

## LEADING RAPID GROWTH: ENTREPRENEURSHIP BEYOND START-UP<sup>1</sup>

*You can fight without ever winning, but never ever win without a fight.*

Neil Peart  
Musician, Author

**RESULTS EXPECTED** Upon completion of this chapter, you will be able to:

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| <p><b>RESULTS EXPECTED</b></p> | <ol style="list-style-type: none"> <li>1. Discuss how higher-potential, rapidly growing ventures have invented new organizational paradigms to replace brontosaurus capitalism.</li> <li>2. Describe how higher-potential ventures "grow up big" and the special problems, organization, and leadership requirements of rapid growth.</li> </ol>                                                                        | <p><b>RESULTS EXPECTED</b></p> |
|                                | <ol style="list-style-type: none"> <li>3. Examine new research on the leadership practices that distinguish high growth companies.</li> <li>4. Explore concepts of organizational culture and climate, and how entrepreneurial leaders foster favourable cultures.</li> <li>5. Identify specific signals and clues that can alert entrepreneurial leaders to impending crises and approaches to solve these.</li> </ol> |                                |

### INVENTING NEW ORGANIZATIONAL PARADIGMS

At the beginning of this text we examined how nimble and fleet-footed entrepreneurial firms have supplanted aging corporate giants with new leadership approaches, a passion for value creation, and an obsession with opportunity that have been unbeatable in the marketplace for talent and ideas. These entrepreneurial ventures have experienced rapid to explosive growth and have become the investments of choice of the venture capital community.

Because of their innovative nature and competitive breakthroughs, entrepreneurial ventures have demonstrated a remarkable capacity to invent new paradigms of organization and management. They have abandoned the organizational practices and structures typical of the industrial giants from the post-World War II era to the 1990s. One could characterize those approaches thus: What they lacked in creativity and flexibility to deal with ambiguity and rapid change, they made up for with rules, structure, hierarchy, and quantitative analysis.

The epitome of this pattern is the Hay System, which by the 1980s became the leading method of defining and grading management jobs in large companies. Scoring high with "Hay points" was the key to more pay, a higher position in the hierarchy, and greater power. The criteria for Hay points include number of people who are direct reports, value of assets under management, sales volume, number of products, square feet of facilities, total size of one's operating and capital budget, and the like. One can easily see who gets ahead in such a system: Be bureaucratic, have the most people and largest budget, increase head count and levels under your control, and think up the largest capital projects. Missing in the criteria are all the basic components of entrepreneurship we have seen in this book: value creating, opportunity creating and seizing, frugality with resources, bootstrapping strategies, staged capital commitments, team building, achieving better fits, and juggling paradoxes.

Contrast the multilayered, hierarchical, military-like levels of control and command that characterize traditional capitalism with the common patterns among entrepreneurial firms: they are flat—often only one or two layers deep—adaptive, and flexible; they look like interlocking circles rather than ladders; they are integrative around customers and critical missions; they are learning- and influence-based rather than rank- and power-based. People lead more through influence and persuasion, which are derived from knowledge and performance rather than through formal rank, position, or seniority. They create a perpetual learning culture. They value people and share the wealth with people who help create it.

### Entrepreneurial Leaders Are Not Administrators or Managers

In the growing business, owner-entrepreneurs focus on recognizing and choosing opportunities, allocating resources, motivating employees, and maintaining control—while encouraging the innovative actions that cause a business to grow. In a new venture the entrepreneur's immediate challenge is to learn how to dance with elephants without being trampled to death! Once beyond the start-up phase, the ultimate challenge of the entrepreneur is to develop the firm to the point where it is able to lead the elephants on the dance floor.

Distinguished business scholar Henry Mintzberg believes that most MBA programs encourage the wrong behaviour and develop the wrong skills.<sup>2</sup> The standard business education compartmentalizes the functions into discrete silos, whereas, it should be integrative. Mintzberg finds little signs that this is appreciated or understood. Like medicine, like engineering, it is a "practice, which is fed by intuition. In a practice, one achieves mastery in the doing and has to pull together disparate knowledge to apply to situations at hand."<sup>3</sup> Steven Dunphy and David Meyer find evidence of differences in the roles of entrepreneurs and managers.<sup>4</sup> Such differences may help to explain the stagnancy and eventual demise of brontosaurus capitalism. Until the 1980s, virtually all the cases, problems, and lectures in MBA programs were about large, established companies.

### LEADING PRACTICES OF HIGH GROWTH COMPANIES<sup>5</sup>

In Chapter 2, we examined a summary of research conducted on fast growth companies to determine the leading practices of these firms. Now, this research will likely take on new meaning to the reader. As one examines each of these four practice areas—marketing, finance, management, and planning—one can see the practical side of how fast growth entrepreneurs pursue opportunities; devise, manage, and orchestrate their financial strategies; build a team with collaborative decision making; and plan with vision, clarity, and flexibility. Clearly, rapid growth is a different game, requiring an entrepreneurial mind-set and skills.

## GROWING UP BIG

### Stages of Growth Revisited

Higher potential ventures do not stay small very long. While an entrepreneur may have done a good job of assessing an opportunity, forming a new venture team, marshalling resources, planning, and so forth, leading and growing such a venture is a different game.

Ventures in the high growth stage face the problems discussed in Chapter 5. These include forces that limit the creativities of the founders and team; that cause confusion and resentment over roles, responsibilities, and goals; that call for specialization and therefore erode collaboration; that require operating mechanisms and controls; and more.

