Eric G. Flamholtz Yvonne Randle

GROWING PAINS

Building Sustainably Successful Organizations

5TH EDITION

WILEY

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CONTENTS

PREFACE

Growing Pains deals with the problems of building sustainably successful organizations® over the long term. The first edition of this book—published in 1986 and titled, *How to Make the Transition from Entrepreneurship to a Professionally Managed Firm*—was written after Eric Flamholtz became aware of the paucity of theory, research, and tools for the management of entrepreneurial organizations.

Prior to the first edition of this book, most if not virtually all of business education ignored entrepreneurship and focused instead on "business administration." This meant focusing on large established companies such as Bank of America, Boeing, Exxon, IBM, McDonald's, Procter & Gamble, and similar institutional "blue chip" companies that had already been in existence for many decades. There was very little literature or cases about starting entrepreneurial firms, or about what we like to think of as "organizational scale-up," the process of transitioning from a successful start-up to a much larger size and different stage of growth.

Now, three decades later, entrepreneurship is an established academic field. Entrepreneurs like Howard Schultz (Starbucks), Richard Branson (the Virgin Group), and the late Steve Jobs (Apple), and more recently Elon Musk (Tesla), Jack Ma (Alibaba), and Mark Zuckerberg (Facebook) are business icons and business heroes. However, there still remains a large gap in the published literature to explain the process of transitioning from the start-up phase of early entrepreneurship to the end-game phase of becoming a sustainably successful organization (or institution) like Starbucks, Apple, or Amgen. Filling this gap is and has been (for almost 40 years) our primary academic and practical focus.

During this period, we have developed one model to explain the determinants of organizational success, another to identify the stages in an organizational life cycle, and a third to explain the origin and underlying causes of growing pains (which occur when an organization has not developed the infrastructure required by its size and complexity at a given stage of growth). Initially, these models were developed to help explain the process of transition from the entrepreneurial stage to the professional management stage (see Chapter 3) in the life cycle of a business enterprise. Later we realized that what we had actually developed was an explanation or general theory of organizational success and failure at different stages of growth.

Purpose and Focus

The overall purpose of this book is to help readers understand what it takes to continue to grow an organization successfully after a new venture or entrepreneurship has been established. Specifically, it provides a lens or framework and related tools to help people understand how to manage organizational growth successfully at different stages from a start-up to a dominant world-class company like a Starbucks.

Unfortunately, too many entrepreneurial companies founder after promising or even brilliant beginnings. Companies such as Boston Market, People Express, Maxicare, and Osborne Computer were all once cited as great entrepreneurial successes, yet all have failed. In the face of these failures and difficulties, some cynical observers have even begun to define an entrepreneur as someone, such as Adam Osborne (who created the first portable computer) or Robert Campeau (a Canadian shopping center developer), who can start and build a company to a given level and then watch it fail.

Similarly, many established companies such as GM, Kodak, Sears, Reuters, and Xerox experience difficulties after decades of success. Some fail and others become no more than corporate zombies, with little life left in them. Xerox was once an icon of corporate success; people would say, "We want to be the next Xerox." Sadly, no one says that anymore. How did this happen? Can symbols of once-great corporate success be revitalized? How can this process be managed?

Our experience in doing research and consulting with many different types of companies in many different places in the world has led us to write this book to help present and potential entrepreneurs and CEOs of established companies (as well as their employees, advisers, bankers, and venture capitalists) understand the pitfalls typically faced by organizations at different stages of growth and to explain how to become sustainably successful over the long term. It is also intended to help governmental policymakers understand the causes of the premature demise of entrepreneurial companies that are so vital to our economy. Although this book will not solve all the problems faced by companies, our experience (as well as the positive feedback we received about the previous editions) indicates that if the ideas and methods described in this book are applied, organizations will have a significantly improved likelihood of sustainable success.

While earlier editions of this book focused almost exclusively on the transition from what we have termed an "entrepreneurship to an entrepreneurially oriented, professionally managed business" (organizations from start-up to approximately $100 million in annual revenues), this edition focuses on *all* stages of growth. We have also included new ideas and concepts (which we have developed over the past few years) as well as new examples and cases of companies—not just in the United States, but also in several other countries around the world. Stated differently, the strategic intent is to refresh the book and make it even more relevant to organizations through their entire life cycle from inception to decline and revitalization.

Intended Audience

This book is addressed to anyone interested in organizational success and failure. This includes the owners, managers, and employees of companies ranging from start-ups to global leaders to those in need of revitalization. The concepts, frameworks, and tools described in this book will also be of interest to investors, bankers, and venture capitalists, and to students and management scholars who are interested in answering the fundamental question, "Why, after successful or even brilliant beginnings, do companies often lose their way with many (if not most) even experiencing decline and bankruptcy?"

To answer this question, we identify the underlying factors that promote long-term success and describe what organizations must do to successfully manage the transitions they face as they grow. Case studies of companies at different stages of growth—drawn from a wide variety of industries—are included to illustrate different aspects of the transitions that must be made over the entire life cycle of organizations. The cases also show how the frameworks provided in this book can be used as conceptual maps of what needs to be done by an organization at each developmental stage. In addition, the book specifies the adjustments the founder or the CEO of an entrepreneurial company needs to make so that he or she can grow with the organization (as Howard Schultz did at Starbucks) and not be left behind.

Overview of the Contents

While this edition of *Growing Pains* focuses on the entire life cycle of an organization (versus exclusively on the transition from an entrepreneurship to a professionally managed organization) and what it takes to build a sustainably successful enterprise over the longer term, its title has remained unchanged. The title *Growing Pains* is still very relevant, even for the advanced stages of growth, and even when growth has ceased. For the absence of growth is, in a sense, a growing pain as well. Our research and practical experience in working with a wide variety of organizations over almost 40 years suggest that all organizations experience growing pains as a normal part of their development. Growing pains indicate that the company has outgrown its infrastructure and that it must develop new systems and processes, as well as a new structure, to support its size. When organizations ignore growing pains, significant problems and even failure can result.

