



THE STAGES OF GROWTH: START-UP TO \$200 MILLION

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Introduction

Make no mistake, taking a company from start-up to \$200 million in revenue can be a daunting challenge. One of the primary reasons is the continuous change that the company undergoes during its early stages of development. Virtually every facet of the company changes several times as it grows, and these changes can be quite dramatic. For a CEO to successfully guide a company through this period requires an understanding of these stages of growth, an understanding of what is most important in each of the stages, and a CEO who can adapt to the changing needs and objectives of the company.

Much as human beings go through stages of development from birth to adulthood, companies follow an analogous evolution. We are all aware of the changing needs and objectives of human beings at various points in their lives, and for most people, these changes occur at relatively predictable ages. A similar pattern of change can be observed in companies as they grow.

With human beings, the period from birth to young adulthood is when the most dramatic changes take place. This is the time when people need special nurturing – they face numerous challenges from the world around them, they have inherent vulnerabilities because of their youth, they are on a very steep learning curve and they make choices that can have an effect on them for many years. This is not only a difficult period, but it is also a very important one; it is the years between birth and young adulthood that establish the foundation which shapes the individual for life.

One need only observe companies going from start-up (birth) to \$200 million in revenue (young adulthood) to recognize the analogy to human development. Like children, companies need special nurturing during these early years – they face numerous challenges from the world around them, they have inherent vulnerabilities because of their youth, they are on a very steep learning curve and they make choices that can have an effect on them for many years. And most importantly, these early years establish the foundation upon which the company is built.

In rearing children the most effective parents understand these stages of human development and actively use that knowledge to guide their children to maturity. Similarly, the successful CEO must do the same; he or she must understand the stages of a company's development and use that insight to successfully guide the company to its "young adulthood".

Finally, just as people go through the different phases at relatively consistent points, so do companies. However, with companies it is not about chronological age. Instead, based on our own experiences with companies as well as our observations of others, these transitions seem to occur at somewhat consistent points in terms of the size of the company. And while revenue may not be a precise indicator of timing, the stages and their implications are much more consistent across developing companies.

Introduction

The Primary Objective

What we have observed is that the companies that seamlessly make the transition from start-up to \$200+ million accomplish a common set of objectives at these early stages of development. These objectives represent the most fundamental imperatives of the company at each stage of growth; hence we refer to them as the *primary objectives*. The primary objective, and all that it implies for the company, must be the unifying focus for the company in each stage. In fact, the attainment of the primary objective is the key factor in determining the company's readiness to transition from one stage to the next.

Achieving the primary objective is crucial because it creates the foundation for the next stage. The risk companies face as they grow is the failure to adequately prepare the foundation before for moving to the next stage. In fact, the primary objectives are so fundamental that if they are not achieved before preceding from one stage to the next, the failure to do so can severely limit the company's growth potential, and even worse, put the company at risk of failure as it grows.

With limited exceptions¹, we have found these primary objectives to be the same for almost every company regardless of the target market, the product or service, or competitive situation. Based on our experience and observations, we have found it useful to think in terms of four distinct stages of development as a company progresses from a start-up to about \$200 million in revenue.

THE STAGES

1. **THE LAUNCH** – \$0 TO \$5 MILLION IN REVENUE
2. **MARKET VALIDATION** – \$5 TO \$20 MILLION
3. **SOLIDIFYING YOUR POSITION** – \$20 TO \$75 MILLION
4. **EXPANDING YOUR TARGET MARKET** – \$75 TO \$200+

¹ While we believe this to hold true for private and public companies, as well as divisions of larger companies, it is not necessarily meaningful for lifestyle businesses where growth and expansion are secondary goals to maintaining a defined income for the owner. We focus here on companies that are intent on growing beyond \$100 million in revenue.

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The Launch – \$0 to \$5 Million

One of the basic challenges for a new company is to ensure that there is “uniqueness” to the product or service being created relative to the existing solutions in the market. Too many new companies emerge without having come to grips with a most fundamental question – one that will certainly be asked at the first round of funding: “Is the differential between the solution we are proposing and the already existing solutions in the marketplace great enough to merit all the effort and money that will need to be expended?”

If the company clearly understands the differential, then the primary objective of the launch stage is to develop, refine and validate the product with very early adopters. This stage is very much a learning process, and the company must complete two essential tasks. The first task is to create and refine the product or service that addresses a specific need, targeted at a specific market; the second task is to identify and develop the value proposition – that is, the ability of the product to satisfy the targeted need and to provide identifiable value to the target customer.