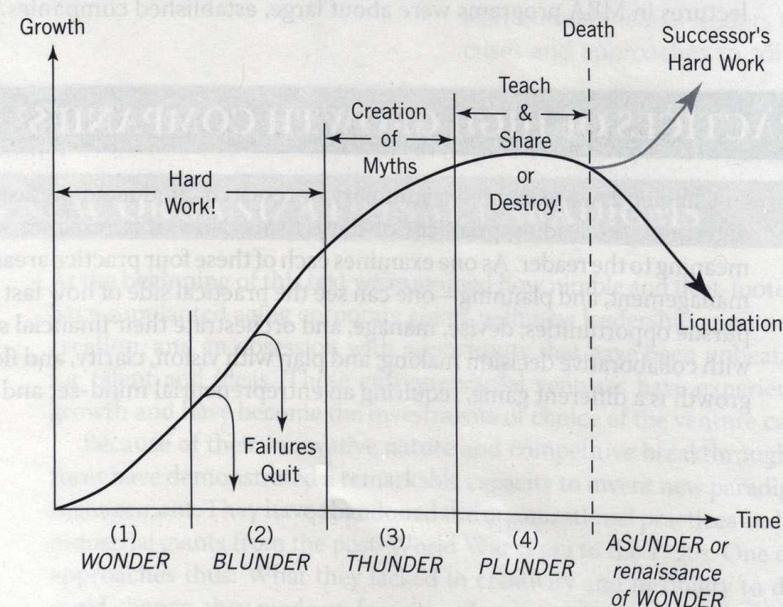
Recall also that founders of rapidly growing ventures are usually relatively inexperienced in launching a new venture and yet face situations where time and change are compounded and where events are nonlinear and nonparametric. Usually, structures, procedures, and patterns are fluid, and decision making needs to follow counterintuitive and unconventional patterns.

Chapter 5 discussed the stages or phases companies experience during their growth. Recall that the first three years before start-up are called the research-and-development (R&D) stage; the first three years, the start-up stage; years 4 through 10, the early-growth stage; the 10th year through the 15th or so, maturity; and after the 15th year, stability stage. These time estimates are approximate and may vary somewhat.

Various models, and our previous discussion, depicted the life cycle of a growing firm as a smooth curve with rapidly ascending sales and profits and a levelling off toward the peak and then dipping toward decline.

In truth, however, very few, if any, new and growing firms experience such smooth and linear phases of growth. If the actual growth curves of new companies are plotted over their first 10 years, the curves will look far more like the ups and downs of a roller-coaster ride than the smooth progressions usually depicted. Over the life of a typical growing firm, there are periods of jerks, bumps, hiccups, indigestion, and renewal interspersed with periods of smooth sailing. Sometimes there is continual upward progress through all this, but with others, there are periods where the firms seem near collapse or at least in considerable peril. Ed Marram, an entrepreneur and educator for 35 years, characterizes the five stages of a firm as Wonder, Blunder, Thunder, Plunder, Asunder (see Exhibit 12.1).

**EXHIBIT 12.1** Growth Stages



Wonder is the period that is filled with uncertainty about survival. Blunder is a growth stage when many firms stumble and fail. The Thunder stage occurs when growth is robust and the entrepreneur has built a solid new venture team. Cash flow is robust during Plunder, but in Asunder the firm needs to renew or will decline.

### Core Leadership Mode

As was noted earlier, changes in several critical variables determine just how frantic or easy transitions from one stage to the next will be. As a result, it is possible to make some generalizations about the main leadership challenges and transitions that will be encountered as the company grows. The core leadership mode is influenced by the number of employees a firm has, which is in turn related to its dollar sales.<sup>6</sup>

Recall, as shown in Exhibit 5.3, that until sales reach approximately \$5 million and employees number about 25, the core leadership mode is one of *doing*. Between \$5 and \$15 million in sales and 25 to 75 employees, the core leadership mode is *leading*. When sales exceed \$10 million and employees number over 75, the core leadership mode is *leading team leaders*. Obviously, these revenue and employment figures are broad generalities. The number of people is an indicator of the complexity of the leadership task, and suggests a new wall to be scaled, rather than a precise point.

*Sales per employee (SPE)* can vary widely among firms, by virtue of an online model and a tremendously effective supply chain management system, Apple Canada can generate a higher SPE than a real estate-based service business.

SPE numbers are boundaries, constantly moving as a result of inflation and competitive dynamics. SPE figures can illustrate how a company stacks up in its industry, but remember that the number is a relative measurement. Business Development Bank of Canada also reminds that the costs attributed to making those sales must be considered.<sup>7</sup> Explosive sales per employee was one of the failed promises of the Internet, and to some extent the irrational dot-com valuations of the late 1990s were an anticipation of technology massively leveraging variable employee expense.

The central issue facing entrepreneurs in all sorts of businesses is this: *As the size of the firm increases, the core leadership mode likewise changes from doing to leading to leading leaders.*

During each growth stage of a firm, there are entrepreneurial crises, or hurdles, that most firms will confront. Exhibit 12.2 and the following discussion consider by stage some indications of crisis.<sup>8</sup> As the exhibit shows, for each fundamental driving force of entrepreneurship, a number of "signals" indicate crises are imminent. While the list is long, these are not the only indicators of crises—only the most common. Each of these signals does not necessarily indicate that particular crises will happen to every company at each stage, but when the signals are there, serious difficulties cannot be too far behind.

### EXHIBIT 12.2 Crises and Symptoms

#### Pre-Start-up (Years - 3 to 0)

##### Entrepreneurs:

*Focus.* Is the founder really an entrepreneur, bent on building a company, or an inventor, technical dilettante, or the like?

*Selling.* Does the team have the necessary selling and closing skills to bring in the business and make the plan—on time?

*Management.* Does the team have the necessary management skills and relevant experience, or is it overloaded in one or two areas (e.g., the financial or technical areas)?

*Ownership.* Have the critical decisions about ownership and equity splits been resolved, and are the members committed to these?

##### Opportunity:

*Focus.* Is the business really user-, customer-, and market-driven (by a need), or is it driven by an invention or a desire to create?

*Customers.* Have customers been identified with specific names, addresses, and phone numbers, and have purchase levels been estimated, or is the business still only at the concept stage?

**EXHIBIT 12.2** Crises and Symptoms (continued)

*Supply.* Are costs, margins, and lead times to acquire supplies, components, and key people known?

*Strategy.* Is the entry plan a shotgun and cherry-picking strategy, or is it a rifle shot at a well-focused niche?

**Resources:**

*Resources.* Have the required capital resources been identified?

*Cash.* Are the founders already out of cash (OOC) and their own resources?

*Business plan.* Is there a business plan, or is the team "hoofing it"?

**Start-up and Survival (Years 0 to 3)****Entrepreneurs:**

*Leadership.* Has a top leader been accepted, or are founders vying for the decision role or insisting on equality in all decisions?

*Goals.* Do the founders share and have compatible goals and work styles, or are these starting to conflict and diverge once the enterprise is under way and pressures mount?

*Leadership.* Are the founders anticipating and preparing for a shift from doing to leading and letting go—of decisions and control—that will be required to make the plan on time?