The book's underlying framework and content are applicable to all organizations, from very small startups to very large companies, nonprofits, and even mega-companies such as IBM, Johnson & Johnson, and Walmart. In earlier editions, Starbucks was used as an example of a rapidly growing entrepreneurial company that had applied many of the concepts and methods in this book. Today, Starbucks has joined the elite group of world-class giants. The concepts, frameworks, methods and tools described in this book are still relevant to Starbucks and to other organizations of all sizes.

This book is divided into three parts. Part One begins with a chapter that provides an overview of the issues facing entrepreneurs and CEOs as they attempt to grow their organizations. It examines both the personal and the organizational issues and related transitions required. This is followed by four chapters that focus on frameworks for understanding organizational effectiveness and transitions: an organizational effectiveness model, an organizational life-cycle model, and a model to explain the origin and underlying causes of "growing pains" that occur when an organization has not developed the "infrastructure" required by its size and complexity at a given stage of growth. The organizational effectiveness model, termed the Pyramid of Organizational Development (discussed in Chapter 2) explains the variables that must be managed by companies to give them the optimal (most likely) chance of long-term success. The life-cycle model (discussed in Chapters 3 and 4) identifies seven stages of growth from a new venture (corporate birth) to an established organization in decline and requiring revitalization. Chapter 3 focuses on the first four stages of growth from a new venture to a mature organization, while Chapter 4 focuses on the advanced stages of growth in the organizational life cycle. The growing pains framework is discussed in Chapter 5.

Part Two presents the most significant managerial tools that can be used to build sustainably successful business enterprises: strategic planning, organizational structure, control/performance management systems, management and leadership development, and corporate culture management. Although the tools of planning, structural design, and the like may be, at least superficially, familiar to some readers, our approach to these key components of a management system differs in some very important respects from others; there is also an integrative aspect to the set of management systems components overall.

Part Three deals with some special issues and topics relating to organizational development and transitions. It includes a chapter dealing with the application of the concepts and frameworks to nonprofits. It also introduces the concept of a leadership molecule and deals with the key aspects of strategic and operational leadership. Finally, Chapter 13 presents several comprehensive case studies of companies that have used the concepts, methods, and tools described in this book to support their continued success.

Key Differences

This fifth edition of *Growing Pains* differs from the fourth edition in several important respects. Although the overall direction and thrust of the book have been retained, all chapters have been revised to include updated material, updated references to companies, and new case studies, as appropriate. However, in some instances we have kept certain examples because they are "classic," or prototypical, of the points we want to make, because there are no better current examples, or because of their historical significance.

Three new chapters have been added that focus upon: (1) how to use the frameworks, tools, and methods in nonprofits (Chapter 11); (2) specific leadership challenges and how to create a "leadership molecule" (Chapter 12); and (3) comprehensive case studies of the applications of our frameworks and tools and results of those applications in selected organizations worldwide (Chapter 13). In addition, we have cited new empirical research that has been published during the past several years that supports the framework and ideas presented in the book. Specifically, we present new data on "strategic organizational development" (in Chapter 2).

Throughout the book, several new cases, examples, or "mini-cases" of companies dealing successfully or unsuccessfully with growth management issues have been added. New mini-cases and international examples of entrepreneurship have been added because of the widespread flourishing of entrepreneurship around the globe, including examples from Europe, Australia, and Asia. A number of companies (including Starbucks) are used throughout the book to provide a consistent frame of reference for the perspective being developed. To a considerable extent, we have drawn on examples of companies where we have in-depth knowledge. In some cases, to protect the privacy of individuals and organizations, we have disguised the company's and individuals' names.

Conceptual Thinking

Our experience over the past 40 years in working with and coaching leaders of many companies throughout the world has shown that there is one key thing (not typically mentioned when discussing the requirement of leadership success) in addition to all of the standard things that leaders are supposed to be able to do. Specifically, this is to be able to think conceptually about their business. The ability of a leader or leadership group to step back from day-to-day operations and the concrete things that business involves is a critical ability that contributes to sustainable success of organizations.

This same cognitive ability is often the difference between great successes in virtually any activity, including sports that are very physical in nature such as American football. For example, National Football League (NFL) teams use the so-called "combine" to test for various abilities such as running speed, jumping ability, and cognitive ability. Specifically, they use the "Wonderlic Cognitive Ability Test." Because NFL football is one of the most physically demanding sports, the emphasis on cognitive ability might seem surprising. However, as coaches in the NFL undoubtedly know, there is also a conceptual aspect to the game. For example, in discussing the ability of his prized recruit at UCLA, quarterback Josh Rosen, Coach Jim Mora stated: "Josh is very intelligent. He is one of those kids that the game comes to more easily than some. He understands concepts."[1]

As the reader will see, some conceptual thinking is required by this book. However, the ability to do this type of thinking will pay great dividends.

Note

1. Chris Foster, "Rosen Is First Among QB Equals," *Los Angeles Times*, April 26, 2015, D9.

ACKNOWLEDGMENTS

This work is a product of nearly 40 years of action research and consultation with many different organizations. These range from new ventures to members of the *Fortune 500*. They were our research "laboratory." Simply stated, the most significant ideas that underlie this book were the products of observing, analyzing, and conceptualizing what actually happened in successful and unsuccessful organizations as they grew. The book could not have been written without having had access to those companies of various sizes, in different industries, with different degrees of success. Accordingly, we are greatly indebted to the CEOs, presidents, senior managers, and others who invited us to serve as researchers, consultants, or advisers for their organizations. (Many of these companies are not mentioned by name, to preserve their privacy. In some cases, fictitious names are used; in others, examples are cited without the company being named at all.)

