Growing Pains

Transitioning from an Entrepreneurship to a Professionally Managed Firm

Fourth Edition

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Foreword by Angelo R. Mozilo
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This book is dedicated to all of the entrepreneurs, business owners, and managers with whom we’ve worked over the past twenty-plus years.
In 1968 my partner, David Loeb, and I embarked on a journey to create the first "national" mortgage banking company in America and, therefore, selected the name Countrywide.

Our company was born in an era of a raging war in Vietnam, the Watergate scandal, and, subsequently, 18 percent mortgage rates and a 25 percent prime rate. At that time the order of the day was simply to survive to see another sunrise.

Since that time of turbulence and uncertainty, we have emerged from a period of relentless and continuous crisis; now we are one of the largest and most respected financial services companies in America.

The basic strength of Countrywide in the sixties and the seventies, as well as in the present, rests with the fact that we possess a culture of best-of-class execution and a core mission of facilitating home ownership for all who desire to experience the American dream of owning a home of their own.

Evolving from a start-up with two partners (namely, Dave and me) to 60,000 employees today, with operations on three continents, has required a continuous evolution from a company fighting for its survival to one that requires professional management and a culture of continuous improvement and proper controls, as well as a structured organization built on a strong foundation. All of this has been driven by a mandate to dominate the markets in which we serve.
Throughout this past decade, Countrywide has experienced its greatest period of growth and expansion, and I attribute much of our success not only to our management team and employees but also to the contributions made by Eric Flamholtz. Eric, with his unique approach, has taken Countrywide from a reactionary management team to one that focuses on mission, planning, execution, and a sound, durable organizational structure. Eric and his team have been an invaluable resource from both a business and a personal perspective.

Growing Pains: Transitioning from an Entrepreneurship to a Professionally Managed Firm (fourth edition), which Eric wrote with Yvonne Randle, is Eric’s most recent book. It effectively surrounds the core issues that must be addressed when a company like Countrywide evolves from a de novo mono-line to a multifaceted, multinational financial enterprise.

Simply put, Growing Pains sets forth a road map that directs the reader down a path of enlightenment as to the challenges of growth but, more important, knowledge of how to effectively manage that growth.

In my opinion this book is a must-read for any management team, irrespective of size, whose company is experiencing long-term growth or who want to ensure that their efforts result in a successful outcome.

Angelo R. Mozilo, Founder and Chairman
Countrywide Financial Corporation
During the latter part of the twentieth century, as well as in the early years of the new millennium, we have witnessed an explosion in entrepreneurship. Companies in areas as diverse as bioengineering, pizza, computers, women’s fashion, chocolate chip cookies, printing, publishing, distribution, real estate, and electronic commerce, to cite a relatively few, have flourished. Some entrepreneurship, including Microsoft, Starbucks, Wal-Mart, PowerBar, eBay, Dell Computers, Amazon.com, Countrywide Financial Corporation, and Southwest Airlines, have become spectacular successes and household names. Many more relatively unknown firms have also been very successful.

In some cases, entrepreneurial firms have led to the creation of entirely new industries; in other cases, they have achieved tremendous success because their founders were able to see their business a little differently. Entrepreneurs, in fact, are responsible for one of the most significant developments of the past forty years: the personal computer. It may seem difficult to imagine that less than thirty years ago, few people had access to computers and that those who did spent their time in large rooms located in laboratories, schools, and businesses. They worked at terminals connected to a mainframe or spent their time preparing punch cards that contained programs. Less than twenty years after they released the first Apple Computer, the vision of Steve Jobs and Steve Wozinak (the founders of Apple Computer) that each person would own a computer became a reality. Today, the average person can own a computer, which has the power not only to help the person be more productive but also
can serve as a means through which to stay connected to others throughout the world. The power of the Internet provides personal-computer users with the ability to communicate with people throughout the world, obtain information on practically any topic, and buy and sell products—all from their homes or offices. The existence of e-commerce has served as a platform for the emergence of additional entrepreneurial companies all over the world.