**Opportunity:**

*Economics.* Are the economic benefits and payback to the customer actually being achieved, and on time?

*Strategy.* Is the company a one-product company with no encore in sight?

*Competition.* Have previously unknown competitors or substitutes appeared in the marketplace?

*Distribution.* Are there surprises and difficulties in actually achieving planned channels of distribution on time?

**Resources:**

*Cash.* Is the company facing a cash crunch early as a result of not having a business plan (and a financial plan)? That is, is it facing a crunch because no one is asking: When will we run out of cash? Are the owners' pocketbooks exhausted?

*Schedule.* Is the company experiencing serious deviations from projections and time estimates in the business plan? Is the company able to marshal resources according to plan and on time?

**Early Growth (Years 4 to 10)****Entrepreneurs:**

*Doing or leading.* Are the founders still just doing, or are they leading the team for results by a plan? Have the founders begun to delegate and let go of critical decisions, or do they maintain veto power over all significant decisions?

*Focus.* Is the mind-set of the founders operational only, or is there some serious strategic thinking going on as well?

**Opportunity:**

*Market.* Are repeat sales and sales to new customers being achieved on time, according to plan, and because of interaction with customers, or are these coming from the engineering, R&D, or planning group? Is the company shifting to a marketing orientation without losing its killer instinct for closing sales?

*Competition.* Are price and quality being blamed for loss of customers or for an inability to achieve targets in the sales plan, while customer service is rarely mentioned?

*Economics.* Are gross margins beginning to erode?

**Resources:**

*Financial control.* Are accounting and information systems and control (purchasing orders, inventory, billing, collections, cost and profit analysis, cash management, etc.) keeping pace with growth and there when they are needed?

*Cash.* Is the company always out of cash—or nearly OOC, and is no one asking when it will run out, or is sure why or what to do about it?

*Contacts.* Has the company developed the outside networks (directors, contacts, etc.) it needs to continue growth?

**Maturity (Years 10 to 15 plus)****Entrepreneurs:**

*Goals.* Are the partners in conflict over control, goals, or underlying ethics or values?

*Health.* Are there signs that the founders' marriages, health, or emotional stability are coming apart (i.e., are there extramarital affairs, drug and/or alcohol abuse, or fights and temper tantrums with partners or spouses)?

*Teamwork.* Is there a sense of team building for a "greater purpose," with the founders now leading leaders, or is there conflict over control of the company and disintegration?

**EXHIBIT 12.2** Crises and Symptoms (continued)**Opportunity:**

*Economics/competition.* Are the products and/or services that have gotten the company this far experiencing unforgiving economics as a result of perishability, competitor blind sides, new technology, or off-shore competition, and is there a plan to respond?

*Product encore.* Has a major new product introduction been a failure?

*Strategy.* Has the company continued to cherry-pick in fast-growth markets, with a resulting lack of strategic definition (which opportunities to say no to)?

**Resources:**

*Cash.* Is the firm OOC again?

*Development/information.* Has growth gotten out of control, with systems, training, and development of new leaders failing to keep pace?

*Financial control.* Have systems continued to lag behind sales?

**Harvest/Stability (Years 15 to 20 plus)****Entrepreneurs:**

*Succession/ownership.* Are there mechanisms in place to provide for succession and the handling of very tricky ownership issues (especially family)?

*Goals.* Have the partners' personal and financial goals and priorities begun to conflict and diverge? Are any of the founders simply bored or burned out, and are they seeking a change of view and activities?

*Entrepreneurial passion.* Has there been an erosion of the passion for creating value through the recognition and pursuit of opportunity, or are turf-building, acquiring status and power symbols, and gaining control favoured?

**Opportunity:**

*Strategy.* Is there a spirit of innovation and renewal in the firm (e.g., a goal that half the company's sales come from products or services less than five years old), or has lethargy set in?

*Economics.* Have the core economics and durability of the opportunity eroded so far that profitability and return on investment are nearly as low as that for the Fortune 500?

**Resources:**

*Cash.* Has OOC been solved by increasing bank debt and leverage because the founders do not want—or cannot agree—to give up equity?

*Accounting.* Have accounting and legal issues, especially their relevance for wealth building and estate and tax planning, been anticipated and addressed? Has a harvest concept been part of the long-range planning process?

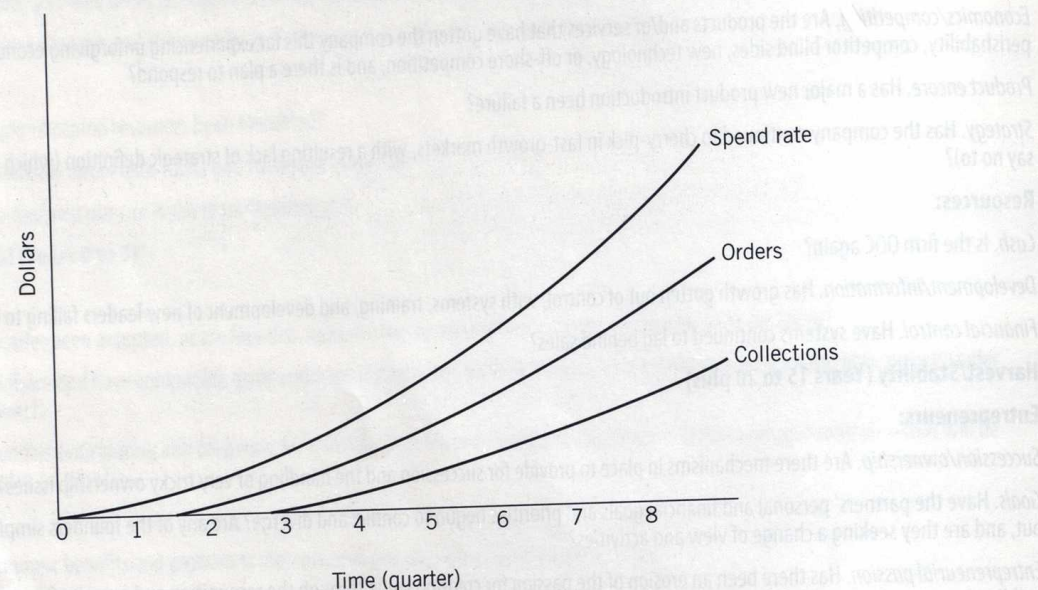
**The Problem in Rate of Growth**

Difficulties in recognizing crisis signals and developing appropriate mitigating measures are compounded by rate of growth itself. The faster the rate of growth, the greater the potential for difficulty; this is because of the various pressures, chaos, confusion, and loss of control. It is not an exaggeration to say that these pressures and demands increase geometrically, rather than in a linear way (see discussion in Chapter 5).