The data presented in Chapters 2, 5, and 11 are drawn from the organizational effectiveness database compiled by Management Systems Consulting Corporation. They are derived from a survey developed by Eric Flamholtz. Omar Aguilera, Senior Consultant with our firm, Management Systems, assisted in the preparation and interpretation of some of the data (updated from the fourth edition) dealing with organizational growing pains and strategic organizational development.

We want to also acknowledge the help that Clara Penny, Management Systems' Vice President of Finance and Administration, provided in preparing the manuscript of this fifth edition. And, we would like to thank the other members of the Management Systems team—Leslie McKenna and Michael Tan—for their support.

Although we acknowledge with gratitude the contributions of all those cited, we remain responsible for the book and its imperfections.

Eric G. Flamholtz
Yvonne Randle
Los Angeles
April 2015

PART

I

A Framework for Developing Successful Organizations

This first part of *Growing Pains* identifies the determinants of organizational success and provides a framework for understanding the key transitions that organizations and their leaders face as they grow. It also focuses on helping the entrepreneur or company leader understand and manage the personal transitions as well as organizational transitions that are required to support the enterprise's continued successful development.

The First Challenge for Entrepreneurs

The first challenge that entrepreneurs face is establishing a successful new venture. The basic skills necessary to meet this challenge are the ability to recognize a market need and the ability to develop (or to hire other people to develop) a product or service appropriate to satisfy that need.

If these two fundamental things are done well, a fledgling enterprise is likely to experience rapid growth. At this point, whether the entrepreneur recognizes it or not, the game begins to change. The organization's success creates its next set of problems and challenges to survival.

As a result of expanding sales, resources become stretched very thin. A seemingly perpetual and insatiable need arises for more inventory, space, equipment, people, funds, and so on. Day-to-day activities are greatly sped up and may even take on a frenzied quality.

The business's operational systems (those needed to facilitate day-to-day activities), such as marketing, production or service delivery, accounting, credit, collections, and personnel, typically are overwhelmed by the sudden surge of activity. There is little time to think, and little or no planning takes place because most plans quickly become obsolete. People become high on their own adrenaline and merely react to the rush of activity.

At this point the organization usually begins to experience some, perhaps all, of the following "organizational growing pains":

- People feel that there are not enough hours in the day.
- People spend too much time "putting out fires."
- Many people are not aware of what others are doing.
- People lack an understanding of the company's ultimate goals.
- There are not enough good managers.
- People feel that "I have to do it myself if I want to get it done correctly."
- Most people feel that the company's meetings are a waste of time.
- Plans are seldom made and even more seldom followed upon, so things often do not get done.
- Some people feel insecure about their place in the company.
- The company has continued to grow in sales but not to the same extent in profits.

These growing pains are not merely problems in and of themselves, they are a symptom of the underlying problem that there is an "organizational development gap" between the infrastructure required by the organization and the infrastructure it actually has. An organization's infrastructure consists of the resources, operational support systems and management systems, and culture required to enable the organization to function profitably on a short- and long-term basis. As described further in Chapter 2, a company's resources consist of the human capital, financial capital, and physical assets of an enterprise. Operational support systems consist of all the day-to-day systems required to produce a product or deliver a service and to function on a day-to-day basis. Management systems consist of the organization's planning system, organization structure, management development system, and performance management system. "Culture" refers to the values, beliefs, and norms that drive the behavior of people in the enterprise as well as the "system" for culture management (whatever that might be). These are the systems required to manage the overall enterprise on a long-term basis.

The Second Challenge for Entrepreneurs

Once an organization has identified a market and has begun to produce products or services to meet the needs of customers within that market, it will begin to grow. As the business grows, it will be faced with the need to make a fundamental transformation or metamorphosis from the spontaneous, ad hoc, free-spirited enterprise that it has been to a more formally planned, organized, and disciplined entity. The organization must move from a situation in which there are only informal plans and people simply react to events to one in which formal planning is a way of life; from one in which jobs and responsibilities are undefined to one in which there is some degree of definition of responsibilities and mutually exclusive roles; from one in which there is no accountability or control systems to one in which there are objectives, goals, measures, and related rewards specified in advance as well as formal performance appraisal systems; from one in which there is only on-the-job training to one in which there are formal management development programs; from one in which there is no budget to one in which there are budgets, reports, and variances; and, finally, from a situation in which profit simply happens to one in which there is an explicit profit goal to be achieved. In brief, the company must make the transition from an entrepreneurship to what we term “an entrepreneurially oriented, professionally managed organization.”

As we will see in Chapter 1, this is a time when the very personality traits that initially made the founder-entrepreneur so successful can lead to organizational demise. Most entrepreneurs have either a sales or technical background, or they know a particular industry well. Entrepreneurs typically want things done in their own way. They may be more intelligent or have better intuition than their employees, who come to rely on their bosses’ omnipotence. Typical entrepreneurs tend to be “doers” rather than managers, and most have not had formal management training, although they may have read the current management best-sellers. They like to be free of “corporate restraints.” They reject meetings, written plans, detailed organization of time, and budgets as the trappings of bureaucracy. Most insidiously, they think, “We got here without these things, so why do we need them?” Unfortunately, the nature of the organization has changed—and so must its senior management.

There is no one pattern for a successful transition from an entrepreneurship to a professionally managed enterprise. Whatever path is followed, the key to a successful change is for the entrepreneur to recognize that a new stage in the organization’s life cycle has been reached and that the former mode of operation will no longer be effective.