While the efforts of some entrepreneurs have led to the development of entirely new industries, other entrepreneurships have achieved tremendous success in existing industries. Firms like Southwest Airlines, Starbucks, and Nike emerged in industries that already existed, but they became enormously successful, in part, by creating new ways of providing existing products or services, or both.

Now that we have entered the new millennium, the focus on entrepreneurship seems not only to be continuing but also expanding. Most leading business schools provide their MBA students with courses on this topic, and many have entire programs dedicated to entrepreneurship.

With all of this focus on entrepreneurship, however, a significant number of firms still experience problems and sometimes fail as they grow and develop beyond the initial “new venture stage.” A key question, then, is this: Why do some entrepreneurial firms (like Starbucks, Nike, Southwest Airlines, and Microsoft) continue to be successful, while others (like Boston Market, LA Gear, People Express, and Osborne Computer) experience problems and even failure? Addressing this question has been the focus of our research and consulting over the past thirty years. This is also the question that we seek to address in this book.

In brief, our research and practical experience in working with entrepreneurial organizations over the past thirty years suggests 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 firms ignore growing pains, significant problems and even failure can result.

The purpose of this book, then, is to help present and potential managers and others understand what it takes to continue to grow successfully after a new venture or entrepreneurship has been started. It provides a lens, or framework, to help people understand how to manage organizational growth successfully in entrepreneurial organizations. It also presents and describes a set of tools that can be used to minimize growing pains, which are an inevitable part of successful organizational development.

This is the fourth edition of Growing Pains. The first edition was published in 1986, the second in 1990, and the third in 2000. We were pleased with the response to the book and the positive comments we have received over
the years. The intent of this edition is to update the book with new ideas and concepts, which we have developed over the past few years, as well as with new examples and cases of companies. The basic structure and format of the book, which has proved valuable to entrepreneurs, managers in entrepreneurial organizations, students in MBA programs, venture capitalists, and bankers, remains the same. Our aim was to enhance and update the book to make it even more valuable for the new millennium, as it is based on our new research and experience.

ENTREPRENEURSHIP VERSUS PROFESSIONAL MANAGEMENT

The basic theme of the book, as indicated by its subtitle, is how to make the successful transition from an entrepreneurship to a professionally managed firm. Some people may conclude that because we suggest that entrepreneurships must make transitions and become something other than what they are, we are negative about entrepreneurship. This is hardly the case. We admire the entrepreneur, not only as an individual willing to bet his or her future on an idea but also as the critical element of our economy and the vanguard of the future. In addition, we believe that entrepreneurship as a state of mind is an essential component of an organization’s culture and must be preserved. An organization must always continue to be “entrepreneurial” in the sense of seeking out new opportunities and innovating, both in terms of new products and processes. But we believe that at some stage of growth, entrepreneurship is not sufficient and that the nature of the organization must change, together with the people who run it.

The term entrepreneurship has, in current usage, taken on meanings that are somewhat different from its original meaning. In the classic sense, the entrepreneur is someone who creates a business, and an entrepreneurship is a business that has been created where none previously existed. In informal usage today, the term entrepreneurship seems to have the connotation of a certain way of managing a company. It appears to imply a very informal approach to management or, at the other extreme, the total lack of management of a firm. Because many initially successful entrepreneurships seem to be lacking in formal systems or procedures, or even a structure, many people incorrectly assume that these things are not required for successful organizations. The assumption, either explicit or implicit, is this: “We got started without formal systems and processes, and we are successful, so we clearly do not need them.” In addition, some people point to giant companies like AT&T, General Motors, and U.S. Steel, to cite just a few, where formal systems and procedures have been carried to such an extreme that the company has become mired in bureaucracy. Therefore, it follows that having formal procedures can actually
be a weakness for organizations. Both of these viewpoints, while undeniably attractive, are essentially simplistic.