Growth rates affect all aspects of a business. Thus, as sales increase, as more people are hired, and as inventory increases, sales outpace manufacturing capacity. Facilities are then increased, people are moved between buildings, accounting systems and controls cannot keep up, and so on. The cash burn rate accelerates. As such acceleration continues, learning curves do the same. Worst of all, cash collections lag behind, as shown in Exhibit 12.3.

Distinctive issues caused by rapid growth were raised with the founders and presidents of rapidly growing companies—companies with sales of at least \$1 million and growing in excess of 30 percent per year. These founders and presidents pointed to the following:

- *Opportunity overload.* Rather than lacking enough sales or new market opportunities (a classic concern in mature companies) these firms faced an abundance. Choosing from among these was a problem.
- *Abundance of capital.* While most stable or established smaller or medium-size firms often have difficulties obtaining equity and debt financing, most of the rapidly growing firms were not constrained by this. The problem was, rather, how to evaluate investors as "partners" and the terms of the deals with which they were presented.

**EXHIBIT 12.3** Spend-Rate/Orders/Collection Leads and Lags

- **Misalignment of cash burn and collection rates.** These firms all pointed to problems of cash burn rates racing ahead of collections. They found that unless effective integrated accounting, inventory, purchasing, shipping, and invoicing systems and controls are in place, this misalignment can lead to chaos and collapse. One firm, for example, had tripled its sales in three years from \$5 to \$16 million. Suddenly, its president resigned, insisting that, with the systems that were in place, the company would be able to grow to \$100 million. However, the computer system was disastrously inadequate, which compounded other management weaknesses. It was impossible to generate any believable financial and accounting information for many months. Losses of more than \$1 million annually mounted, and the company's lenders panicked. To make matters worse, the auditors failed to stay on top of the situation until it was too late and were replaced. While the company has survived, it has had to restructure its business and has shrunk to \$6 million in sales, to pay off bank debt and to avoid bankruptcy. Fortunately, it is recovering.
- **Decision making.** Many of the firms succeeded because they executed functional day-to-day and week-to-week decisions, rather than strategizing. Strategy had to take a back seat. Many of the representatives of these firms argued that in conditions of rapid growth, strategy was only about 10 percent of the story.
- **Expanding facilities and space . . . and surprises.** Expansion of space or facilities is a problem and one of the most disrupting events during the early explosive growth of a company. Leaders of many of these firms were not prepared for the surprises, delays, organizational difficulties, and system interruptions that are spawned by such expansion.

### Industry Turbulence

The problems just discussed are compounded by the amount of industry turbulence surrounding the venture. Firms with higher growth rates are usually found in industries that are also developing rapidly. In addition, there are often many new entrants, both with competing products or services and with substitutes.

The effects are many. Often, prices fluctuate. The turbulence in the semiconductor industry is a good example. From June 1984 to June 1985, the price to original equipment manufacturers (OEMs) of 64K memory chips fell from \$2.50 each to 50 cents. The price to

OEMs of 256K chips fell from \$15 to \$3. The same devastating industry effect manifested in the years 2000–2002 when cellular airtime pricing plunged by more than 50 percent. And more recently the price for flat screens (LCD, plasma, etc.) has plummeted. Imagine the disruption this caused in marketing and sales projections, in financial planning and cash forecasting, and the like, for firms in these industries. Often, too, there are rapid shifts in cost and experience curves. The consequences of missed steps in growing a business are profound.

## THE IMPORTANCE OF CULTURE AND ORGANIZATIONAL CLIMATE

### Six Dimensions

The organizational culture and climate, either of a new venture or of an existing firm, are critical in how well the organization will deal with growth. Studies of performance in large businesses that used the concept of organizational climate (i.e., the perceptions of people about the kind of place it is to work) have led to two general conclusions.<sup>9</sup> First, the climate of an organization can have a significant impact on performance. Further, climate is created both by the expectations people bring to the organization and by the practices and attitudes of the key managers.

The climate notion has relevance for new ventures, as well as for entrepreneurial efforts in large organizations. An entrepreneur's style and priorities—particularly how he or she manages tasks and people—are well known by the people being managed and affect performance. Recall the entrepreneurial climate described by Roger Enrico of Pepsi, where the critical factors included setting high performance standards by developing short-run objectives that would not sacrifice long-run results, providing responsive personal leadership, encouraging individual initiative, helping others to succeed, and developing individual networks for success.

Evidence suggests that superior teams function differently than inferior teams in their setting priorities, in resolving leadership issues, in what and how roles are performed by team members, in attitudes toward listening and participation, and in dealing with disagreements. Further, evidence suggests that specific approaches to management can affect the climate of a growing organization. For example, gains from the motivation, commitment, and teamwork, which are anchored in a consensus approach to management, while not immediately apparent, are striking later. At that time, there is swiftness and decisiveness in actions and in follow-through, since the negotiating, compromising, and accepting of priorities are history. Also, new disagreements that emerge generally do not bring progress to a halt because there is both high clarity and broad acceptance of overall goals and underlying priorities. Without this consensus, each new problem or disagreement often necessitates a time-consuming and painful confrontation and renegotiation simply because it was not done initially.

Organizational climate can be described along six basic dimensions:

- **Clarity.** The degree of organizational clarity in terms of being well organized, concise, and efficient in the way that tasks, procedures, and assignments are made and accomplished.
- **Standards.** The degree to which management expects and puts pressure on employees for high standards and excellent performance.
- **Commitment.** The extent to which employees feel committed to the goals and objectives of the organization.
- **Responsibility.** The extent to which members of the organization feel responsibility for accomplishing their goals without being constantly monitored and second-guessed.
- **Recognition.** The extent to which employees feel they are recognized and rewarded (non-monetarily) for a job well done, instead of only being punished for mistakes or errors.
- **Esprit de corps.** The extent to which employees feel a sense of cohesion and team spirit, of working well together.