Making an Organizational Transition

As an organization grows, it will, in fact, face not just one but several significant transitions and transformations that need to be managed. A key question for senior leaders (whether they are the entrepreneur of a new company or the CEO of a billion-dollar-plus company), then, is, “What should we do to take the organization successfully to the next stage of growth?” To answer this question satisfactorily, it is necessary to understand that there are predictable stages of organizational growth, certain key developmental tasks that must be performed by the organization at each growth stage, and certain critical problems that organizations typically face as they grow. This understanding, in turn, requires a framework within which the determinants of successful organizational development may be placed.

Part One of this book focuses on identifying these determinants of success, on the identification of the predictable stages of organizational growth (each requiring transitions), and on the personal transitions that entrepreneurs and other leaders need to make to support the transitions from one stage of growth to the next.

Chapter 1 deals with the personal and organizational transitions that are necessary during the life cycle of a business enterprise. It examines a variety of personal and professional changes or transitions that must be made by the chief executive officer or “CEO” as a company grows. These individual transitions include the changing nature of the CEO’s role, changes in managerial style, and the behavioral and attitudinal changes required to support successful organizational transitions. It also examines the strategic and "architectural design" changes required for healthy organizational development as a company grows over time.

Chapter 2 presents a holistic framework for successful organizational development. It deals with the issue of what makes an organization successful and profitable. Drawing on research and experience from consulting with organizations of all sizes and types over nearly 40 years, it presents a systematic approach to understanding the six critical variables that determine organizational effectiveness. It examines these six critical tasks of organizational development and describes what must be done to accomplish each. Chapter 2 presents a method for self-assessment of the strength of a business in terms of these variables, which we call the Pyramid of Organizational Development. A database is provided for the reader's comparison of their company's "strategic development scores" with that of other businesses.

Chapters 3 and 4 together identify and examine the seven different stages of organizational growth, from the inception of a new venture through the early maturity of an entrepreneurial organization, and to the ultimate decline and revitalization of a company. Chapter 3 focuses upon the first four stages of growth from a new venture to scale-up, and from scale-up to professionalization of the enterprise as well as consolidation. Taken together, the four stages described in Chapter 3 comprise the period or era from an entrepreneurial start-up through transformation to becoming an entrepreneurially oriented professionally managed enterprise. Chapter 4 examines the remaining three stages—diversification, integration, and decline-revitalization. These chapters also examine the relative emphasis that must be placed on each of the six critical developmental tasks at each stage of the organization's growth.

Chapter 5 identifies and describes the growing pains that all developing organizations experience. It provides a method for assessing these growing pains and determining their severity. Senior managers need to be able to recognize such growing pains as symptoms of the need to make changes in their organizations. Chapter 5 also presents a method for self-assessment of the "growing pains" being experienced by a business as well as for interpreting the degree of "risk" of problems (including ultimate failure) facing the company. A database is provided for the reader's comparison of their company's growing pains scores with that of other businesses.

Taken together, the ideas in Chapters 1 through 5 provide a conceptual map of the "tasks" that must be focused upon to build a sustainably successful business. Part One also provides a guide for analyzing and planning the transitions that must be made in moving a company from one developmental stage to the next.

CHAPTER

1

Transitions Required to Build Sustainably Successful Organizations®

It is well established that approximately 50% of all new ventures will fail within five years. For every Southwest Airlines that succeeds, there is a People Express that goes bankrupt. For every Facebook, there is a Myspace that was once popular, but that is now an afterthought. For every Starbucks, there is a Diedrich Coffee that failed. For every Dell, there is an Osborne Computer (who very few people even remember—even though it reached $100 million in sales revenue in three years before going bankrupt, and was a leader in personal computers prior to the founding of Dell).

It is a great achievement to create a successful start-up, given their 50% failure rate. It is an even greater challenge to create a company that is sustainably successful over "the long run." As we view it, the long run relates to sustainable success over several *decades*. At a minimum, it involves success over at least two generations of company leaders. In sports such as baseball, basketball, or football, it is possible to have sustained success with a specific group of players and a single coach; but true "sustainable success over the long run" exists only when leadership has passed from generation to generation with sustained success. One company that has achieved this is General Electric (GE). Founded in 1878, GE continues to be a global leader. Another is Heineken, the Netherlands-based beer company. Heineken was founded in 1864, and also continues to be a world leader in its space. A third is Toyota. Toyota, focused on the production of automobiles, was founded in 1933 as a department of Toyoda Automatic Loom Works, which itself traces its history to 1926. Toyota Motors was created as a spinoff from the parent company as Toyota Motor Company in 1937.

Sustainable success for a long period is very challenging, but possible, as shown by GE, Heineken, and Toyota. It is difficult even over a relatively shorter period such as 15 years. A comparison of companies listed on the Nasdaq stock exchange from 2000 to 2015 shows that there were significant changes in the composition of the top listed companies by "market cap" (market capitalization, the standard measure of a public company's value).[1] Only three companies were in the top 10 on both dates: Microsoft, Intel, and Cisco. Several companies that were listed as among the top 10 in 2000 were no longer on the list in 2015, including Dell, Sun Microsystems (purchased by Oracle), JDS Uniphase, and Yahoo!.

Organizational Success, Decline, and Failure

Why are some companies able to continue to manage growth successfully over the longer term (at least 10 years) while others are not? Why are some company founders and leaders like Howard Schultz at Starbucks and Richard Branson of Virgin Group able to continue to grow with their companies, while other founders and leaders such as Donald Burr, who founded People Express (and who had an MBA from Harvard!) or Adam Osborne, who founded Osborne Computer, fail to make the required transitions as their businesses increase in size and complexity? What do successful companies and their leaders do differently compared with those that are less successful or even those that have failed? Is it simply chance or something that can be learned and managed?

