required to purchase new systems but it must convert data and retrain staff on the new systems.
- Multiple products increase the complexity of operations throughout the business. This applies to R&D, purchasing, operations, warehousing, sales and servicing. Each product will have its own product cycles of innovation requiring re-engineering of plant and new sales and marketing programs. Sales and support staff now have to be trained across more products increasing the training time for each person.
- The introduction of new locations greatly increases the management complexity. New reporting systems need to be introduced involving new target setting, key performance indicators, performance reviews, budgets and exception reporting.
- Increasing numbers of executives puts a strain on management as each new executive needs to be made familiar with the firm's operations, its policies, reporting systems, products and markets. At the same time, the culture of the business which helps to make decision-making somewhat easier, needs to be conveyed to new executives, often across multiple sites.
- The biggest problem is the sheer rate of recruitment. With a reasonable level of retention, even the best of firms will have problems recruiting at the rate needed to maintain quality and culture. More and more time of senior staff will be taken up with recruitment interviews. New people will need to be trained thus taking up the time of existing employees as well as costing the business the salaries and overheads of new employees before they can become productive.
- New people need accommodation and support systems. Thus the business is in a constant scramble to find new office space and to equip staff with computers, furniture and telephones. Factory and warehouse workers need space to work, equipment to work with and space to store components, work in progress and finished goods inventory. Many staff need car spaces.

Staff need to be supported by professionals in training and staff benefits. Operations need to be supported by staff coverage during sickness and vacation periods.

Many costs during the dizzy process of growth are not linear. Office space can't be grown one person at a time and telephone systems come in networks of limited sizes which need to be replaced entirely when they reach their technical limits. Factories and warehouses can only be expanded to a certain limit before they need to be duplicated or replaced.

This entire growth infrastructure is an investment. It is either going to have to be funded by the surplus generated by current sales, the issue of equity or debt finance. Equity funding, while avoiding the liquidity risk of repayment, still must see a return on the investment. This has to come from a dividend stream or increases in capital appreciation. If new equity is constantly being released onto the market, capital appreciation is difficult to achieve and shareholders want to see dividends. However the business needs the cash used to pay dividends to fund growth. A catch 22!

Debt is an obvious candidate for sourcing this investment funding. Debt funding may, however, be difficult to secure in new ventures with uncertain markets and low fixed asset platforms. Also debt funding requires servicing which will use up cash. Ultimately of course, loans need to be repaid, which is not a problem providing it can be continually refinanced.

The only successful way out of the growth trap is to generate the investment funds from current sales. The only way to achieve this is to produce generous gross margins on sales. It is the surplus cash generated from current sales which typically fuels the growing business. Thus it is almost an imperative for rapid growth that the firm generates significant cash surpluses both to fund new investments but also to service increasing levels of debt.

High gross margins provide other benefits to the firm. Few growth businesses are able to maintain constant growth. Sooner or later, the firm will incur either internal problems associated with co-coordinating its growth or will suffer a setback in the market. While some problems might be able to be forecast, it is anticipated that most will not. Unfortunately, the disruption will often come at a time when the investment to support the next level of growth will already have been made and committed. However, the resultant income won't be sufficient to support the new cost level. Without the generous margins generated from current sales, the business would quickly move to an insolvent position and either have to drastically cut back or have to sell out. It is high margins which allow businesses to make mistakes and recover from them.

This ability to absorb mistakes can also be seen as an ability to buy time. Rather than have to instantly cut back or take drastic action, the firm with a cash buffer can take time out to review the issues, change direction or take corrective action and come back into the market with a renewed approach. While it might have lost some impetus, it is not put out of business.

Growth eats cash, so you need high margins to fuel the engine

Premium pricing associated with high margins provides the firm with a price buffer in the event of a competitive attack. The high price and generous margins allows the firm to use its surplus cash to counter aggressive marketing, meet competitive product changes or fight out a price war. Unless the competitor has an equally large war chest to fight with, the firm with high margins can better withstand a competitive attack. In the worst case, the firm will end up with lower prices and a slower growth rate, but will survive.

Healthy surpluses on trading can also allow a firm to invest higher amounts in R&D than its less endowed competitors. This, in some cases, can allow the firm to move ahead more quickly in bringing new innovations to market thus increasing its lead in the sector.

High growth firms tend to have products which are not price sensitive. This usually comes from high product differentiation and servicing a high compelling need to buy. However, not all will have this advantage. Others achieve growth through lower costs, thus generating better margins than their competitors. The increased margins allow them to innovate more, pay better salaries and thus attract higher quality staff, increase their marketing spend per unit of output and attract a lower cost of capital. While costs may be decreased by finding an attractive lower cost of input, say through off shore manufacturing, most cost advantages come from better processes. These could be associated with better information technology, better management or better operations productivity.

Where sales are somewhat insensitive to price, it is worth investigating the impact of sales at different price levels. Increased margins can sometimes come from increasing profits while decreasing unit volumes. Consumers' perception of value is not always associated just with utility. In many cases quality is associated with price, thus a high priced item may convey an impression of higher quality or a means of enhancing self-image.

Growth Check List

- Has the firm tested out different price levels to determine sensitivity?
- Can products or services be differentiated within the market to offer different product/price options?
- Have different distribution channels been investigated to test price sensitivity?
- Have quantity price discounts been used to drive up customer loyalty?
- Does the firm have a program for customer retention?
- Are cross selling opportunities being used to drive up transaction and customer productivity margins?
- Has an analysis been undertaken of the profitability and servicing costs of different groups of customers?
- Has the firm investigated buyer behaviour to see which features or attributes of the buyer utility and purchasing decision can be enhanced to increase price or decrease marketing costs per unit of sale?
- Are there specialist niche markets which could be addressed with minor variations to the product or service which might generate high margins?
- Has the firm benchmarked its sales and marketing activities with best practice and leading companies within its sector?
- Has the firm benchmarked its component, manufacturing and servicing costs with those in its sector?
- Are processes within the firm investigated for improvement in costs and/or productivity?
- Can design engineering or value analysis be used to decrease costs and/or improve productivity?

- Are economies of scale available in the firm? Has the firm investigated ways of securing higher volumes through special agreements in order to reduce costs across the entire output?
- Could outsourcing be used to reduce selected costs within the firm?

Personal Insight

Software, like pharmaceuticals, has very high R&D costs but very little production costs. Thus the gross margins, at least on the software license sale, can be very high. This does allow you to offer flexible pricing, volume price discounts, different prices for different markets and so on. It also means that you can afford to give away software components as compensation for errors which affect customer relationships.

With high fixed initial costs, additional sales over the break-even point have a very positive effect on the profit. Thus software lends itself very well to using distributors where margins must be shared. However, even a 20% license fee can be a healthy contribution to a business which has already recovered its development costs.

Growth Potential Index

1. Sales price is highly competitive, sales are very price sensitive and the firm has little influence over input costs.
2. The firm has some influence over sales prices but the sector would attract new competitors if profit levels were unusually high. The firm is unable to influence its input costs.
3. The firm is able to charge a premium price for its products without attracting competitor retaliation. The firm has favorable input costs. Margins are sufficient to provide a buffer for unforeseen negative events and to provide for a surplus which can be invested to grow the business.
4. Premium prices are able to be charged. Customers are not price sensitive. Favorable costs are able to be achieved. Margins are high, enabling reasonable levels of cash surpluses to be reinvested in growing the business. The business may be impacted by economic cycles and competitive activities.
5. Premium prices are able to be charged. Customers are not price sensitive. Considerable economies of scale and learning curve effects offer scope for on-going cost reductions. The business is not subject to fluctuations due to economic cycles or competitive activities. Significant cash surpluses are able to be generated to fund growth and service debt.

12

Managing risk

Business owners often neglect to uncover and analyse potential risks to their businesses. It is almost as though the budget itself is expected to look after all the possible things which could happen to the business. More sophisticated firms undertake sensitivity analysis on the revenue numbers to estimate the impact of unusual growth or decline in sales and then work this back through their budgets to ensure they can cope with any situation those scenarios might produce. Few businesses, however, go to the trouble to look deeper into their external environment and internal operations to uncover those risks which could substantially damage their business.

Every business is built on a set of assumptions about their external environment and their internal operations. While some things might be obvious, any number of external events can impact the business, some of which are man-made while others are natural occurrences. Few businesses bother to plan for large man-made or natural disasters unless these are a regular feature of their local environment. Thus businesses located in Florida should plan for periodic hurricanes.