### Bella Dance Academy

"Lina Ball has taken her passion for dance and built it into a thriving business that is growing by leaps and bounds."<sup>10</sup> With an opening like that on the Canadian Newswire, Lina Ball received much attention when she won BDC's Young Entrepreneur of the Year Award for the Northwest Territories. Born and raised in Nanaimo, British Columbia, where she began dancing at the age of three, two decades later Lina Ball moved with her husband in 2003 and opened Bella Dance Academy in Yellowknife in a warehouse with high ceilings. To promote her dance school she did it all. That first season she offered ballet, tap, jazz, modern, and hip hop classes. Students ranged from 16 months to 65 years old. In addition to teaching 120 students in 25 different classes singlehandedly, "I did everything and anything I could to promote the classes that first year. I worked at festivals, handed out flyers, did a mail-out, ran radio and newspaper advertising, talked to daycares and schools—just anything." In the second year Lina added four instructors as the number of students and classes grew.<sup>11</sup> In late 2008 they moved to a new location with two studios. Adding more instructors to her staff, additional challenges were faced. Clearly Lina was not simply doing, she had to lead her team and create a culture of those who shared her passion. The Canadian Newswire reported that "Lina's business plan has been carefully thought out" and quotes her as saying: "We set goals every year and we've always met our enrollment numbers. It's really important to me to increase at a steady pace, but also to keep the quality of the programs and to create a positive environment for the students." Lina notes staffing in a remote location is a problem: "It takes at least a year to train a student to teach, and most of the kids leave Yellowknife after they graduate. So I train them for a year to teach for one or two years and then they're gone. That's been hard." But her Bella Dance Academy has recently benefited from an instructor that in 2009 tried out for CTV's "So You Think You Can Dance" and returned to teaching.<sup>12</sup> Lina and her dancers of all ages and abilities have become part of the community performing throughout the year for public events and at a seniors' residence. Bella Dance Academy ([www.belladance.ca](http://www.belladance.ca)) also puts on its own recitals and shows, e.g., *Nutcracker*.

Sources: "Lina Ball Has Yellowknife Dancing! Owner of Bella Dance Academy Wins BDC's Young Entrepreneur Award for the Northwest Territories," *Canadian Newswire*, October 21, 2008; Daron Letts, "Hip Hop is On Top," *Northern News Service*, September 10, 2008; Daron Letts, "Dancer Mum on Results of Her Star Audition," *Northern News Service*, April 24, 2009.

### Approaches to Entrepreneurial Leadership

In achieving the entrepreneurial culture and climate described above, certain approaches to leadership (also discussed in Chapter 5) are common across core leadership modes. David Halabisky, Erwin Dreessen, and Chris Parsley all of the Small Business Policy Branch of Industry Canada concede that entrepreneurial behaviour may be the "most crucial component in determining the growth path of a firm."<sup>13</sup>

**Entrepreneurial Leadership** No single leadership pattern seems to characterize successful ventures. Leadership may be shared, or informal, or a natural leader may guide a task. What is common, however, is an individual who defines and gains agreements on who has what responsibility and authority and who does what with and to whom. Roles, tasks, responsibilities, accountabilities, and appropriate approvals are defined.

There is no competition for leadership in these organizations, and leadership is based on expertise, not authority. Emphasis is placed on performing task-oriented roles, but someone invariably provides for "maintenance" and group cohesion by good humour and wit. Further, the leader does not force his or her own solution on the team or exclude the involvement of potential resources. Instead, the leader understands the relationships

among tasks and between the leader and his or her followers and is able to lead in those situations where it is appropriate, including managing actively the activities of others through directions, suggestions, and so forth.

This approach is in direct contrast to the communal approach, where two to four entrepreneurs, usually friends or work acquaintances, leave unanswered such questions as who is in charge, who makes the final decisions, and how real differences of opinion are resolved. While some overlapping of roles and a sharing in and negotiating of decisions are desirable in a new venture, too much looseness is debilitating.

This approach also contrasts with situations where a self-appointed leader takes over, where there is competition for leadership, or where one task takes precedence over other tasks.

**Consensus Building** Leaders of most successful new ventures define authority and responsibility in a way that builds motivation and commitment to cross-departmental and corporate goals. Using a consensus approach to management requires working with peers and with the subordinates of others (or with superiors) outside formal chains of command and balancing multiple viewpoints and demands.

In the consensus approach, the founder is seen as willing to relinquish his or her priorities and power in the interests of an overall goal, and the appropriate people are included in setting cross-functional or cross-departmental goals and in making decisions. Participation and listening are emphasized.

In addition, the most effective individuals are committed to dealing with problems and working problems through to agreement by seeking a reconciliation of viewpoints, rather than emphasizing differences, and by blending ideas, rather than playing the role of hard-nose negotiator or devil's advocate to force their own solution. There is open confrontation of differences of opinion and a willingness to talk out differences, assumptions, reasons, and inferences. Logic and reason tend to prevail, and there is a willingness to change opinions based on consensus.

**Communication** The most effective leaders share information and are willing to alter individual views. Listening and participation are facilitated by such methods as circular seating arrangements, few interruptions or side conversations, and calm discussion versus many interruptions, loud or separate conversations, and so forth, in meetings.

**Encouragement** Successful leaders build confidence by encouraging innovation and calculated risk-taking, rather than by punishing or criticizing what is less than perfect, and by expecting and encouraging others to find and correct their own errors and to solve their own problems. Their peers and others perceive them as accessible and willing to help when needed, and they provide the necessary resources to enable others to do the job. When it is appropriate, they go to bat for their peers and subordinates, even when they know they cannot always win. Further, differences are recognized and performance is rewarded.

**Trust** The most effective leaders are perceived as trustworthy and straightforward. They do what they say they are going to do; they are not the corporate rumour carriers; they are more open and spontaneous, rather than guarded and cautious with each word; and they are perceived as being honest and direct. They have a reputation of getting results and become known as the creative problem solvers who have a knack for blending and balancing multiple views and demands.

**Development** Effective leaders have a reputation for developing human capital (i.e., they groom and grow other effective leaders by their example and their mentoring). As noted in Chapter 5, Bradford and Cohen distinguish between the heroic leader, whose need to be in control in many instances actually may stifle cooperation, and the post-heroic leader, a developer who actually brings about excellence in organizations by developing entrepreneurial middle management. If a company puts off developing middle management until price competition appears and its margins erode, the organization may come unraveled. Linking a plan to grow human capital at the middle management and the supervisory levels with the business strategy is an essential first step.