Through rigorous research and analysis of organizations and their leaders over the past four decades,[2] we have answered these questions and have developed practical tools that can help leaders of companies at all sizes increase their probability of long-term success. Why, for example, did Starbucks Coffee (originally founded as a local roaster with stores in 1971 and later reconceived in 1986–1987 as a "specialty retail/café" hybrid) become a global brand and industry leader,[3] while Diedrich Coffee (which was similarly founded in 1972 and later redefined like Starbucks as a cafe in 1983) has been broken into pieces (company stores and franchised stores) and sold to competitors including Starbucks?[4] How did Starbucks become the global leader in its space even though other companies like Coffee Bean and Tea Leaf (founded 1963) and Peet's (founded 1966) existed before Starbucks was ever purchased and refocused? As we will see in the next chapter, Starbucks' success is not an accident, nor is it unique. The keys to Starbucks' success were some critical transitions made both by its founder and CEO, Howard Schultz, and by the organization itself. Starbucks developed and followed a plan, not just a classic strategic plan but one that focused upon organizational development as well.

We shall describe this in some detail and distill the lessons for other company founders and their organizations.

Lessons like these are not only important for the founders of entrepreneurial companies like Howard Schultz, Steve Jobs (Apple Computer), or John Paul DeJoria (Paul Mitchell hair products and Patron Spirits Company), they are important for venture capital and private equity investors, boards of directors, banks that lend to such companies, managers of such companies, and students of management who aspire to either start their own business or work in a company going through such transitions over time. They are also of importance to society as a whole. Companies create jobs. Successful companies create more and more jobs, while failing companies destroy jobs. For example, successful companies such as Starbucks, Google, and Apple are job-creating machines! However, when companies like Borders (retailer of books), Woolworths (specialty department store), People Express (airline) and Osborne Computer (computer manufacturer) fail, they destroy jobs and people's livelihood, and negatively impact lives.

Government programs to stimulate companies' growth have been established in countries such as Canada and Poland for just this reason. Canada created the Build in Canada Innovation Program (BCIP) to kick-start businesses and get their innovative products from the lab to the marketplace. The government of Poland has created the Polish Agency for Enterprise Development. It is a tragedy when a company fails after a promising entrepreneurial start because the entrepreneurs do not understand how to build the organization.

Building Sustainably Successful Organizations®

The purpose of our research and really, what we might describe as our life's work, is to help entrepreneurs and others understand what must be done to build sustainably successful organizations®. We have been helping organizational leaders plan for and implement the transitions required to promote long-term success for almost 40 years. This book will summarize our methods, tools, and insights in a practical and systematic way.

Two Types of Transitions Required for Sustainable Success

Our research and experience have shown that there are two different but related types of transitions that must be made at different stages of growth in order for an organization to continue to flourish and grow successfully.

One type of transition concerns the founder or ultimate leader of an organization—which is typically the chief executive officer or CEO. This person must make a variety of personal and professional changes or transitions as their company grows. These include understanding and embracing the changes in the CEO role that need to occur to effectively manage an increasingly larger and more complex organization, developing new skills, adopting a new mindset (that supports, among other things, having increasingly less direct control over results), and changing one's managerial style. For simplicity, we term these the "personal transitions."

The second type of transition relates to the organization's strategic and "architectural design." These organizational development transitions can include changes in the organization's systems, processes, or structure, as well as changes to what the company actually does (who its target customers are and what it offers them).

If these two types of transitions are not made effectively, they will have a significant impact on organizational effectiveness, efficiency, and success. In fact, the inability to make effective and appropriate personal and organizational transitions is a key underlying reason why organizations experience problems and, in some cases, fail. This chapter will focus on both types of transitions.

The Personal Transitions Facing Founders and CEOs

As organizations grow and change, those in management and leadership roles also need to grow—in their skills and capabilities—and change how they approach their roles. For example, the CEO of a start-up needs to spend his or her time very differently from that of a $1 billion enterprise. We will discuss tools and techniques for making these changes in Chapter 9. In this chapter, we focus on the very specific challenges facing the founder or the entrepreneur as his or her business grows.

Unlike the CEOs of large, *Fortune 500*–type organizations, who are typically promoted through the ranks over a period of many years, the CEO of an entrepreneurial company is typically someone who either was the founder of a company, was part of a founding group, or is the spouse or child of the founder. Examples are legion and include not only those cited above but also some other very familiar names such as Mark Zuckerberg (Facebook), Larry Ellison (Oracle), Jack Ma (Alibaba, China), Anita Roddick (The Body Shop), Martha Stewart (Martha Stewart), as well as some currently less familiar but equally significant names, including Ren Zhengfei (Huawei), Li Ning (Li-Ning, China), Isaac Larian (MGA Entertainment), and Yerkin Tatishev (Kusto Holdings, Singapore). To understand transitions that founders/entrepreneurs must make as their companies grow, it is useful to first consider who they are as people and how they got to be CEOs.

Characteristics of Entrepreneurs

Although there are no precise demographic and psychological profiles available, our experience has shown that CEOs of entrepreneurial companies tend to have certain things in common. About 90% of these people have one of three types of background: (1) a marketing background, (2) a background in some technical area, such as engineering or computers, or (3) a background in a particular industry. For example, an individual may have sold computer-related devices for a large company before deciding to start his or her own company focused on developing and producing similar products. Alternatively, a person may have been an engineer or other technical specialist and become skilled at product development before deciding to establish a new business. Finally, someone may have worked in a particular industry such as travel, executive search, construction, real estate, garment manufacturing, or a variety of technology areas including software development, computer chips, or telecommunications.