However, businesses should be sensitive to economic, social and technological trends which could impact their operations. For example, for many businesses the rate of interest can have a long-term impact if it changes quickly in either direction, while some are impacted immediately with just small increases. A business which is sensitive to such changes should review the impact on the business of possible changes. Similar scenarios might be undertaken with oil price movement, commodity price changes and/or currency fluctuations.

Some underlying trends will impact a business over a longer period. Thus the aging population, or the levels of immigration, may impact the location and type of housing required or the demand for certain types of leisure activities. Some changes in technology are obvious, such as increases in computer power, capacity of internet channels and the capabilities of mobile phones. Others are possible but will not impact the marketplace in the short term, such as breakthroughs in medical science. The business needs to monitor those aspects of its environment which can impact its ability to achieve its targeted revenue numbers. Any change in trends or dramatic shifts in conditions which effect their industry should be examined for impact.

In closer proximity to the firm are the operations of its major customers, suppliers and competitors. The actions of major customers, if they go out of business, get relocated or are acquired, relocate major parts of their business or undertake a major change in direction, can be very damaging to a firm. What was at one time an assured flow of business, can dry up in a relatively short period. Thus monitoring the health of major customers is an important part of risk management of the firm. Most businesses are sensitive to their dependence on a large customer but few take action to spread their risks or to work with the customer to arrive at a risk reduction strategy. Also, the business should look at its exposure to any one project or customer to ensure that it is managing the risk of default on an agreement.

Distributors are another area of potential risk

At the same time, the business will be dependent on a number of suppliers, some critical to the on-going operations of the business. If any major supplier should go out of business, have their operations significantly disrupted or be acquired by a competitor, it could present a significant risk to the operations of the firm. While dual sourcing has been used by many companies, this may not always be feasible, but at least the firm needs to review the impact of such events and consider what action could be taken to reduce the disruption.

The business may have a number of strategic partners which work with it on joint sales or implementation activities or generate sales leads. With any external business there is no guarantee that they will continue an arrangement indefinitely. Where levels of activity are critical to the firm's performance, such arrangements should be put on a formal basis so that obligations of each party are clearly understood. If the firm is unable to secure adequate assurances of continued joint activities, management should seriously look at other avenues for business.

Distributors are another area of potential risk. They need to be carefully monitored to ensure they are devoting adequate resources to the firm's business and that they are willing, able and capable of securing the level of business necessary to meet their targets. A business which is overly dependent on one, or a few distributors, is really not in control of its own destiny. Actions should be taken to secure additional distributors, build an internal capability or enter into some level of guarantees with the major distributors.

Businesses which deal with importing or exporting of products also need to be sensitive to delays in transport. Shipping is notorious for delays through weather, dock workers disputes, changes in government regulations and natural disasters. Possible delays should be simulated to show the impact on the operations of the business and the most likely disruptions planned for.

Competitors can have the greatest impact on the future profitability of the firm, whether it is a price war, the introduction of a new product, the impact of a new innovation on their cost of sales or the impact on their reputation of winning a major account or performance prize, their activities will impact the firm. Monitoring competitor activity and trends is an important part of risk management. Since much of the information is in the public domain, such as their web site, their published brochures, product information, press releases and annual reports, much information can be collected about their operations. From this information and industry rumors, much of their strategy can be ascertained. This information needs to be fed into the strategy plan of the firm.

Failure to achieve targets is often the result of internal mismanagement or disruptions. These are mostly under the control of the business and therefore the firm has much less excuse for not predicting their occurrence and thus planning for them. Trends in physical activity can certainly be monitored to provide an early warning system of deviations or problems. It is the simulations which should be undertaken before events occur which provide the best weapon against disruptive events. Problems which can be foreseen can be considered and contingency plans developed or other actions taken to reduce the impact of possible problems or avoid them altogether.

Consider delays in research and development as an example. Creative activities and complex activities are difficult to predict with any accuracy, however, staff constantly forecast optimistic completion dates. The role of the strategic planner should be to develop alternative completion dates over a wide range of possible horizons to project the impact of delays on the business. With this in mind, the business can decide to devote more resources to the activity, plan other development activities as back-up or build in buffers for downstream activities in the event of delays. Certainly the firm would be unwise to make contractual commitments on the basis of deadlines which cannot be guaranteed.

Another overall risk in any business is quality, yet many firms fail to monitor quality performance throughout their operations. The overwhelming body of research in this area shows that problems which fail to be uncovered early in value added activities cost many times their monitoring cost if discovered late in a process or in customer use. Recall of products is expensive, fixing problems on customer sites is very time consuming and unproductive and compensating customers for errors which could have been foreseen is simply a waste of shareholders' funds. Growth businesses can be severely disrupted if quality problems are not caught early in a process. Not only do they waste precious resources, but they can stall the entire business.

Many high growth businesses market high priced products which are sold to other businesses. The sales cycles are often long and the number of new customers in any period is often small, thus any fall in new customers can have a big impact on revenue. High growth businesses are typically very customer centric. They recognise the impact of the loss of an existing customer and the high costs of obtaining new customers. Their marketing strategy and customer support systems concentrate on providing the customer with an outstanding result. They pay close attention to each customer and monitor their relationships with them. Their aim is to ensure a high level of repeat and cross sold business and aim to generate significant new revenue from referrals. In this way, they work to minimise the risk of losing customers but also reduce the cost of gaining additional customers.

Other sales environments carefully monitor the progress of customer contact to ensure that additional effort can be put into situations which are problematic. Thus the sales activity is monitored from first contact all the way through to closing the deal. This information is used to compare sales performance on an individual salesperson to the firm average. Any deviation stimulates intervention to help recover the situation or to move resources to higher potential prospects.

Risks are, however, not just in activity monitoring. Firms can experience severe disruptions through the loss of key employees through resignations, illness or sometimes death. Succession planning should not be limited to senior executives. The entire organisation should be undertaking a risk analysis of the impact of the loss of any employee. Activities such as cross training, documentation of knowledge, standardisation of procedures and planned succession paths will alleviate some of the risk. On a more positive side, firms can actively work to retain staff. Individuals can be encouraged to develop their own skills so that they can take up opportunities within the firm. The firm can put resources into building a more open and supportive culture. Human resources staff can work with individuals to discover where they can assist them to achieve their own personal ambitions both inside and outside work. Not only does high turnover disrupt the business, it is very expensive to recruit and train replacement staff. This is one of the highest risk areas for any business and yet it seems to receive very low levels of attention.

Another overall risk in any business is quality

Another area of high risk to the high growth business is lack of finance. Few businesses can grow just from internally generated funds, most will require access to debt finance and some will need additional injections of equity. Typically any significant level of external finance will require many months to secure and will take up a significant portion of senior executives' time. Generally it is difficult if not impossible to secure finance when the business is in trouble. Business plans need to project financing needs several years into the future and should take into account the different possible levels of business which could be experienced under different assumptions. A business can be equally disrupted having too much business as too little. In the former case, funding is needed to finance increasing levels of working capital and infrastructure investment. In the case of too little business, funding may be needed to cover for work in progress or inventory which is not able to be sold or to pay salaries and other costs while the business is being reduced in size. Funding arrangements need to be put in place well in advance of need so that little delay occurs when funds need to be drawn on.

A big risk for many high growth firms occurs in their acquisition activities. Many firms grow by acquiring capacity, products or people through an acquisition. In some cases, this is the only way they can maintain their growth rates. However, only a minority of acquisitions are successfully integrated into the original business. While many senior executives take extensive trouble to find and secure the right acquisition, they seem to think the job is completed with the signing of the deal. However, most acquisitions prove to be highly disruptive due to problems of integration. Without a detailed plan for integration and experienced personnel to handle the risks associated with it, the benefits sought through an acquisition are unlikely to be achieved.

Growth Check List

- Does the business project best, most likely and worst case scenarios for their revenue streams?
- Are underlying assumptions in business forecasts validated?
- Does the business examine the impact of the loss of major customers, suppliers and partners?
- Are external trends in the economy tracked and possible changes examined for potential impact on the business?
- Are competitor activities monitored?
- Has the firm examined the impact of delays in procurement of key inputs to the business?
- Has the growth of the business been projected several years forward to uncover needs for staff, accommodation, plant capacity, warehouse space and so on?
- How sensitive is the business to on-going relationships with key partners?
- How does the business monitor the performance of its distributors and agents? What assurance does it have that they will meet the targets set?
- What level of succession planning has been undertaken within the firm?
- Is cross training, up-skilling and career planning an integral part of human resource planning?
- Does the firm have a quality monitoring and intervention program across all sensitive activities?
- Does the firm have a funding plan for the next few years? Has this also noted the level of involvement of senior executives in securing the necessary funding?
- If the firm undertakes acquisitions, is there a detailed integration process in place? Is it adequately staffed by senior staff with experience in such programs?
- Does the firm have a positive working relationship with its bank?