## ENTREPRENEURSHIP FOR THE 21ST CENTURY: BIG BREAKTHROUGHS

Extraordinary individuals and enterprises have been built in recent years and contributed to the entrepreneurial revolution: Austin Hill's slew of ventures, including most recently Akoha; Gabrielle Chevalier has brought her company Solutions 2 GO to \$500 million in annual revenue in just four years; Nina Gupta envisions taking Greenlite public and to \$100 million in annual sales; Doug and Danny Elder aim to take their already successful promotional events "on tour" to other Western Canadian cities. These entrepreneurs created "high standard, perpetual learning cultures," which create and foster a "chain of greatness." The lessons from such great entrepreneurial leaders and enterprises provide a blueprint for entrepreneurship in the 21st century. They set the standard and provide a tangible vision of what is possible. Not surprisingly, the more exciting, faster growing, and more profitable companies in Canada today share striking similarities.

### Austin Hill

Serial entrepreneur and angel investor, Austin Hill was born in Ottawa in 1973 and grew up in Calgary, where he developed a passion for computer technology. He created his first venture Cyberspace Data Security when he was 17 years old. In 1994, Hill started an Internet provider in Montreal called Infobahn Online Services with his brother. They merged with another ISP to create TotalNet, which they sold in 1997.

In 1997, with his brother and father, Austin Hill launched Zero-Knowledge Systems and raised \$65 million in venture capital. He played a vital role for a decade including running a spinout "Synomos" that ultimately failed in 2005, the same year that Zero-Knowledge Systems changed its name to Radialpoint. "We wanted the world to know what we stood for—power to the people—privacy for all—we were passionate about changing the way the future would look. We were social entrepreneurs believing that we could both make a profitable company and a contribution to the betterment of society at the same time."<sup>14</sup> Their recruiting included a mobile billboard driven past Montreal software companies with the enticing phrase "wanna make Internet history?" After much turmoil, including "reducing head count by the hundreds because of undisciplined growth," in early 2003 Zero-Knowledge started to generate positive cash flow.

In his blog, Austin Hill points out:

The process of building innovative enterprises requires experimentation and failure. How much experimentation is a function of risk appetite and cost of money. The cost of money was incredibly low and the risk appetite for technology stocks were so much in abundance that we were fielding random calls from retail investors looking to buy stock or get on a waiting list for the IPO for almost 2 years before we even had revenue.

We proved ourselves able to play by the rules of that time and raised money and built real products and teams in a way that the market was rewarding (getting big fast, become the market leader by the size of your brain trust and the broad range of your opportunities).

When the rules of the market changed, we changed with them and made sure we could continue to work with customers finding a business model and customer profile that would grow with us. We made a lot of mistakes that in hindsight now seem obvious. But we rushed into our mistakes recognizing them as valuable lessons and we were eager students.

When we started Zero-Knowledge my internal email signature carried the phrase "Make new mistakes more often." Our team culture helped us to react and evolve as we saw new opportunities, identified failing products and responded to the dramatic shifts that occurred in the capital markets.

### Gabrielle Chevalier

The owner of Mississauga, Ontario-based Solutions 2 GO Inc., Gabrielle Chevalier was ranked number two on a list of the top 100 women entrepreneurs in Canada in 2007 and again in 2008. With revenue growth from \$37 million in 2004 to \$453 million in 2008, Solutions 2 GO is a video game distributor carrying hundreds of titles by Nintendo, Sony, and Microsoft. A typical day calls for processing up to 10,000 orders from clients that include major Canadian retailers such as Wal-Mart, HMV, Blockbuster, Future Shop, and Best Buy. According to Chevalier, "In our business, we exist solely to connect manufacturers and retailers. Neither will accept any excuses from us. As a start-up with very aggressive growth plans, Solutions 2 GO wanted an IT partner who was knowledgeable, experienced, and responsive."<sup>15</sup> Gabrielle Chevalier chose Lynn Cooke's 360 Visibility Inc.—also listed on Canada's Top Women Entrepreneurs. Cooke co-founded 360 Visibility in 2003 "around a vision of providing all enterprise participants in a client organization with the information they need to make swift, well-informed, coordinated, and above all profitable business decisions." Lynn Cooke must be on the right track because 360 Visibility experienced three-year revenue growth of 883 percent.

### Nina Gupta

Another one of Canada's Top Women Entrepreneurs, Nina Gupta, is at the helm of Greenlite—a leading manufacturer of energy efficient lighting products created in 1996 when her instincts told her that "North America's lighting business was going green." Based on years of experience in the family's automotive lighting business, she ventured into the residential and industrial lighting sector.<sup>16</sup> Those instincts have paid off as Greenlite revenues broke \$30 million in 2008, a fair jump from \$6 million just four years prior. Beyond promoting her product she is a social activist, her goal is to encourage us to switch to CFLs (compact fluorescent light bulbs) thus saving the natural environment. She also boasts of Greenlite's workforce being 80 percent female. Nina Gupta describes herself as "tenacious, hard working, focused, and honest." And admits to being "a compulsive neurotic list maker writing down plans for everything." In the future she hopes that "a public offering will raise enough money to purchase factories and assembly facilities to become a \$100-million company in the next five years."