Most CEOs of entrepreneurial companies are enthusiastic about markets and products but are not very interested in management or the "nuts and bolts" of day-to-day operations. Many of them find accounting boring. They have no more interest in their own accounting system than the typical homeowner has in the household's plumbing: They want it to work, but they do not care to understand how it works. Many tend to look at financial statements only to determine "the bottom line."

Entrepreneurs are typically above average in intelligence, willing to take risks, uncomfortable in environments in which they are told what to do, want things done quickly, and are fond of seeing things done their way. Most, but not all, do not have good listening skills and many seem to have ADD (attention deficit disorder). They are like butterflies flitting from one thing to the next, or like Tennessee Williams's proverbial "cat on a hot tin roof."[5] Anyone who has spent serious time with many entrepreneurs will recognize the behavior that includes an inability to focus on one thing for very long, an ingrained impatience, and an expectation of virtually instant results. One colleague estimates that 90% of entrepreneurs have the ADD syndrome.

Most of these CEOs have made open-ended commitments to their business, which means that business does not merely consume a great deal of their life; in most instances, their business is their life. The pejorative term *workaholic*, however, would be a misleading description of such people; rather, they view the business as a very complex, infinitely interesting game. It is a source of profound personal pleasure.

Entrepreneurs are accustomed to being the dominant person in business situations. Above all, entrepreneurs possess a strong desire to be independent of others' ability to control their behavior. They like to feel in control. The typical CEO of an entrepreneurial company either consciously or unconsciously values control both as an end in itself and as a means to other ends. This personal preference has most likely been reinforced in a variety of ways for a relatively long time.

The Impact of the Need for Control on Continued Successful Growth

In the early stages of organizational growth, the typical attributes of an entrepreneurial CEO are beneficial and necessary for the company. Fledgling enterprises need strong direction and open-ended commitment to make everything work properly. At this time, a compulsive CEO who knows about everything that is going on and who pays attention to the smallest detail will have a tremendous positive impact on operations.

As the organization increases in size, however, an entrepreneurial CEO's typical way of doing things (and personality) can begin to adversely affect success. Specifically, everyone in the company (including the CEO) may have become used to the idea that almost every issue—whether major or not—will be brought to the CEO's attention for decision or final approval. In other words, the CEO may have become an unwitting bottleneck in the organization. More insidiously, if the CEO has not been extremely careful, an entire organization inadvertently may have been built on people weaker than the CEO. Even though the business has grown in size and added many managers and professional specialists, the CEO may remain the most skilled person in the company in most, if not all, areas. This means that the CEO has not been able to increase the company's capabilities beyond his or her own admittedly considerable personal skills. Such a situation puts limits on the organization's capacity to grow and develop.

The CEO's desire for personal control over everything done in the organization, which was a considerable strength during the start-up stage, thus becomes a limitation or bind on the company during later stages of growth. The CEO's need to control everything can lead to an unintended dysfunctional consequence of slowing an organization down to a bureaucratic pace.

Also, some CEOs consciously want to retain control at all costs and therefore do not want to hire people who are better than they are at any particular task. Others are afraid that if they hire someone to perform a task that they cannot do themselves, they will become too dependent on that person. For example, the CEO of one service firm with $5 million in annual revenues was doing most of the company's computer programming work himself. When asked why he was spending his time in this way, he replied, "If I had someone else do it, I would be vulnerable if he left me."

Some CEOs are able to recognize their own limitations relative to their companies' changing needs. As one founder and CEO of an entrepreneurial company aptly stated, "I'm an entrepreneur.

I'm very good at controlling things—making a decision and seeing it accomplished by sheer willpower alone, if necessary. But our company has grown beyond that style. I'm not uncomfortable with the company, but I'm not as effective." Such CEOs realize that, for the good of the enterprise, they need to make the transition from a manager who is used to controlling everything and being the center of all that happens to someone who is still important but is not an omnipresent, omnipotent figure.

Even when the need for it is recognized, however, this type of change can be stressful. For some CEOs, whose identities are closely bound up with their companies, it represents a threat—a potential loss of perceived potency. Many CEOs are simply not able to give up control to any significant degree and end up strangling their organizations.

Some CEOs go through the motions of giving up some degree of control because intellectually they know that this is essential; but emotionally they cannot really bring themselves to do it. For example, one entrepreneur built an organization that achieved a billion dollars in revenues in less than one decade. Recognizing that the size of the enterprise now made it impossible for him to manage in the old way, he brought in two heavyweights—experienced professional managers whom he had to pay high salaries to attract. One was a marketing manager, and the other was a finance-oriented manager who would be responsible for day-to-day operations. The entrepreneur himself moved up to chairperson. Unfortunately, he then proceeded to turn the professional managers into managerial eunuchs. When the organization began to do poorly, he announced that he had experimented with professional managers but, reluctantly, he had to reassume personal control himself. Similarly, this was the root cause of Steve Jobs' battles with John Sculley during his first term at Apple (which ended in 1985). Steve Jobs was, in common parlance, a control freak.

The Tendency to Stick to a Success Formula

Another barrier to continued successful growth relates to the understandable human tendency to repeat what has worked in the past. If a success formula has worked in the past, it is reinforced by success, and tends to be repeated—even after the conditions that enabled it to be successful have changed. For the founder and CEO, many factors reinforce the set of behaviors that has been successful, including conventional wisdom that says, "If it ain't broke, don't fix it." The problem is that organizational success leads to changes in the key underlying determinant of future success—that is, size. Size matters in business as well as in other areas of life. The greater the size of an organization, the greater its complexity. This, in turn, means that managing and leading the business will also be more complex. Like a rubber band that is stretched to its ultimate breaking point, an organization will inevitably grow to a size where the success formula that created its success (including the way that the CEO has managed and led the business and its development) will no longer function as well and will require change.