Personal Insight

In the early months of my first business, Pioneer Computer Group, my non-executive Chairman asked me to put together a monthly Board reporting package that included all the normal financial reports. He did make one other request however. He wanted a worst case cash projection. This report would provide a monthly forward profile of cash availability taking into account the costs of running the business but excluding any new sales or discretionary expenditure.

Of course if you don't make any sales, you must eventually use up your accounts receivable, then your work in progress and finally your cash reserves. In the end you run out of cash. What he wanted to know was, 'how much buffer did we have?' How much warning would we have of a cash flow problem? We determined that 3 months to cash out was a reasonable target. After all, we still had a prospect pipeline and repeat business from our existing customers.

That report became our most valuable management report. When we showed cash out at under three months, we would start taking action to bring cash in earlier, delay discretionary expenditure and try to close high probability sales earlier. As the horizon moved closer, we would identify staff to be made redundant, move development staff to consulting and training and look to cut regular expenses. We would work with our bank to obtain a loan if we could see the problem correcting itself within a few months. Finally of course, we would have to make redundancies.

I have no doubt that the worst case cash flow report stopped my business from going bankrupt several times.

Growth Potential Index

1. The firm does not have the staff or the processes to undertake any reasonable level of risk analysis.

2. The firm undertakes some risk analysis around financial results but no detailed risk planning is undertaken at operational level. The firm has no processes which would support such an activity.

3. Major risks are identified and plans have been developed to deal with them when they occur, but no mitigation or avoidance plans are normally developed and implemented. Some monitoring of activities provide the firm with an early warning system and some areas have detailed plans for action.

4. A risk analysis across the enterprise is undertaken on a periodic basis. Monitoring of both external and internal activities and events occurs and extensive plans have been developed to deal with situations as they occur. The business, however, operates on the most likely scenario.

5. The business strategy has been developed and implemented to take into account those risks which would have a damaging effect on the business achieving its objectives. Extensive analysis of possible risks is reviewed periodically and measures taken to control or mitigate such situations. The business strategy is revised to ensure that potential risks will have minimal effect on the overall objectives of the business.

13

Assembling a capable management team

Why is it that only a minority of start-up firms ever get beyond six employees and less than 5% ever develop to more than 20 employees? Even when all the external conditions are highly positive, few firms develop into gazelles, i.e. firms which experience 20%+ growth rates over several years. If the demand side of the market is growing and the barriers to entry are low, one would expect there to be a large number of firms capable of taking advantage of the market conditions to grow to a reasonable size. The evidence is, however, overwhelming that very few will ever develop into any substantial size. The answer, therefore, must lie with the management of the enterprise itself.

It is very obvious that many owner/managers have no desire to grow, being content to limit the development of the business to suit their lifestyle. Others simply do not have the knowledge, skills or aptitude to grow the business. For some, it is a lack of imagination and they are simply following the footsteps of others but are unable to find creative means of advancing beyond the business model they started with. Some are limited in personal financial resources and are unable to persuade others to assist them financially.

Then, of course, there are those who have a need to micromanage the business. Since they must be involved in every decision and oversee every activity, they inhibit the growth of their enterprise through their own intervention. There are also those owners who have the desire to grow but simply have poor judgement, hiring the wrong people, taking the wrong advice and following strategies which have low probabilities of success.

Clearly some businesses fail to grow, not because of limitations in management talent and experience, but because the external conditions seriously inhibit their growth. This could be the high cost of finance, a severely depressed economy, a lack of skilled workers, severe competition with their chosen sector and import and/or export restrictions.

In situations where the environment provides positive support for growing firms, high growth firms tend to display similar characteristics.

There is a growing body of research which shows that the more successful firms are started by individuals or groups of executives who have significant experience within the industry in which they start a new venture. These firms understand how to work within the sector, have extensive networks which enable them to recruit good staff and are able to establish strategic partnerships within the industry, contracts with established suppliers and open doors to key customer accounts. They bring to their new venture knowledge of how to identify and manage risks within their sector and knowledge of systems, processes and policies for undertaking larger volumes of business. They develop organisation structures which can readily grow to the level which they hope to operate at.

No individual builds a great business; they only lead the team

However, it takes more than industry knowledge and a capable management team to grow a business over an extended period of time. Very few markets are stable over many years, being impacted by new inventions, new entrants and changing business models. Thus any business which grows over an extended period of time must have an entrepreneurial capability. This is the ability to see opportunities where others don't, an ability to construct different business models, a strong sense of timing about market changes, a willingness to have a go in the face of incomplete or ambiguous market data and the acceptance that some projects will fail.

Driving a business forward in the face of changing conditions also requires leadership and good judgement. A strong vision, a sense of partnership and involvement and a sense of personal achievement and growth are all characteristics of a positive work culture. A business grows over time, not by doing the same thing all the time, but by evolving to take advantage of opportunities in the market place. A business which is open to new ideas, willing to try new approaches to doing business, encourages people to try small experiments will proactively generate avenues for growth.

Growth itself creates organisational strains. New employees must be brought into the organisation and assimilated, new areas of specialisation will be needed, lines of communication will get longer, systems of reporting become more formalised and so on. The growth of the organisation is limited to the extent that current employees can absorb and assimilate new staff. If retention of existing staff is low, this places a severe limitation on the rate of growth of the business.

Clearly growth is limited by the rate at which new employees can be recruited, trained and assimilated. Thus higher productivity and growth can be influenced by reducing attrition or turnover. High growth firms seek ways of keeping good staff, encouraging them to see career opportunities inside the firm rather than outside and by developing their skills so they can make a greater contribution to the firm. Individuals who understand how the firm works and have developed extensive personal networks inside the firm are able to make a greater contribution to the growth of the business than a new recruit. Since the time taken to assimilate or inculcate new recruits limits growth, firms which devote additional resources to assimilating new employees will provide a better platform for growth.

In order for a business to grow, all parts of the business must work in harmony. This means that each individual must co-ordinate their activities with those they connect to in the business. If each person is required to have their actions and decisions reviewed with several other people in the firm, the productivity of each individual is going to be very low. Productivity is therefore increased where individuals are able to make decisions without such review. This is achieved by having policies which guide decision-making and actions and physical systems which direct the flow of products through the valued added activities.

Thus the more the business is able to devolve decision-making and provide guidance through polices, procedures and systems, the higher is the potential rate of growth. Decision-making also needs to be supported by a strong vision and a set of values against which decisions can be tested. The more that decision-making can be made without detailed review, the higher the potential productivity of the business.

High growth firms recognise that senior management have limited time to review decisions throughout the business. These firms typically have highly decentralised structures, often breaking the business up into smaller business units as the business grows. They also have a strong set of organisational values and a strong vision which guides decision-making. Induction programs for new employees spend considerable time educating them on the culture of the organisation and the manner in which it does business. Staff who follow these principles need less supervision and therefore less time is taken within the organisation on managing others. These firms also have superior target setting systems, performance review systems and highly developed personal incentive schemes to stretch employees to work towards common organisational goals.

Some firms have introduced schemes to capture ideas and suggestions of employees, acknowledging that creative and useful ideas are not limited to senior management. Some firms provide training in opportunity evaluation and business planning to allow individuals to test out their ideas and put them forward for funding. While this will not necessarily generate significant new revenue streams, it does build a culture of openness and a feeling of involvement for employees.

High growth firms also have resilience. Experienced business executives know that business plans are very rarely implemented as written. Every plan is based on a number of assumptions and those often prove to be unfounded or are invalidated by economic, environmental and industry changes. Thus the business may not develop in the manner originally planned. Experience shows that the best solution to this problem is to have a proven management team which has the experience to cope with the changes which inevitably will occur. Thus an executive team which has the qualifications, experience, mix of skills and industry networks to implement the original plan is important but the team also needs to have the ability to react to changing conditions and still be able to achieve reasonable results. To some extent this is simply business wisdom. A team which includes industry executives who have been through several business cycles and perhaps some industry restructuring should have this capability.

Some businesses bring this knowledge in house through a Board of Directors and/or a Board of Advisors. These groups would include older industry executives but may also include executives and professionals from other sectors which can bring new insights into problems faced by the business.