THE PRIMARY OBJECTIVE OF THE FIRST STAGE IS TO DEVELOP, REFINE AND VALIDATE THE PRODUCT WITH VERY EARLY ADOPTERS

The product development process should begin with a reasonably well defined market need that the company plans to address better than anyone else. A basic version of the product is defined and created which emphasizes the key differentiation. Very early adopter customers are then acquired; ideally they are customers who will work closely with the company to refine and help shape the product. This is typically an iterative process where the mapping of target market, the addressed need and the product capabilities are continuously refined to increasingly bring them into close alignment.

In this process it is not unusual for the product to undergo a number of changes, possibly even significant changes, as the company gets feedback from the market (customers, non-customers, and competitors). It is also not unusual for the specific need being addressed and the market being targeted to be modified. While it is rarely a direct path from the start of this stage to the end goal, this stage should end with a very well defined mapping – target market > market need > product capability. Until that has happened, it will be premature for the company to proceed to the next stage.

Once the market, need and product are closely aligned, the next essential task is to articulate the value proposition and refine it with the initial customers. Regrettably, this is a common failure in many early stage companies. All too often young companies are more intent on acquiring the next customer rather than ensuring the successful use of their product by existing customers. This is a mistake; by whatever means necessary companies must ensure that their early customers are successfully using their product.

While this may sound simple, it can be quite difficult to achieve. In order to help acquire additional customers and secure additional funding, your early customers should be able to

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answer the following question: “How does the product or service they’ve purchased solve their problem and what is the economic value of that?” To achieve this result the company must work closely with its early customers, after the sale, to help them realize the full benefit of the product they purchased. While there may be many reasons why a customer selected your product, the rationale they relate to others must be consistent with what you will be communicating to new prospects.

As difficult as it may be to accept, this stage is not about sales volume. With a target market full of potential customers, most small companies can readily capture a respectable number of very early adopters. But to expand your market share in later stages, you must have an initial customer base that is extremely successful in using your product. It is the validation of your product by these very early adopters that represents one of the main building blocks – or foundation – needed to ensure success in subsequent stages of growth.

Market Validation – \$5 to \$20 Million

The second stage – market validation – requires a significant mental shift, from a pure start-up, entrepreneurial mindset to a more comprehensive view of the business. The shortcuts that may have been acceptable in the launch stage must be replaced with more deliberate business processes and decision making. The company is still in a very vulnerable state – its broader market acceptance is still unproven; it lacks scale; its infrastructure is not fully developed; and it has other vulnerabilities that are expected in a young company. The challenges of this phase will test both the capabilities and the decision making of the CEO and his management team, and it is these factors which make this stage perhaps the riskiest of the four stages.

The primary objective in this stage is to validate the market’s acceptance of the product by going after additional early adopters and broadening the customer base. The company should remain sharply focused on the existing product > target market > value proposition, and demonstrate its appeal to a larger base of customers. Achieving the primary objective in the second stage will require the company to expand its sales effort and its product delivery capability. Consequently, the company must now begin to put in place the initial infrastructure that will be necessary to support a growing customer base. But as discussed later, these actions should be commensurate with the specific needs of this stage.

THE PRIMARY OBJECTIVE IN THE SECOND STAGE IS TO VALIDATE THE MARKET’S ACCEPTANCE OF THE PRODUCT BY GOING AFTER ADDITIONAL EARLY ADOPTERS AND BROADENING THE CUSTOMER BASE

Having refined the product to align it with the needs of the target market, having defined the value proposition, and having acquired initial customers able to reinforce the value proposition – the task now is take that “package” and replicate its early success with other customers. Despite the success the company achieved with some very early adopters, the company has yet to prove that it has a product acceptable to a broader market. While the launch stage was about creating

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and refining the “package”, this stage is about demonstrating that the package has appeal to a wider segment of the market – beyond the more “risk-accepting” very early adopters.

As a new company, and one that is most likely still not profitable, it can be a challenge to overcome the reluctance of customers that are more risk averse. But to demonstrate success in the broader market, the company must be able to attract a larger base of customers – and those customers will most likely be the ones who are able to clearly understand the benefits of the product and how it can deliver value to them. Since these customers do not have the risk profile of the earliest customers, they must be willing to balance the risk of doing business with a small company with the desire to acquire the benefits of the product. *Hence, the key is that they must be able to understand and acknowledge the value proposition of the product.*

Commensurate with the company’s increasing sales must come a strengthening of the company’s ability to deliver and service its product; and this is where the challenge comes in. The company will be tempted to look at many aspects, from people to production and organization to operations. But it will be prudent to extend its delivery capability just far enough to meet the likely growth needs of this stage. If the company was very successful in the launch stage, management may be feeling very optimistic, and therefore inclined to be too aggressive. At this stage of the company’s development these should be considered interim decisions, and the infrastructure should only be expanded as is necessary to meet the needs of this stage. The following stage is where the longer term decisions are best made – at a time when the company should be on much firmer footing.