The Core Dilemma Facing the CEO or Founder

All of the critical characteristics of a founder or CEO of an entrepreneurial company combine to create what can be characterized as the core dilemma that must be resolved if an organization is going to continue to grow successfully over time: *The mindset, skills, and capabilities of entrepreneurial leadership that led to initial success are no longer sufficient or appropriate for future success once an organization* *reaches a certain critical size*. Specifically, at some point, the significant or possibly total focus on markets and products, and the lack of interest in and subsequent neglect of management of the nuts and bolts of day-to-day operations will turn strength into a limitation. Similarly, the willingness and desire to personally "do whatever is necessary" (and, in turn, control everything) will also turn from strength to a limitation. Taken together, this means that the entrepreneurial success formula must inevitably change, if success is to continue.

Aligning the Entrepreneur's Mindset to Support Continued Successful Growth

There are three key ideas that must be embraced by company leaders as their organizations grow. First, a key notion that must be embraced is that *past success is not a guarantee of future success*. This means that both the mode of operation and the way that a company is operated must inevitably change. This also typically means that the founder or CEO and his or her team will need to develop new skills and change the way that they execute their roles.

The second key idea that must be embraced is that *infrastructure matters*. When a company is founded and begins to grow, the most important questions are: "Do we have market?" "Do we have a product or service that is desired by the market?" and "Can we make a profit providing that product or service to the market?" If these questions are answered in the affirmative, the company will be successful and grow—at least for a while. At a certain point in this growth, however, significant attention needs to be devoted to developing the infrastructure required to continue to grow and operate successfully. As used here, "infrastructure" relates to the resources, systems, processes, structure, and organizational culture required to support effective and efficient day-to-day operations and continued growth. Just as a city or nation requires an infrastructure to facilitate growth, so does an economic organization like a company require an infrastructure.

The problem with focusing upon and developing organizational infrastructure is twofold. Although it is not typically an objective that excites or energizes an entrepreneurial leader, infrastructure is as critical to a business as to a house. In a house, when you turn on the lights or the water tap, you want it to work flawlessly, but you might not really care about whether or not you have certain types of wiring or copper pipes. You might well be much more concerned about the decorations and furnishings of the house. You *know* that wiring and pipes are important, but the details are not inherently interesting. With organizational infrastructure, the entrepreneur might know that it is important, but not find it inherently interesting.

The third key notion that must be changed or managed is that developing infrastructure (systems, processes, etc.) means creating bureaucracy. Infrastructure implies process and systems; and processes and systems (to many entrepreneurs) imply bureaucracy. Since bureaucracy is the mortal enemy of innovation and entrepreneurship, an entrepreneurial leader might recoil at the thought of embracing what seems to be tantamount to bureaucracy—just as he or she might not want to embrace a poisonous snake! Another challenge for the entrepreneurial leader, then, is to understand that not only is infrastructure important, but that it does not necessarily mean creating bureaucracy.

The construct we use as the basis for the vision of the required transformation is *making the transition from an early stage entrepreneurship to an entrepreneurially oriented, professionally managed organization*. This means that the organization must develop the processes, systems, and capabilities to manage the large, more complex enterprise it has (or will soon) become. Many entrepreneurs also equate professional management with bureaucracy, and reject that as an aspiration. For example, Steve Jobs once referred to professional managers as "bozos," and once said: "Why would anyone respect professional managers? They can't *do anything*." This is a misunderstanding of the role and function of professional management. It also explains why Jobs was once fired by his own firm. When Jobs returned to Apple, he changed his perspective and approach and hired Tim Cook, a quintessential professional manager, who became the company's CEO in 2011.[6]

Alternatives for the CEO as the Organization Grows

Faced with the difficulties described above, what can a founder or entrepreneurial CEO do?

Four basic alternatives are available to the CEO who recognizes that the organization can no longer be run in the old way. As described below, they are: (1) do nothing and hope for the best, (2) sell the business and start over, (3) move up to chairperson and bring in a professional manager to run the organization, or (4) make a systematic effort to change personal behavior to fit the needs of the company at its new stage of development. Let us look more closely at each of these alternatives.

Business as Usual. First, the CEO can do nothing—or, rather, do "business as usual"—and hope for the best. This could be called the "ostrich strategy." The strongest argument for this course of action is that the company has been successful with its current style to date, and "If it's not broken, don't fix it." Unfortunately, corporate graveyards are littered with companies that had promising starts but, because of this strategy, did not continue to develop.

Sell the Business and Start Over Again. A second strategy is for the entrepreneurial CEO to sell the company when it gets too big to continue with an entrepreneurial style, and then set about building a new company. A variation on this theme is merging with another company to bring in new senior managers. This was the strategy of Steve Jobs, who began to develop a new company, "Next," after leaving Apple. This means the founder must become a serial entrepreneur. Some founders are capable of doing this, while for others their business was a one-idea opportunity that cannot be repeated.

Bring in a Professional Manager. The third strategy is for the CEO to become chairperson and bring in a professional manager to run the business. When a founder has sufficient self-insight to realize that he or she is really an entrepreneur or "creative person" and not really an executive, this can be an attractive option. The founder can become the Chief Creative Officer (or whatever other title seems appropriate) and turn over operation to others more capable of running an organization. A great example of this is Mark Zuckerberg, founder of Facebook. As Zuckerberg has stated, "I'm not an operator."[7] Some of our clients have also pursued this alternative—including a package delivery business, where the founder realized he was "not CEO material" and hired a CEO to whom he reported (as COO) on an operational level. The founder was, of course, the owner of the company and had to approve the CEO's recommended strategic plan and capital expenditure budgets. He was also disciplined enough not to throw his weight around and overrule the CEO's managerial decisions and actions, even when long-term employees came complaining about something. As a result, he did not undermine his CEO.