Growth Check List

- Does the management team wish to grow the business?
- Are the owners of the business prepared to take on the risks of developing new products and/or new markets?
- Will the owners be prepared to give up some equity ownership in order to finance the growth of the business?
- Do the managers have personal incentives to grow the profitability and size of the business?
- Does the business have a plan which shows how the organisation will develop as the business grows and identifies the key executive talent which has to be recruited?
- Does the firm have a well-articulated vision and a set of values which are widely acknowledged as key drivers of the business?
- Is the culture within the business open to staff empowerment, devolution of authority and a willingness to allow individual initiative?
- Are the performance setting and monitoring systems in place to support decentralisation of decision-making?
- Is innovation encouraged and supported within the business?
- Is the firm actively looking for ways to expand the business through diversification, acquisition or strategic partnerships?
- Does the firm have an extensive network of contacts throughout the industry?
- Have some of the senior management team extensive experience in corporations two to five times the size of the current business?
- Does the business have a well-defined plan for targeted acquisitions?
- Does the business have a senior executive with extensive experience in the integration of acquired businesses?
- Is the management team open to suggestions and feedback from all levels of the organisation?

Personal Insight

In my last venture, Distinction Software, I was fortunate to be able to recruit several people who had worked for me in my prior businesses. I put together a software development team which had worked together for more than eight years. To complement them, I managed to hire one of the best project managers from my former employer. But the gem in the team was a former VP of marketing whom I had worked with at Ross Systems. Rick had left Ross in Atlanta to work with some former colleagues in New York. With the sale of that business, he was looking around for his next position. I asked him to join us as COO and gave him the opportunity of buying equity in the business.

While there are risks in any venture, I had a highly capable and proven group of people who had all worked together in one way or another for several years. They trusted each other to get on with the job and to not let the team down. They all had equity in the business and a determination to make it successful. When we sold the business five years later for six times revenue, they all came out of the venture with a capital gain more than their entire salary for the five years we were together at Distinction.

Growth Potential Index

1. The current management team has no desire to grow the business.
2. The current management team lacks some key skills, experience and knowledge and no plans are in place to recruit to fill the gaps. The current team has not acknowledged any deficiencies which need to be filled. It is not obvious whether the team will stay with the venture if the going gets tough.
3. The current management team is highly competent in most of the key areas and has the skills and experience to take the venture forward. Key gaps have been identified but no plan is in place to fill the gaps. Some members of the team have made personal financial or time commitments. The team has the desire to grow the business.
4. The management team has the experience, capability and knowledge to take the venture forward and has plans to recruit some key individuals as part of the growth plan. The team has the entrepreneurial capability to see new opportunities, to find innovative ways to develop the business but lacks the skills to raise the funds to drive the business forward. The team has made significant financial contributions and/or made time and/or reputation commitments to the venture.
5. The management team is experienced, has the necessary range of skills and experience to grow the venture and has an organisational plan for both growth and succession. It is clear that the team is very committed to the venture even if it proves to be more difficult than expected and requires a higher level of personal sacrifice. The team has the entrepreneurial capability to continue to identify and pursue opportunities and to raise the funds to do so.

14

Working the numbers

When a business is small, the owner can physically see what is going on, can personally review the work of each staff member and will be involved in virtually all external transactions. They can almost physically feel what is going on. The noises around them tell them about what is going on. They can hear phones ringing, machines working, doors opening and closing and keyboards clicking. If the level of activity changes, they can look around, ask questions and take action immediately. However, this sense of what is happening soon disappears with size. Physical activity now takes place in a different part of the building, in another building or another location. Management is often isolated on another floor or another location. That sense of knowing must, from then on, rely on communications – an often inexact and untimely process.

As the business grows, physical activities must be translated into information – data with meaning. As the business becomes more complex and longer term decisions are made, the ability to convey what is going on becomes more and more difficult. There are problems of measurement, of aggregation and interpretation. Many things which can be seen or heard don't have any simple way of conveying meaningful information using verbal, printed or graphical representation. Gradually the business moves to periodic reports based mostly on financial information. However, the interpretation of financial information is problematic since much of it is based on assumptions and conventions.

Accounting has struggled for centuries to convey complex physical states and activities into meaningful numbers. But imagine how difficult it is to convey performance information when you have numerous choices of revenue recognition rules, depreciation methods, capitalisation rules, periodic expense recovery rules and so on. Then there are the decisions to make on what R&D costs to expense, which provision to make for warranty claims, what percentage of outstanding debts to write off and how much to set aside for inventory write downs. At best, decision makers can compare one period to another to see what changes have taken place – but do they really know what is going on?

Budgeting systems should be in place to define levels of activity throughout the business. However, few budgeting systems cope well with lumpy business activities. Most often they are prepared using linear projections and by assigning revenues and expenses equally across the 12 months. This fails to take into account the seasonality of the business, differences in working days in each month and the lumpiness of expenses. Instead of setting out what can reasonably be expected to happen in each month, executives spend a lot of time rejecting results for obvious business reasons.

Growth means complexity, so you need monitoring systems to tell you what is happening

Another common mistake of budgets is to assume that the original budget is still valid in the light of changing circumstances. Instead of updating the budget to predict where the business is likely to be by year end, the variances accumulate with greater and greater deviations from the budget, leaving the variance analysis as a meaningless exercise. Unless year-end projections are revised continually, the business continues to make decisions on out of date assumptions.

High growth businesses often operate in turbulent environments. It is the rapidly changing external environment that is often the reason for their existence and success, thus systems which cannot cope with rapid change are actually inhibiting the ability of management to take advantage of the very environment within which they exist.

Of course no business stands still while numbers are being prepared and reported. Most firms report monthly performance several weeks after the end of the month and annual financial reports often take several months to prepare. In the meantime, changes are happening throughout the market and inside the business. While stable businesses may be able to cope and manage under these circumstance, high growth businesses have learned that timing is everything and that the information they need is more than financial data and that they need it as soon as possible.

A business which is in touch with its underlying activities, monitors physical as well as financial activity. It maps physical transactions throughout the enterprise and then designs systems to monitor them. It sets performance levels for each activity and warning bands to alert action. Individual staff are given responsibility for monitoring performance and policies are defined as to what action should be taken in the event of an unusual activity change.

Some monitoring devices are set up to provide early warning signals, or ‘lead indicators’ of a change in the external environment. These are used to predict levels of business activity which would normally follow from the lead activity. Thus a downturn in sales leads would predict a downturn in sales, a need to reduce manufacturing and component purchasing and ultimately, would predict a downturn in profit. Lead indicators can be external to the firm, such as interest rate changes, housing starts, consumer confidence and so on. They often exist at the interface of the firm to its customers, suppliers and partners. Each lead indicator is linked to activity levels within the firm. Thus a change in an external lead indicator will predict a future change in an internal activity of the firm. By monitoring lead indicators the firm can take action to correct a possible disruptive situation through additional marketing, sales effort, trimming costs and so on. Successful high growth firms don’t wait until the end of the month to find out how they have done, they monitor activities continuously so they can take action as soon as possible when activity levels change.

Successful firms also assign responsibility for achieving activity levels at a very low level in the organisation. This way the firm does not wait until the reporting system eventually reports a problem to senior management. Events which deviate from the expected are reported as soon as possible at a detailed level to the person who is most able to influence the change. Incentives for performance are also put in place for both prediction accuracy as well as performance.

Few plans ever result in events happening the way they were predicted. Thus business plans needs to be tested across multiple scenarios to ensure that a reasonable financial return can be achieved even in the most unlikely circumstances. Every plan is based on a set of environmental and internal performance assumptions. Robust financial forecasts should declare and test the validity of the basic assumptions. By changing basic assumptions to different possible situations, the model can be tested for robustness. Those assumptions which have the greatest sensitivity can then be addressed with counter measures or additional activities to minimise their impact.

Entrepreneurial businesses do not grow in a linear manner. They monitor external situations and identify business opportunities they can take advantage of. Thus you see many high growth businesses branch out into related activities which complements their mainstream activity. The business, however, needs to have processes for capturing these ideas, evaluating and then resourcing them. Since entrepreneurial opportunities are not risk free, the business also needs to have a culture which allows new opportunities to be investigated and developed in stages. Successful progress would encourage more investment while setbacks and failures need to be written off and lessons learned. High growth businesses have systematic processes for evaluating opportunities which uncover underlying assumptions, test out financial feasibility and the impact of likely outcomes on the main business. Only if the opportunity is reasonably profitable and possible failure can be absorbed, will such ventures proceed.