The same is true about making key strategic decisions before they are required. The decisions management will begin thinking about run the gamut from product extensions, to distribution, to manufacturing, to development, to target market expansion, to raising new capital to fund growth, etc. The decisions are numerous because management may view this as the time to build out the business, thereby enabling it to pursue the market niche it positioned itself to go after in the launch stage. But the reality is that the size of the market, the acceptance by customers, the competitive response – none of these are yet known with reasonable certainty. The company may have won some very early adopter customers, but its success in the broader market is still not assured. This stage is really about gaining that assurance – and the company must stay focused on validating its acceptance by a broader base of customers.

The risk in being too aggressive in this stage is that the company overcommits, creating a financial burden that is not sustainable if there are setbacks. We have seen many examples where overly optimistic assumptions about growth and market acceptance resulted in decisions about manufacturing, distribution, geographic expansion and other scaling considerations that created severe financial burdens for the company. And in a company not yet strong enough to overcome these burdens in the face of unexpected challenges, the result can be fatal. It is important to recognize that the financial impact of having to scale up further is much less damaging than the financial impact of having to scale down, particularly at this stage of a company’s development.

The other risk in making these decisions prematurely is that they will require significant management attention – diverting focus from the task at hand – that of more broadly proving the

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market acceptance of its product. While some of these decisions and actions may be necessary, most should wait until the next stage. It is a mistake for companies to attempt to do too many different things and diffuse their efforts at this early stage of development. Don't succumb to this temptation.

Solidifying Your Position – \$20 to \$75 Million

This next stage is about winning the battle in the marketplace; and putting in place the infrastructure necessary to sustain the continuing growth of the company. Having demonstrated broader market appeal in the previous stage, the company is now in a position to make longer run decisions on many fronts – people, infrastructure, product, geographic expansion, pace of growth, etc.

The primary objective in this stage is the creation of a defensible market position; one that can withstand setbacks from a variety of internal and external events, without risking failure of the company. The setbacks may come from competitive challenges, shortcomings in the company's internal operations, general downturns in the overall market, or any number of events that companies continually face. In short, this means that it is now time for the CEO to turn his attention into creating a sustainable business.

**THE PRIMARY OBJECTIVE IN THE
THIRD STAGE IS THE CREATION OF A
DEFENSIBLE MARKET POSITION**

By this stage the company should have good validation of the market acceptance of its product and value proposition, a good idea of the target market and why they buy, and sufficient experience with a broad enough customer base to make a full scale sales and marketing effort productive. It is also the time when the company acquires the appropriate level of confidence (based on results and not just expectations) to make longer term decisions – the ones that the company was tempted to make in the previous stage, but hopefully did not.

Attaining this goal is all about execution, particularly in sales and operations. The company should be solidifying its position as one of the leading providers for new customer decisions in its targeted niche. This is the stage where you crank up the sales / marketing effort; you now have enough actual experience to build a sales and marketing "machine", making the investment in a large scale sales and marketing effort pay off. With a differentiated product and improving scale sufficient to minimize the concerns of most prospective customers, the company should be effective enough in marketing and sales to be a dominate factor in its target market.

There are a number of decisions around the sales and marketing which must be made as the growth plans for the company are executed.

We all know that products are never complete; but the CEO must determine the appropriate level of spending that will continue to strengthen the company's position in the target market, while at the same time not being being tempted to overspend.

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If you've had one person responsible for sales and marketing, is this the time to separate the responsibility for the two functions? The crucial underlying question is – can the present head of sales manage an organization that will be evolving from a handful of people cherry picking opportunities, to a much larger, geographically dispersed, high volume sales team? Related questions are: What is the appropriate size of the sales organization? How should it be structured? What incentive structure is appropriate? Ask yourself this critical question: Is the head of sales and marketing prepared to handle these significant sales issues and all the marketing related issues?

Do we expand into international markets? If so, do we go direct, use a distributor, and/or partner with someone? Which international markets do we target? Launching operations in international markets can be very expensive and the payback can be fairly long depending on the approach taken.

Concurrent with the ramp up in sales, the company should also be solidifying the operational side of the business. This must go hand in hand with the growing customer base to avoid the risk that the company fails to deliver on the expected level of service that the broader customer base (not just early adopters) expects.