A variation on this theme is for the entrepreneur to turn over the CEO position to another individual in the business who is better suited to handle the CEO position. This was done reasonably successfully by Howard Schultz at Starbucks who turned the business over to Orin Smith. However, after Smith retired from Starbucks, the next successor, Jim Donald, came from outside the organization and was later fired, with Schultz returning to the position of CEO. Schultz later stated that Starbucks would never again hire someone in that position from outside the organization who did not deeply understand the company's distinctive culture.

Change Behavior, Skills, and Role. Finally, a CEO may choose to make the personal and managerial style changes necessary to be able to take the organization to its next growth stage successfully. This can also involve a redefinition of the CEO's role. We will provide more detail on the specifics of leadership transitions in the context of leadership development—the subject of Chapter 9.

As described earlier in this chapter, a critical ingredient in the success of such an attempt is the CEO's willingness to live with less control over the organization and its activities. Our experience in coaching CEOs through this transition is that it is possible, but it is not easy.

Cultural factors can play a role in a CEO's willingness to give up a degree of control. In many Asian counties, founders and CEOs (both men and women) are expected to be "strong" individuals, as they typically are. The cultural expectation can lead to a situation where the CEO makes all of the major (and probably many, if not most, of the minor) decisions. This can result in the CEO being the only strong individual in the company, surrounded by "helpers" or people capable of executing tasks and decisions, but not making them. This makes the company totally dependent on the CEO and results in a self-fulfilling situation where the CEO does not expect others to be capable of making decisions and therefore makes them himself or herself. Similar expectations and behavior are also found in various Latin American countries, including Mexico.

Such a situation does not exist only in Asian and Latin American countries; there are many examples of this behavior in the United States and Europe as well. For example, in one medium-sized bank in which we worked as consultants, the founder was an exceptionally strong and dominating individual, and had "trained" other managers not to challenge him. They simply waited for him to make decisions, which they executed. After his retirement, when the next president took over, he had different expectations, and wanted a true managerial team. It took about two years to change this "obedience culture" in which people simply followed orders.

Still another factor that might limit a CEO's willingness to reduce the degree of control exercised over operations is personal experience. Some CEOs have tried to reduce their level of control, but the results have been disappointing. Other CEOs have not tried to do it themselves, but have observed others try with unsuccessful results. These are powerful barriers to changing leadership practices. For example, one CEO, who headed a residential real-estate development company we worked with for many years, had observed only negative results in decentralization of operations. He was therefore very reluctant to follow the same organizational strategy in his firm. He ultimately became convinced that a variation on this was a necessity for his company to facilitate further growth, which, in turn led to positive results.

The CEO's Existential Dilemma: What Do I *Do* Now?

The CEO who elects to stay with the company and delegate authority to managers now faces another problem. As more than one CEO has asked us, "What do I do now? What is my role?" It is likely to be more than a little discomforting for a person who has been hyperactive and involved in virtually all phases of an organization's activities to find that all tangible roles have been delegated and the only thing left is to be responsible for intangibles. These intangibles include ultimate responsibility for the company's vision, organizational development, and culture management.

The entrepreneurial CEO has become accustomed to being the most versatile person in the orchestra: the individual who could play violin, bass, trombone, drums, or harp. He or she could even be a one-person band. Now, however, the CEO's job is more like that of an orchestra leader. The CEO may not be at all sure that he or she likes or values this new and unfamiliar role. It does not seem to be productive in a concrete way.

In fact, this new or redefined role is indispensable. The CEO needs to focus on ensuring that the company has a clear and well-communicated vision. People need to know where the company is going and, in this sense, the CEO is the person who is responsible for charting and then working with his or her team of senior executives to keep the organization on course. The CEO is responsible for championing a holistic view of the development of the entity to ensure that there is a focus on creating strengths, overcoming limitations, and identifying areas for improvement. This function is known as "strategic organizational development." Again the CEO is not responsible for the specific organizational development initiatives; he or she is responsible for orchestrating the process. Finally, the CEO needs to focus on ensuring that there is a clear definition of the corporate culture, as well as a method for managing it. In all of these areas, the CEO is responsible for articulating the "what" (is done), but not the "how" (it is being done).

A CEO may not be equipped to handle this new role because he or she does not adequately understand this new role or have the skills required to effectively perform it, or both. Moreover, many CEOs cannot admit weakness by letting anyone guess that they know neither what to do next nor how to do it. Some try to bluff their way through by acting in an executive manner and issuing peremptory edicts. Others try to cope by becoming hyperactive, burying themselves in their work. Often, however, this is merely make-work or busy work, an attempt to fool themselves into believing that they are still doing something valuable. A CEO who does not know what to do next but is afraid to admit it and seek help is setting the stage for future organizational crises.

At this stage of the company's development, the CEO's role involves becoming a strategic leader. The focus needs to be on the future direction of the enterprise and its long-term objectives, versus doing work or managing day-to-day operations. There needs to be a focus on managing the organization's culture and on serving as a role model for others. Each of these aspects of the CEO's new role requires the ability to think abstractly or conceptually about the business rather than merely in terms of concrete products.

The Need for Organizational Transition

In addition to making personal changes, CEOs and other senior managers must face the challenge of managing organizational transitions. It is obvious that a company with $100 million in annual revenues is fundamentally different from one with annual sales of $1 million. It follows, then, that as an organization grows, it needs to develop new systems, processes, structures, and ways of managing the