Successful businesses also use industry and best practice benchmarking to test their performance levels. Since high growth demands the highest productivity possible, testing internal performance levels against other firms can uncover situations where additional effort in training, or new systems and processes should be implemented. A business which is open to learning from others can tap into a greater pool of knowledge than can be accumulated internally. Most leading firms actively support benchmarking studies in order to learn how to do things better but also to encourage their own staff to be open about introducing better processes into the business.

Personal Insight

One of the lessons that I learnt from the COO of my last company, Distinction Software, was how to manage a sales pipeline. Large capital goods generally take months, if not years to sell. They are often complex technical sales which require large outlays by the customer to purchase and install the product. Thus the current sales effort is not just about closing deals in the near future, it is about generating sales for many months and often years into the future. Basically, if you are not opening a discussion with a prospect now, you are not going to secure the sale in months or even years from now.

My COO implemented a 17-step sales management program. The funnel was filled at the top with leads, basically names and phone numbers from advertising, our web site, exhibitions and telemarketing activities. The steps then progressed through lead qualification, first contact, visit, proposal, demonstration, reference calls, contract review and signature until the money was in the bank. From one step to the next, there was an expectation that only a small percentage would move closer to a sale. Thus we needed something like 1,000 leads to generate one signed deal.

This process allowed us to track every lead and the activity of every salesperson. Any step completed would throw up an action for the salesperson and an expected date by which the next step should be achieved. By reviewing the entire pipeline, you knew if you were going to make your sales targets, with some degree of accuracy, for many months into the future.

Growth Check List

- Does the business have an integrated enterprise wide transaction processing system?
- Is there a budgeting system in place for all operating units?
- Does the business monitor its physical activities?
- Are performance targets set for both financial and physical activities?
- Are individual activities managed by the individual who has the most influence over the activity?
- Does the business develop an annual plan and then monitor performance against it?
- Does the business have a longer-term strategic plan?
- Are planning assumptions identified and then validated where possible?
- Does the business identify and track lead indicators?
- Do individual managers have clear and unambiguous targets which they are accountable for and against which their performance is going to be judged and rewarded?
- Does the business undertake scenario planning to identify the impact of different assumptions on overall performance?
- Are industry benchmarks undertaken to identify areas of improvement?
- Are physical and financial trends within the business monitored to identify areas where improvements need to be made or to identify unusual positive or negative changes which need to be investigated?
- Does the business periodically investigate the impact of varying its debt to equity ratio to project the impact on shareholders returns?
- Does the business investigate new business opportunities on a regular basis to discover new areas of investment?

Growth Potential Index

1. The firm does not have the capability to provide a meaningful analysis of its operations in both physical and financial terms.

2. Financial projections are prepared but are at a high level of aggregation and are based on assumptions which are not properly investigated and validated. Detailed cash flows are not available. The firm has not invested in systems to monitor physical activities on a comprehensive and consistent basis.

3. Detailed financial projections are prepared which show acceptable levels of profits and return on shareholders funds (ROI) but some assumptions are questionable and no scenario analysis has been undertaken. Detailed cash flows are available. Systems are in place to monitor physical activities across parts of the business.

4. Detailed financial projections are prepared which show acceptable levels of profit, revenue growth and ROI. Underlying assumptions have been validated and are acceptable. No scenario analysis has been undertaken. Systems are in place to provide monitoring of physical activities and these are used to set key performance indicators across the business.

5. Detailed financial projections with worst, most likely and best case scenarios are prepared. Underlying assumptions are validated. Profit and ROI targets are robust and achievable under all scenarios. Comprehensive monitoring of physical activities is undertaken which provide the basis for KPI and performance reviews. Key indicators are monitored to provide early warning of changes in the product/market environment of the firm.

Conclusion & growth potential score

In any entrepreneurial venture, high growth is a remarkable achievement. Few make it. Most studies show that only about 4% of all privately held companies achieve double-digit growth for a few successive years. Only a very few manage to sustain high growth over a long period of time. Clearly what enabled the spurt of growth was undermined either by internal issues or changes in their competitive environment. Some do manage to get back on track but stumble again several years later.

Most of our knowledge of high growth firms comes from looking backwards in time at firms which have achieved outstanding growth. Generally you can see something which was outstanding about the business or the senior executives that you can point to and say, 'That's why they were so successful.' As you examine more and more of these cases, patterns emerge. Many fast growth firms have similar characteristics but even so, they are not all the same. Those factors which created success in one industry may not have been the ones which underpinned success in another. However, at a more basic level they all tend to demonstrate similar attributes, those which I have selected in this book.

Perhaps the one industry which has the most to gain and the most to lose in getting the mix right is the venture capital (VC) sector. I have read most of the available textbooks on VC investment and most of the textbooks on new venture creation and I have spent considerable time in recent years reviewing business ventures for possible angel or VC investment. This examination has made me increasingly sensitive to what can go wrong with a venture and, more importantly, what you have to get right to provide a high probability of success.

The venture capital investment model takes a portfolio view of investment. VC firms look for ventures which have a high probability of a successful exit. In their eyes this almost always is underpinned by high growth potential. They then choose a number of investments which have high growth potential – note that they do not expect everyone to be a winner. What they expect is that each one has the chance to be a winner but that only time will show which one(s). What you see historically is that they tend to hit a high growth winner about ten percent of the time.

What the VC sector is doing is betting on probabilities. If they have the right components they believe that, on the basis of their accumulated wisdom, they will get it right some of the time. Although to be fair, many of their lower performing ventures would make most of us very happy with the results since these still demonstrate very good profits.

While I have taken account of what academic research and literature has to offer, my main insights into potential growth have come from my own research and work around VC investment. VC firms focus on the process of growth which I consider to be the most challenging aspects of management to get right. They are especially interested in sustainable growth over a three to five-year period. If they are interested in exiting through an initial public offering (IPO), they are specifically concerned with building a platform for long-term growth. The principles which I have included in my High Growth Wheel of Success are what I consider to be the fundamental attributes which the VC firm concentrates on when investing in high growth potential businesses.

How does this help you? Perhaps you have a business which has some growth potential but you have been unable to see how to kick it into a higher growth rate.

In order to drive a growth strategy, you need a holistic view of the enterprise. You have to seek out those factors which inhibit growth and remove them and exploit those which stimulate growth. In its crudest form, growth is simply growing revenue. Providing you maintain your gross margin, the more transactions you do, the more profit you make. But the smart companies work on several dimensions of growth at the same time. They not only want more transactions per unit of time but they want to increase the profit margin each transaction generates. They increase their gross margin by increasing their price and/or by decreasing costs. This is then combined with increasing productivity of their sales effort by increasing prospect conversion rates and decreasing sales lead times.

Another dimension which they tackle is resource productivity. By reducing the amount of resources taken to secure a sale they reduce the cost of sales thus increasing gross margins. They tackle what we can refer to transaction velocity which is a measure of the rate of transactions per unit of sales and marketing resource.

> **What the VC sector is doing is betting on probabilities**

Given a finite resource to devote to the sales effort, the high growth business directs it efforts to decreasing the time and resources needed to close the sale. Every sale has a number of steps which the customer goes through before they actually hand over the cash. These stages of sale conversion each consume resources, but more especially consume time. If you decrease the resources used throughout the process, you can support more transactions. If you then reduce the overall time taken for a transaction to covert from interest to sale, you bring in revenue quicker, accumulate profit faster and thus grow quicker. So by focusing on the resources and time taken for each step in the sale process and optimizing each one in a systematic way growth can be proactively driven.

Many transactions require the customer to undertake many steps to get to the point of purchase. For example, they might search for a product or service, gain an appreciation of competitive product and service offerings, evaluate the differences, identify points of supply, get references, perhaps try the product out, go through the purchase and take delivery. Thus, there are many steps in this process which can be improved. Your objective should be to make this as easy as possible but to move them as quickly as you can to the purchase decision point. For example, an information dissemination system which enables potential buyers to decide not to buy, might allow greater resources to be devoted to the better qualified leads. You need to work out where to put resources into each step of the process which gains you the highest productivity of conversion.

Comparative marketing research has shown that high growth firms have higher referral levels, higher account penetration and lower marketing costs per unit of sale. They put more effort into satisfying their existing customers in order to cross-sell more products, increase the rate of usage of products and provide a solid base for referrals. They know that prospect fear about making the wrong decision is the biggest impediment to closing a sale. By having their existing customer willingly refer them to others, take part in case studies and conference articles, they can substantially reduce this obstacle in the purchase decision. They spend much less on getting a sale and reduce the time from interest to purchase.

You should break you own customer purchase decision down into the many steps the customer goes through to make a decision and then put the effort in to improving the productivity and reducing the time of each step. The end result will be to increase transaction velocity and thus growth.