This requirement also brings into play a wide range of questions, decisions and actions.

Is it time to go after the lowest cost manufacturing option, whether that is offshore and/or a commitment to a very high volume? Or do we still need to find a middle ground that gives us the flexibility to make changes or reduce our commitments?

If we are not already doing offshore development, is this the time to expand our capability and reduce cost? How do we add that capability – through the use of contract resources or by establishing our own directly managed team?

Should we raise capital for more aggressive expansion? If so, what is the best source of capital for this growth?

The reality is that there are many decisions, almost all with significant implications, that must be addressed during this stage of growth. Making the right decisions can position the company to grow very quickly, while the wrong decisions can significantly limit growth or prove very costly. Each decision must be well thought out and timed to support continued growth and sustainability.

The end result of these efforts will be the establishment of a solid core business – one that can help the company survive a potential “setback” caused by any number of events. It is absolutely critical to have a solid core business to fall back on as the company moves to the next stage.

Expanding Your Target Market – \$75 to \$200 Million

Unless you are fortunate enough to have a very large potential market based on a horizontal application that everyone needs (like Microsoft or Oracle), you must now begin thinking about

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what's next. To maintain the desired growth rate, most companies will have to broaden what should have been a relatively tight focus to this point. Many companies, eager to do something new, begin this process far too early – before they have a solid core business to fall back on.

The primary objective in this stage is to lay the groundwork for expanding the addressable market, thereby permitting continued growth. The prerequisite for moving to this stage is having a solid core business to fall back on. Should the market expansion efforts cost more than expected, take longer, or not be as successful as anticipated – all of which occur with great frequency – the company will not be critically compromised. The failure may be painful, but at this stage it should not be fatal – as it very well could have been at an earlier stage.

THE PRIMARY OBJECTIVE IN THE FOURTH STAGE IS TO LAY THE GROUNDWORK FOR EXPANDING THE ADDRESSABLE MARKET

Expanding the addressable market can be done in many different ways and the optimal approach will vary by company. For example, if you have not already expanded internationally, that might now be a viable option. You will still need to think long and hard about which specific international markets to tackle first, but such a step can allow for additional growth.

You might want to consider offering new products that leverage off your current market position and customer base. Or you might find that you have products or technology that are readily adaptable to another industry segment.

To complicate the decision further, you will want to think about whether it is best to grow organically or by acquisition. Acquisitions present an entirely different set of challenges for a company and the management team often fails to recognize the complexities in selecting and integrating another company.

The real message here is that there are any number of options for expanding the addressable market, but this step represents a serious challenge for some companies and it is one not to be taken lightly. There must be a strategic framework for expanding the market: are you leveraging your market position and customer base; are you leveraging some technology or product capability that is your strength; are you leveraging a manufacturing advantage? Too many companies embark on expanding their business without having thought through the business rationale for their expansion plans.

In this process you must be objective about your strengths and weaknesses – not only what you think they are, but more importantly, how others would perceive them. You also need to understand the characteristics of the market and the competitive framework. Depending on the capabilities of your team, this may be an ideal time to draw upon the strengths of external resources to help put together the expansion strategy. Not only can outside resources have skills that you might not have internally, but they will also be better able to offer an objective, unbiased view of your company and the challenges you will face.

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The real challenge in the expansion planning process is brought on by the diverse nature of the options available to the company, determination of the precise timing for expanding the addressable market, and the development of a specific strategy that works best for your company. If the company is to continue on a growth path, it must first recognize and accept the need to plan for this requirement, because determining the proper path and then executing on it takes time. But be warned, there is substantial risk to the company if this phase begins too soon – before the company has a solid core business to fall back on. Prematurely shifting the focus of the management team and directing significant company resources to something as challenging as market diversification has proven fatal for many companies.

Conclusion

As in human development, companies go through predictable stages of growth. In each stage, accomplishing defined objectives is of paramount importance. A common mistake for developing companies is attempting to rush through a stage too quickly – before the objective of the stage is met – or even worse, bypassing a stage altogether.

The temptation to rush through this natural progression occurs for many reasons. Among them are miscalculating where you are in the development of the company, the impatience of the CEO and management team, the impatience of the board and investors – or most likely, some combination of all of these. But regardless of the reason, the company puts itself at risk in moving too quickly. Accomplishing the primary objective at each stage creates the foundation for the next, and to begin building the next layer before the prior one is complete sets the company up for failure at the first setback. Experience has repeatedly shown us that the quickest path forward is achieved by remaining focused on the objective of the current stage, by following the natural progression, and by properly building the foundation. Following this course will not only get you there more quickly, but will do so with far less risk.