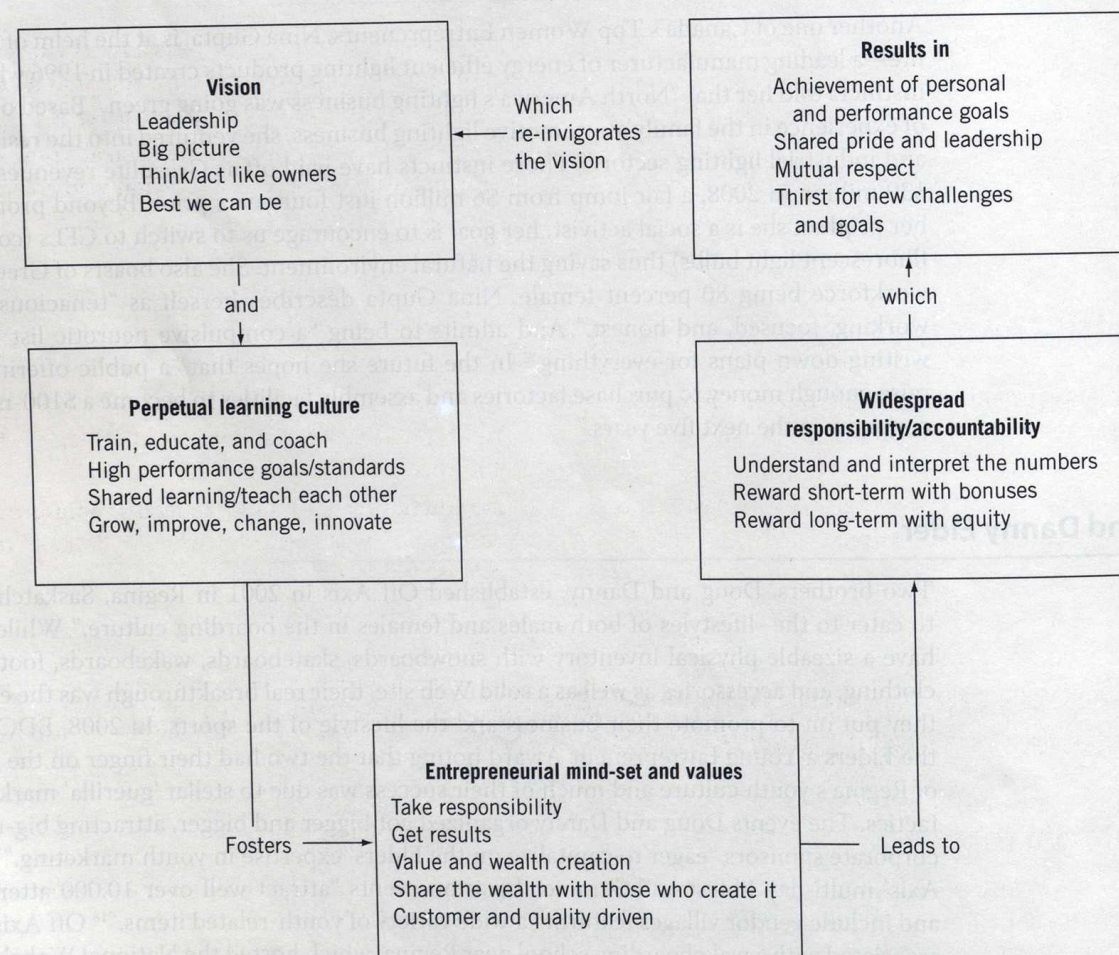
### Doug and Danny Elder

Two brothers, Doug and Danny, established Off Axis in 2001 in Regina, Saskatchewan to cater to the "lifestyles of both males and females in the boarding culture." While they have a sizeable physical inventory with snowboards, skateboards, wakeboards, footwear, clothing, and accessories as well as a solid Web site, their real breakthrough was the events they put on to promote their business and the lifestyle of the sports. In 2008, BDC gave the Elders a Young Entrepreneur Award noting that the two had their finger on the pulse of Regina's youth culture and much of their success was due to stellar 'guerilla' marketing tactics. The events Doug and Danny organized got bigger and bigger, attracting big-name corporate sponsors "eager to capitalize on the Elders' expertise in youth marketing."<sup>17</sup> Off Axis' multi-day Jibfest and Summer Invasion events "attract well over 10,000 attendees and include vendor villages featuring a wide variety of youth-related items."<sup>18</sup> Off Axis was associated with a wakeboarding school near Regina, which hosted the National Wakeboard Championships in 2008 and Doug and Danny were contemplating an event tour with stops in various Western Canadian cities appealing to their demographic—15 to 24-year-olds.

## The Chain of Greatness

As we reflect on these great individuals and enterprises, we can see that there is clearly a pattern here, with some common denominators in both the ingredients and the process. This chain of greatness becomes reinforcing and perpetuating (see Exhibit 12.4). Leadership that instills across the company a vision of greatness and an owner's mentality is a common beginning. A philosophy of perpetual learning throughout the organization accompanied by high standards of performance is key to the value-creating entrepreneurial cultures at the three firms. A culture that teaches and rewards teamwork, improvement, and respect for each other provides the oil and glue to make things work. Finally, a fair and generous short- and long-term reward system, as well as the necessary education to make sure that everyone knows and can use the numbers, creates a mechanism for sharing the wealth with those who contributed to it. The results speak for themselves: extraordinary levels of personal, professional, and financial achievement.

**EXHIBIT 12.4** The Chain of Greatness



## Chapter Summary

1. The demands of rapid growth have led to the development of new organizational and leadership paradigms.
2. The entrepreneurial organization today is flatter, faster, more flexible and responsive, and copes readily with ambiguity and change. It is the opposite of the hierarchy, layers of management, and the more-is-better syndrome prevalent in brontosaurus capitalism.
3. Entrepreneurs in high-growth firms distinguish themselves with leading entrepreneurial practices in marketing, finance, management, and planning.
4. As high-potential firms "grow up big" they experience stages (Wonder, Blunder, Thunder, Plunder, Asunder or Wonder redux), each with its own special challenges and crises, which are compounded the faster the growth.
5. Establishing a culture and climate conducive to entrepreneurship is a core task for the venture team.
6. A chain of greatness characterizes some breakthrough approaches to entrepreneurial leadership.

## Study Questions

1. Why have old hierarchical management paradigms given way to new organizational paradigms?
2. What special problems and crises can new ventures expect as they grow? Why do these occur?
3. Explain the stages many ventures experience and why these are unique.
4. What role does the organizational culture and climate play in a rapidly growing venture?
5. Why are many large companies unable to create an entrepreneurial culture?
6. Why is the rate of growth the central driver of the organization challenges a growing venture faces?

## Mind Stretchers *Have you considered?*

1. Many large organizations are now attempting to reinvent themselves. What will be the biggest challenge in this process, and why?
2. How fast should a company grow? How fast is too fast, organizationally and financially?
3. In your ideal world, how would you describe what it is like to live and work within the perfect entrepreneurial organization?
4. Do you have what it takes to lead a rapid-growth enterprise? Will you know when to do less, trust others, and lead more?

## CASE

## WATCH THAT NEXT STEP

Richard Ivey School of Business  
The University of Western Ontario

**IVEY**

Research and  
Development

## Preparation Questions

1. Make a list of the positive and negative signs of growth at Avalon Electronics.
2. What should Wally Haas' priorities be?
3. What are the next hurdles? Will they be organizational, financial, or technical?