You can see how easily transaction velocity fits within the High Growth Wheel of Success. Clearly timing impacts the willingness of customers to want a new solution, the compelling need reduces customer resistance and competitive advantage ensures yours is the solution chosen. Whether it is selecting a market to compete in or evaluating internal changes, the forecast impact on transaction velocity will demonstrate whether the change will stimulate growth.

At a more holistic level, I think the advantage of the High Growth Wheel of Success is that it does represent the factors which you have to work on to lift your game. However, scoring a 5 on one factor and neglecting the others won't do it. Your business will simply be undermined unless you happen to be especially lucky. You may gain a spurt of growth over a limited period but that will end as the other elements gain in importance.

You can see this again and again with inherited businesses. The founder hands over a profitable and growing business to the children that manage to keep it going for some years, but eventually the business withers and is sold off. That essential component of entrepreneurial talent was missing. In other situations you see the reverse. A lackluster or failing business is handed over to the children who turn it round and build a world class business. Quite often you see a change in direction, some risky decisions that worked and a business that ends up in a very different industry from its origins.

In the case of the failures, they gradually lost their competitive advantage, failed to innovate and the successors were not able to find new directions for continued growth. In the case of the winners, the successors moved the business into new areas, found a strong competitive advantage and aggressively pursued new growth opportunities.

An average management team can keep a venture growing in a situation where they have many advantages going for them – high scores across many of the principles I have outlined. However, it is the outstanding management team which is needed to fix a business which has few of the principles I have identified. Their job is clearly to move the business towards the sweet spot in the High Growth Wheel of Success. While some elements are simply a matter of application and experience, others require creative talent.

Each principle in the High Growth Wheel of Success provides a key to better management of any existing enterprise. Every additional step taken on any element moves the business towards a better managed, more profitable and more sustainable business. Thus the effort made to examine your own practices will not go unrewarded.

Most business owners have only a patchy knowledge of what it takes to achieve high growth. They read about successful entrepreneurs and hear stories about winning ventures and pick out salient points. Some successes are obvious, they have great inventions or have found a way to change an entire industry. Then they look at their own situation and don't see how they can apply those case studies to their own environment. The problem is that, what they see is a very huge gap, a different industry or different problem being solved. While they might like the stories they see little or no relevance to their own situation. What they need is knowledge which they can use in their own industry and, more specifically, in their own business. They need a framework and process to find out is how they can incrementally move from where they are today to something which is better and is also achievable.

This is the purpose of the Ultimate Growth book. What I have provided in the High Growth Wheel of Success is a map to incremental improvements in growth potential in any industry and any business.

First you need to identify where you are across the 14 principles. Next, you need to consider where you are most vulnerable – generally where your scores are lower. Then, gather your management team together for a strategy session and put some creative thinking time into how you can improve your situation. The lessons of history show us that every industry has had its high growth mavericks. While some industries are more supportive of high growth in that they can support many high growth firms due to the overall increase in demand, every industry has the potential to be reshaped by an entrepreneurial firm.

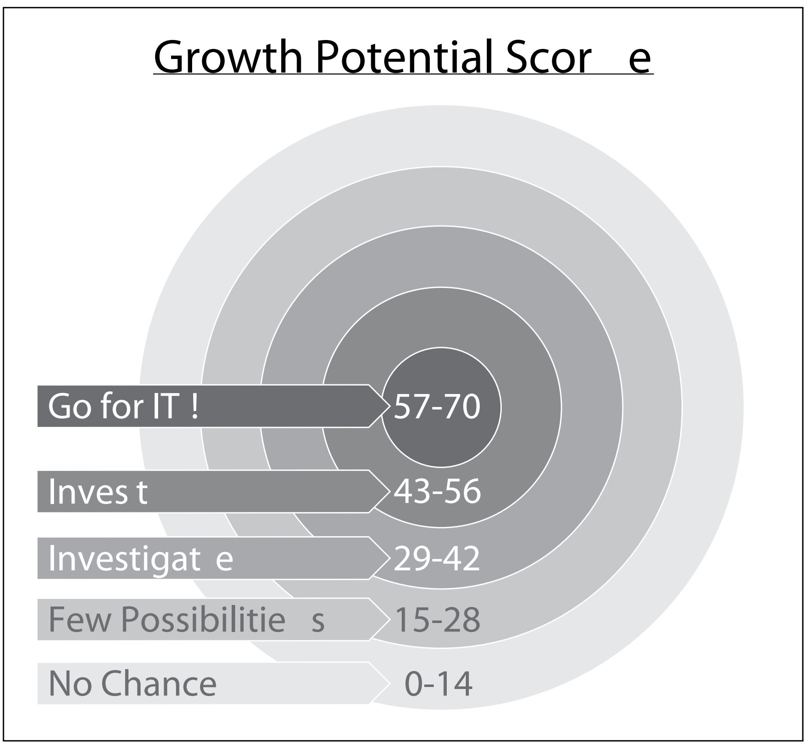
You might need to get some help. Perhaps this is where a Board of Advisors or a revised Board of Directors can help. Consultants can help in specialist areas where you have a clearly identified task to undertake and you have some good references on their abilities to help.

Don't think you have to do everything at once or in a hurry. A business which is profitable and stable is a great achievement anyway. Don't disturb something that works until you have a good strategy for how you are going to move forward.

The High Growth Wheel of Success won't guarantee that your business will move into high growth, it simply sets out a framework which shows that your probability of moving into high growth is greatly improved if you move towards the sweet spot in the centre. What you should achieve is a more profitable, more resilient and better managed business by going through the process.

Growth Potential

The Growth Potential Score summarises your scores across the 14 Critical Success Principles from the High Growth Venture Wheel of Success. While any business has the possibility of achieving a high growth rate under unusual circumstances, the Growth Potential Score projects the likely probability of success. Thus a high score above 40 has a very high chance of pushing the enterprise into a growth spurt while a score over 60 would suggest a sustainable growth rate.



Your score might be interpreted as follows:

Score	Assessment	Action
0 – 14	No Chance	The business has fundamental internal and external inhibitors to growth. Sell out and invest in a new business.
15 – 28	Few Possibilities	There are possibilities but the business would need to be refocused into a new part of the market and major changes would have to be made to internal operations.
29 – 42	Investigate	There are some real possibilities for growth but care should be taken about where to make changes. If the external conditions are positive the internal ones should be able to be fixed.
43 – 56	Invest	The business has real growth potential and may already be experiencing it but it is not yet sustainable. Invest to fix the internal problems and shift the business externally to focus on high potential areas.
57 – 64	Go for It!	The business is in the sweet spot right now. Don't delay. Take the risk to push forward.

Appendix One
Growth Theories

There is no single accepted theory of growth for commercial enterprises which is well supported. However, there have been a number of major contributions from a small number of authors which have greatly advanced our understanding of the nature of growth, its drivers and its limits. In this review, I have been very selective in the ones I have chosen, perhaps because they have contributed most to my own understanding of what drives growth in a venture. Of course, there are many other studies that have looked at elements of the business as it pertains to growth and where these have provided pragmatic insights into a theory of growth. I have incorporated their contributions into the earlier chapters.

Breaking new ground – *The Theory of the Growth of the Firm* by Edith Penrose

At the time of publication, 1959, this work was a radical view of the firm. For the first time an academic had looked inside the firm to try to understand the process of growth, what impacted the rate of growth and what were the limits or inhibitors of growth. Edith Penrose was an economist by training and thus this work was a considerable departure from the current treatment of the firm as simply one element in the way economies worked. While there was always consideration of economies of scale, organizational structure and issues of strategy, no one before Penrose had looked at the impact of knowledge, motivation and entrepreneurial talent on firm growth.

Penrose covered many of the aspects of growth which today we take for granted, such as the role of diversification and acquisitions in growth. She looked at both demand and supply as promoters or inhibitors to growth and the role of competition as it impacts the ability to grow. While many saw limits to growth due to organisational size and complexity, she argued that firms would reorganise to manage the next stage of growth and that growth could always be achieved by pursuing new opportunities. Larger firms had an advantage in pursuing growth as they had the economies of size as well as the reach to find new avenues for investment.

Penrose thought that a key element in achieving growth was the accumulated knowledge within the firm. Not only did this provide ‘wisdom’ but it gave a wider bandwidth to finding new opportunities. She argues that the rate of growth of the firm was limited by the rate at which new managerial talent could be absorbed and integrated into the existing management team. Knowledge within the firm regarding the objectives, values and policies which guide decision making, also allows the firm to move away from mico-management. Decision making itself is an inhibitor of growth if all decisions have to be taken by senior management. Thus the rate of growth and the level of growth can be advanced to the extent that employees at lower levels of the firm can be trusted to make the right decisions. The stronger the culture which guides decision making, the more that decisions can be pushed down within the organisation. Thus the ‘managerial’ limit to growth can be overcome.