Although it is true that having well-defined and formal processes for managing the business is often not a decisive factor in determining the success of a new venture, we believe (and will demonstrate throughout this book) that developing certain systems and processes is essential if a firm is to continue to grow successfully and profitably throughout its life cycle. In addition, although it is true that many firms choke on their own bureaucracy, it is not because these firms have formal systems; rather, it is because of the way these organizations use their systems. Moreover, some firms, such as Compaq Computers (which merged with Hewlett-Packard in 2002) and Federal Express, were, in fact, professionally managed entrepreneurial enterprises from their inception (as discussed in Chapter Five), and this led to their spectacular success.

For some people the term professional management has negative connotations. They see it as synonymous with bureaucracy. The fact that a firm is professionally managed does not mean that the entrepreneurship must inevitably become bureaucratic. In our view, a professionally managed firm has achieved the best of both worlds. It is entrepreneurial without entrepreneurship being its only strength; it is well managed without becoming choked on its own systems and procedures. An analogy might be a great sports team that has an excellent offense as well as a superb defense. Entrepreneurship is the essence of an organization’s offense, while effective management is the essence of its defense. Just as a great defense can create opportunities for the offense, so can the systems, processes, and structure initiated by professional managers create opportunities for entrepreneurship.

The basic message we want to convey is this: entrepreneurship, as a state of mind and a component of culture, must continue, regardless of the size of an enterprise. However, the form of an entrepreneurial organization must change over time as it grows and increases both in size and complexity. It must evolve from a “pure” or early-stage entrepreneurship to what we have termed an entrepreneurially oriented, professionally managed firm. This is not a bureaucracy (an organization must never become bureaucratic), but it must inevitably change and develop more formal processes if it wants to maximize the likelihood of continuing to be successful. These make up, as we explain in Chapter One, the infrastructure required to facilitate future growth, just as a building’s foundation provides the platform for its elevations. If an organization does this and it becomes an entrepreneurially oriented, professionally managed firm (or what we refer to throughout this book as simply a professionally managed firm), then it is likely to continue to grow and develop successfully, just as Starbucks, Countrywide Financial Corporation, and Microsoft have each done. If it does not do this at all or not sufficiently well, then it is likely to experience difficulties (for example, Sun Microsystems, Sybase, AOL), or
even fail, just as Osborne Computer, Boston Market, and Maxicare did. We examine examples like these in this book and explain how firms like Starbucks have successfully made the transition from entrepreneurship to professional management while companies like Boston Market did not.

For many people the term *entrepreneurship* has the connotation of a small firm, but that is not how the term is being used here. There are many examples of large entrepreneurships, especially as we enter the electronic age, when firms such as eBay, Yahoo!, and Amazon.com can become very large almost overnight. There are also companies that are smaller in size (as measured by revenues or number of employees) that are merely small businesses and not entrepreneurial in any sense of the word.

When we use the terms *entrepreneurship* or *entrepreneurial company*, we are referring to the entrepreneurial ethos or mind-set and not to a particular size of firm. We are also referring to an organization that has not made the transition to a professionally managed firm. Similarly, when we use the term *professionally managed*, we are referring to a firm that has retained the entrepreneurial spirit, while at the same time developing the systems required to effectively manage the much larger firm it has become. In this sense, we use the terms *entrepreneurially oriented, professionally managed firm*, and *professionally managed firm* interchangeably.

**INTENDED AUDIENCE**

This book is addressed principally to the owners, managers, and employees of entrepreneurial companies (including not-for-profit companies), to investors, bankers, and venture capitalists, and to students and scholars of management who are interested in the success and failure of entrepreneurships. It focuses on the question, Why, after successful or even brilliant beginnings, do entrepreneurial companies often lose their way? More important, it explains what all companies, especially those at the entrepreneurial stage, must do to be successful as they grow and describes the transitions they must make to survive. Case studies of entrepreneurial 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. 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 CEO of an entrepreneurial company needs to make so that he or she can grow with the organization, as did Howard Schultz at Starbucks, and not be left behind.

The book is also addressed to those interested not only in entrepreneurships but in established companies as well. Although it has been positioned