Wally Haas had much to celebrate as 2007 slipped into 2008. As he welcomed the new year, he could proudly look back on a banner performance at his firm, St. John's, N.L.-based Avalon

Microelectronics. Haas had founded the company—a maker of specialized software for microchips used in high-speed data transfer—just four years earlier as a tiny start-up in a remote

This case was written by Ken Mark, Eric Morse, Stewart Thornhill, and Mary Weil, Pierre L. Morrisette Institute for Entrepreneurship, Richard Ivey School of Business, University of Western Ontario, for purposes of classroom discussion.

location with little more than a good idea. Over the past 12 months, it had generated sales of \$1.5 million, a ten-fold increase from the year before. Better yet, Haas was projecting sales to grow as much as 40 percent in 2008, a pace he expected to maintain for several years to come.

But even as the metaphorical champagne flowed, Haas knew that the outlook for Avalon wasn't all wine and roses. Serious issues were beginning to emerge, and Haas's company was struggling to keep up as demand for its products and services began to outstrip the company's capacity. Much to Haas's chagrin, Avalon was starting to turn down business. Fortunately, Haas's market position was protected for the time being as there were no direct competitors in Avalon's niche to snatch the clients the company couldn't take on right away. But Haas was certain that it was only a matter of time before someone would try. The only solution to his problem was to expand Avalon, fast. The question was, how—and where?

"I'm worried about the near future," Haas would say when asked about his business. "What happens when firms in our space start to encroach on our turf? We may be growing at 40 percent a year, but what happens five years down the road if our competitors are growing at 400 percent a year?"

Haas's capacity problems stemmed from the fact that he'd had a hard time convincing software engineers to leave major industry centres and move to Newfoundland to join his company. Few that had been trained in North America or Europe had been tempted by his overtures, mainly because they could earn higher salaries and work for larger, more prestigious companies in tech-savvy cities like Ottawa and San Francisco. Avalon had attracted international interest from engineers in developing countries, such as India and China. But Haas—a native Newfoundlander who'd spent 12 years in Ottawa with Nortel Networks and PMC Sierra before returning home to start Avalon—worried that most of these candidates were more interested in getting to Canada and acquiring citizenship than in working specifically for Avalon. They might be willing to start out in St. John's, but he feared they would leave for other cities as soon as they acquired legal status to remain in the country. Understandably, Haas was reluctant to invest in a hire only to see that person move on as soon as the opportunity presented itself.

One solution to his problem was to open a second Avalon design centre in an established tech hub, where it would be in the middle of existing talent pools. But where? Haas had been investigating the issue and had yet to come to any firm conclusions. He could, for instance, open a design centre in California's famed Silicon Valley, but that would be expensive due to the salary expectations of local engineers, whose skills were already in

high demand and richly compensated. A cheaper option would be to open an office in an Asian hub. But whatever cost savings Haas would realize overseas would be offset by lower productivity. A third option, going to Ottawa, would strike a balance between cost and productivity, but even then Haas would have to find a manager to run the office while he managed headquarters in St. John's. No matter where he was located, he would need someone he could trust fully and completely.

Even if Haas resolved these issues, the very nature of Avalon's work would make it difficult to move some of its operations. Avalon develops what are known as "IP cores." Essentially, these cores are bits of software that enable inexpensive, generic microchips to perform customized functions. This allows firms in the data-transfer business, such as Nortel or Cisco, to buy off-the-shelf chips—at less cost than buying or developing their own custom chips—and then program them in ways to differentiate their hardware products from those of competitors. The work is highly collaborative, Haas says, meaning that it would be difficult for Avalon to function with geographically dispersed teams. And if this is true for branching out in Canada, it's doubly so for setting up in another country. "We need to consider factors like cultural proximity," he says. "We may speak the same language as engineers in other countries, but we rely on different expressions and have different expectations."

If Haas had one advantage as he confronted his expansion issues, it was his familiarity with the challenges of running a software company in a region better known for its troubled fishery and booming energy sector than its technological prowess. He had already overcome a number of them in getting Avalon this far. When it came to financing his new venture back in 2004, for example, Haas was certain he was onto a good thing and he saw the potential for decades of growth. But because his idea tapped a new area of expertise—and because he was proposing an unusual business for Newfoundland—he found it difficult to attract investors.

Tenacity paid off, though, and Haas was eventually able to secure government financing, using his personal investment in Avalon as leverage, as well as the company's acceptance into a local tech business incubator. Within a year, Avalon released its first product. Before long it was winning customers with large and deep pockets. Soon, however, Avalon found itself operating at maximum capacity—and then beyond, leaving Haas to greet the new year in a quandary: "We just can't find enough qualified engineers. Should we only expand in St. John's or should we open an office in Ottawa, or Silicon Valley or Asia? We're growing fast, but we could be growing much faster."



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## C · H · A · P · T · E · R

# 13

## FRANCHISING

*Franchisees are chosen based on a number of criteria, including entrepreneurial drive.*

Don Schroeder  
President and CEO, Tim Hortons

*It's possible, if the economics are right . . . When you build a great franchise it can be a lot of fun.*

Dan Aykroyd  
Actor

RESULTS EXPECTED

Upon completion of this chapter, you will be able to:

1. Understand what franchising is and discuss the nature of the role of the franchisor and the franchisee.
2. Explore the process of becoming a franchisor.
3. Compare the profile of a successful franchisee to the profile of a successful entrepreneur.
4. Describe a basic screening method for evaluating franchises with a higher success probability.
5. Analyze the franchise relationship model and its use as a guide for developing a high-potential franchise.

RESULTS EXPECTED

### INTRODUCTION

In this chapter we will explore what franchising is and how well it fits the Timmons Model definition of entrepreneurship. We will consider the scope of franchising and examine the criteria for determining a franchise's stature, from the perspective of an existing or prospective franchisor. We will present several templates and models that can be helpful in conducting due diligence on a franchise opportunity.

Let us consider how well franchising fits our definition of entrepreneurship from Chapter 1. Just as the focus of our definition of entrepreneurship is opportunity recognition for the purpose of wealth creation, so too is the focus of franchising. Franchising offers a thoughtful system for reshaping and executing a delivery system designed to extract maximum value from the opportunity. Just as opportunity, thought, and action are