However, in my view, the greatest contribution of Edith Penrose was to place the entrepreneur at the heart of a theory of growth. Her theory of growth was hinged on the perceptions of productive opportunities for the firm by the owner. Therefore, the opportunity for growth ‘will be restricted to the extent to which a firm does not see opportunities for expansion, is unwilling to act upon them, or is unable to respond to them.’ So the first precondition for growth to occur is the willingness of the owner to look for productive opportunities to grow. Today we see this as an essential characteristic of the entrepreneur.

Penrose argued that, all other things being equal, growth came from entrepreneurial activity. She described this as entrepreneurial versatility, fund raising ingenuity, entrepreneurial ambition and entrepreneurial judgment.

Entrepreneurial versatility refers to the way in which an entrepreneur creates ways in which new products can be brought to market or new geographic markets pursued. Here ‘imaginative effort, a sense of timing, the instinctive recognition of what will catch on and how to make it catch on become of overwhelming importance.’

Fund raising ingenuity refers to the ability of the owner to raise needed funds for expansion. This is partly due to the ability of the entrepreneur to create trust in others and persuade them of the merits of his venture.

Entrepreneurial ambition refers to the motivation of the owner towards growth. Some desire growth because it enables them to do a better job of delivering their products and services to the market while others seek growth for personal recognition as the founder of a business empire.

Entrepreneurial judgment refers to the quality of decision making of the owner. Clearly some people make more mistakes than others when it comes to business decision making. This element is strongly steeped in common sense, self confidence and other personal qualities, but it also refers to the ability of the owner to gather information, use consultants and decide when and how to act.

Edith Penrose determined that it was the entrepreneur's view of the future and its possible opportunities that most determined the shape of the company over time.

The Stages of Growth Theories

There have been several well accepted theories defining the organisational changes which occur with different stages of growth of the new firm. Larry Greiner published an article in the *Harvard Business Review* in 1972 entitled '*Evolution and Revolution as Organizations Grow'*. Neil Churchill and Virginia Lewis developed this further into a 1983 article entitled *'The Five Stages of Small Business Growth'* also published in the *Harvard Business Review.* Mel Scott and Richard Bruce looked at growth crisis points in their article entitled '*The Five Stages of Growth in Small Business'* published in *Long Range Planning* in June 1987.

These models all show that significant changes will occur within the business as growth occurs. The major complexity factors are numbers of staff, numbers of customers, numbers of products and numbers of locations. In order to achieve five times the level of business you have right now, most of these parameters will change. What is not so obvious to most entrepreneurs is that the business will need to be managed differently with each additional level of complexity. You can learn a lot about how your business will need to change by setting out what the business should look like at each level of complexity.

Almost without exception, small businesses face a crisis of management as they grow. The entrepreneur in the early days is able to drive the business through sheer energy, passion and vision. He or she knows everyone and staff are motivated because they are part of the grand adventure. As the firm adds staff, new people come into the business who were not part of the grand vision and their motivations and needs are likely to be different. They may see it more as a job than a mission. They have different needs and thus management styles have to change. At the same time, the growth brings with it specialisation of tasks and more formal organisational structures. Reporting lines become clearer, job descriptions become the norm rather than the exception and performance targets and monitoring is introduced. Soon there is a new layer of management between the CEO and the operations. What was a project has now turned into a business.

GROWTH PHASES

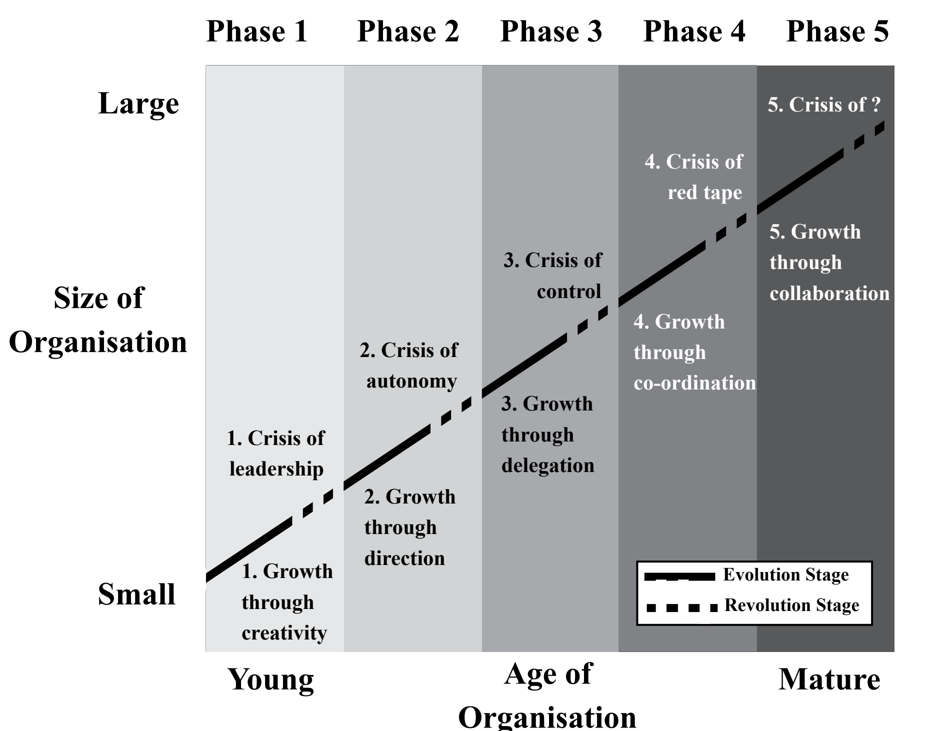


Diagram 1: The Stages of Small Business Growth,
Source: Larry Greiner, Evolution and Revolution as Organisatizations Grow, *Harvard Business Review*, July-August 1972

Greiner argued that growth proceeded until a crisis occurred. Each crisis was followed by a different management style. As the business grows, communication becomes increasing formalised as communication lines become longer. The left hand no longer knows what the right hand is doing. Customer service quality falls as new customers don't have the advantage of personal links with the founders. Problems escalate with the second location and now daily face-to-face communication is not physically possible. External shareholders and/or external Directors force more transparent decision making and thus the entrepreneur can no longer make decisions on the fly. Larger numbers of staff, customers and other stakeholders now depend on the business for their livelihood. Many entrepreneurs simply are not able to make the transition or don't want to.

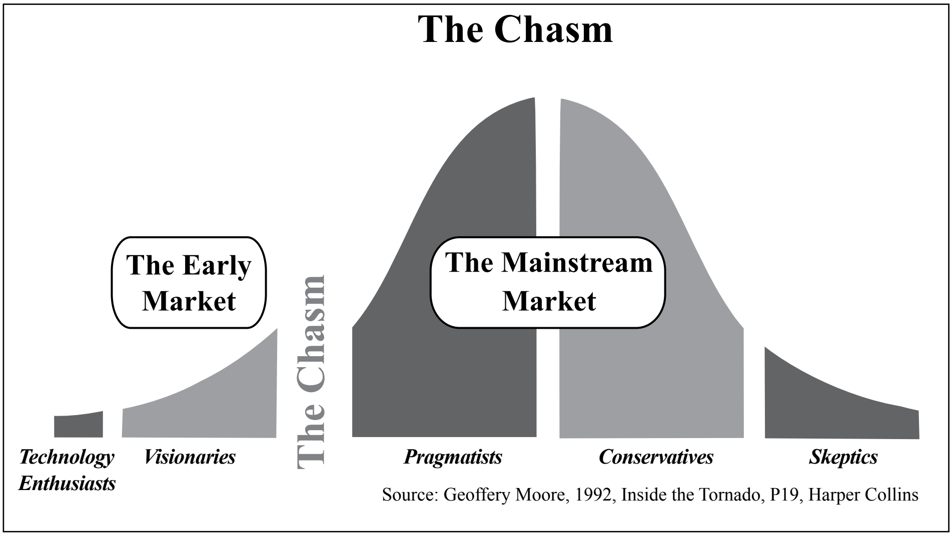
Churchill and Lewis took a different view of small business growth breaking the stages of growth into those that reflected a combination of increasing size, diversity and complexity. The stages were labelled Existence, Survival, Success, Take Off and Mature. While many of the characteristics of the Churchill model are the same as the Greiner model, the difference was whether the firm chose, or is able to move to the next level. What the Churchill and Lewis model showed was that there were many choices open to the business as it grows larger and more complex, including the choice to limit the growth and/or to sell the business. The owner's aspirations, goals, skills and willingness to delegate, become key factors in the growth orientation of the business. This very much supports Edith Penrose's assertion that the entrepreneurial ability of the owner is a key factor in the growth of the firm.

Geoffrey Moore on Managing Hyper Growth

If you were selling high tech products in the 90s you had to learn the language of '*Crossing the Chasm*' developed by Geoffrey A. Moore. His books '*Crossing the Chasm*' and '*Inside the Tornado*' were a breakthrough in marketing of technology based products. He brought to life a very different view of the Technology Adoption Life Cycle as it applied to infrastructure products such as computers, relational databases, network hardware and software, graphics workstations, and so on. The products he dealt with were mostly involved with setting technology standards against which complementary products interfaced.

His major contribution to growth, especially hyper growth of high technology products, was to show that the market orientation, customer relationships and operational management of the firm had to change dramatically as it moved through the product/market life cycle.

"The point of greatest peril in the development of a high-tech market lies in making the transition from an early market dominated by a few *visionary* customers to a mainstream market dominated by a large block of customers who are predominantly *pragmatists* in orientation. The gap between these two markets, heretofore ignored, is in fact so significant as to warrant being called a chasm, and crossing this chasm must be the primary focus of any long-term high-tech marketing plan. A successful crossing is how high-tech fortunes are made; failure in the attempt is how they are lost." (From the Preface to Crossing the Chasm)



In the early stage of a product, you are seeking the Innovators. These *Technology Enthusiasts* like to get involved with the detail, they like to fiddle, they are propeller heads that like to play with new technology. They see the possibilities of new technology but they have no money – but they do have influence and can help sell to *Visionaries* when the product can deliver some useful functionality.

The Early Adopters are the *Visionaries* who are willing to purchase the emerging technology because they can see how they can gain a first mover advantage. They have a specific project and want customer solutions. They have money and love to talk about their use of new technology. However, because they are risk tolerant, they provide little help in convincing the Early Majority who want a standard product that works.

The Early Majority are the *Pragmatists* who want a "whole product". The product must come fully packaged with proper implementation support and standard interfaces. To get across the Chasm, Moore recommends aiming for a small niche market which has a serious problem that no one has solved, one in which you can quickly establish a leadership position. The focus on development is then to produce a complete solution for just that one niche market.

Once across the Chasm, the firm picks off adjacent niche markets, one at a time with each receiving a whole product. Moore calls this the Bowling Alley. Once sufficient volume and market share has been achieved, the product then moves into the Tornado. This is where grabbing market share is critical and demand exceeds supply. Attention now must be given wholly to operational excellence in delivery. It is inside the Tornado that final market leadership will be determined. This is where the de-facto standard for that product sector is established. Out of the Tornado you arrive on Main Street.

The Late Majority are *Conservatives*. They are price sensitive, highly skeptical and demanding. Finally there are the Laggards or *Skeptics* who buy once a product has been completely established and the price has dropped considerably.

The work of Clayton Christensen on Innovators

Examining growth rates of high technology companies has been a life's work for Harvard Business School Professor, Clayton Christensen. His books *The Innovator's Dilemma* (1997) and his follow-on book with Michael E. Raynor, *The Innovator's Solution* (2003), are a remarkable insight into growth capabilities of companies which compete in technology sectors.

There is quite a lot of research to show that few companies are able to achieve sustained growth over a long period. One 2001 study by Zook and Allen, showed that only 13% grew consistently over a 10-year period. Jim Collins, in his book *Good to Great* (2001), showed that only 9% of his sample of companies was able to outperform the equity market averages over a 30 year period. In a study of the Fortune 50 by The Corporate Strategy Board (1988), only 5% successfully maintained growth over a 40-year period.

Christensen showed that innovations are either sustaining or disruptive. Leading technology companies work with their best customers to bring improved performance of their existing products to market – they concentrate on winning business through incremental or sustaining innovation. In doing so, they often over-engineer the product, delivering more functionality than the majority in the market need or want.

On the other hand, disruptive innovations bring products to market which don't compete within existing markets or for existing customers. Instead, they offer new features and/or provide less functionality or are smaller, cheaper and simpler products, thus drawing on a new segment of the market – perhaps one which was underserved previously. These new disruptive technology products gradually improve in performance, quality and functionality and end up eroding the mainstream markets of the incumbents.

While sustaining innovation is a method for achieving growth, it will attract the retaliation of existing competitors, who will often compete along the same innovation path. Low-end disruption occurs when the disruptive innovation takes away the low end of the market of existing players, most often offering simpler, cheaper, less functional alternatives. Incumbents abandon this end of the market as it is the least profitable part of their market. However, the low-end firm gradually takes more and more of the market share as it moves up market.

Market disruptors find markets where existing products are not being used because they lack the specific functionality needed for their use. Disruptive technologies seek new underserved markets where competitive pressure is considerably less.

His advice for growth oriented businesses is:

- Launch new growth businesses or acquire new growth businesses on a regular basis and especially when the core business is still healthy
- Divide business units to maintain patience for growth. Smaller businesses can absorb a disruptive technology more easily and their goals for success are lower. If you have many small projects happening, you can make a sizable overall growth rate.
- Demand early success. Minimise subsidisation of new-growth ventures. The new venture must show early success with real customers and demonstrate revenue potential otherwise it is shut down. This stops money being thrown after a poor idea and stops profitable new ventures from being shut down when the main business stalls.

The growth business finds a balance between sustaining innovation and disruptive innovation, but it keeps investing in both. To be successful, it does not simply have a set of development projects in disruptive innovations, it has a process of identifying disruptive opportunities, evaluating them, allocating resources to them and then bringing them into the mainstream business.

Entrepreneurship – The New Discipline

It was not until the middle 1970s that entrepreneurship started to emerge as a subject for research and study. Until this point, academics taught small business management. However, this field of knowledge had not tackled the problem of firm growth beyond the boundaries of the owner manager and a few employees nor had it ever considered how to best assess a business opportunity.

Early academics, like Jeffry Timmons, often considered the grandfather of entrepreneurship, set out to provide a body of knowledge about new venture creation. His screening tool for business ideas has provided the foundation for many business idea evaluation systems of today.

Also in the 70s came the emergence of a formal venture capital industry, mostly fuelled by the rapid growth of the computer industry. The early fund managers had to develop their own methods for assessing investment opportunities as no established comprehensive and systematic tools were available to them.

As the field of entrepreneurship developed, so did the venture capital sector. An accumulated body of anecdotal evidence developed around the best way to invest money to support a high growth venture, almost essential for a VC investment. This knowledge, as well as emerging research into high growth ventures, made its way into the textbooks for entrepreneurship students. It is this body of knowledge today which provides the basis of screening tools for high growth potential investments.

Conclusion

We know a lot more about high growth ventures than we did at the time of Edith Penrose and we certainly have a greater ability now to choose investments which have a stronger probability of growth. The works of Moore and Christensen have uncovered real insights into growth enablers, especially in the high technology sectors. The stage models of growth theories help us to understand how to plan for increased complexity as the organisation develops. However, we still don't have a magic bullet. Certainly, if we have all the right external factors in our favour, we at least have the necessary preconditions to support a high growth venture, but it will still come down to the ability of the management team to execute on the opportunity. While mediocre execution can still manage significant growth over the short term, it is only superb execution and, perhaps some good luck, which will see sustained growth over a longer period of time.

Appendix Two
Growth Potential Index Table

Principle Number/Description		Score				
The Market						
1	Finding the right place, right time	1	2	3	4	5
2	Finding the compelling need to buy	1	2	3	4	5
3	Targeting the right customer	1	2	3	4	5
4	Developing channels to market	1	2	3	4	5
Realising the Opportunity						
5	Innovation as the driver	1	2	3	4	5
6	Achieving a clear competitive advantage	1	2	3	4	5
7	Building in sustainability	1	2	3	4	5
8	Engineering scalability	1	2	3	4	5
Making it Work						
9	Developing a clear vision	1	2	3	4	5
10	Pulling it all together in a plan	1	2	3	4	5
11	Creating robust margins	1	2	3	4	5
12	Managing risk	1	2	3	4	5
Turning the Wheel						
13	Assembling a capable management team	1	2	3	4	5
14	Working the numbers	1	2	3	4	5
Total Score						